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BENEFITS BRIEF

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Tax Reform Legislation Moves Through the House and Senate

On Thursday, November 16, the House passed H.R. 1, the Tax Cuts and Jobs Act (the "House Bill"), by a vote of 227-205. Thirteen Republicans, many from high-tax states affected by the bill's limitations on the deductions for state and local taxes, broke with their party to vote against the bill, while no Democrats voted for it. Later Thursday night, the Senate Finance Committee approved its version of the Tax Cuts and Jobs Act (the "Senate Bill") after four days of a contentious markup. The Senate is expected to vote on the tax bill after the Thanksgiving recess.

The House and Senate Bills would provide for the most sweeping changes to the U.S. Tax Code since 1986. Very generally, the bills would reduce business and individual tax rates, eliminate many deductions and other tax incentives, and overhaul the international tax rules. Notably, both bills also contain several provisions that would change the tax rules with respect to retirement plans, executive and nonqualified deferred compensation ("NQDC") arrangements, employee fringe benefits, and health and welfare plans. Our side-by-side summary comparing the retirement, executive compensation, fringe benefit and health and welfare provisions in the House and Senate bills can be found here.

Background

On November 2, House Ways and Means Committee Chairman Kevin Brady (R-TX) released the initial version of the Tax Cuts and Jobs Act). The Ways and Means Committee began its mark-up of the bill on November 6 and reported it out of Committee on a party-line vote on November 9 after making numerous changes to the original version. You can read our summary of the original House bill here and our summary of the original executive and NQDC changes in the House bill (since revised) here.

Senate Finance Committee Chairman Orrin Hatch (R-UT) released the original description of the Senate Bill the night of November 9, and the Finance Committee began its mark-up on November 13. Committee members submitted over 350 amendments, and an amended Chairman's mark with numerous modifications and additions to the original mark was released on November 15. The Chairman's modified mark was designed in part to comply with the Senate's strict "Byrd Rule," which prohibits legislation from adding to the deficit outside the government's 10-year budget window. To satisfy the Byrd Rule, the Senate's proposal sunsets many of the individual tax cuts as of December 31, 2025, and takes advantage of $318 billion in revenue from zeroing out the Affordable Care Act (ACA) individual mandate penalty. And it appears that the revenue raised by repealing the individual mandate and sunsetting the individual rate cuts also had the effect of negating the need to make painful cuts in other areas, including with respect to retirement and nonqualified deferred compensation plans.

Notably, neither the House-passed bill nor Senate Finance-approved bill contains changes to the tax incentives for retirement savings. The inclusion of limits on pre-tax contributions to 401(k) and other types of defined contribution plans through so-called "Rothification" had been under strong consideration for inclusion in the bill as a significant "revenue raiser" to offset the cost of individual rate cuts, but this provision was not included in either the House or Senate bills after the significant pushback by the Save Our Savings Coalition, an advocacy group founded and advised by Groom Law Group and Capital Counsel. For more information about the Coalition, visit SaveOurSavings.org.

The original version of the Senate Finance Chairman's mark had, however, included several provisions that would have been problematic to employer-sponsored retirement plans. It would have eliminated the ability of age 50 and over employees receiving wages of $500,000 or more in the preceding year to make catch-up contributions of an additional $6,000 to 401(k), 403(b) and governmental 457(b) plans. The Senate bill also would have applied the 10% early withdrawal penalty tax to taxable distributions from a governmental section 457(b) plan before age 59 1/2 unless an exception applied. In addition, an amendment filed by Finance Committee Chairman Hatch would have provided for the "Rothification" of the age 50 catch-up rules by increasing the limit from $6,000 to $9,000 while requiring that all such catch-up contributions be made on an after-tax "Roth" basis. Fortunately, however, none of these provisions were included in the final version of the bill approved by the Committee.

In addition, earlier versions of both the Ways and Means and Finance bills would have effectively eliminated nonqualified deferred compensation plans and radically transformed equity and long-term incentive compensation programs. Specifically, early versions of both bills had included a proposal to repeal Code section 409A and add a new Code section 409B in its place. Section 409B would have eliminated an executive's ability to defer taxation of future earnings beyond the year of vesting, dramatically expanded the definition of "nonqualified deferred compensation" to include stock options and stock appreciation rights (SARs), and required all existing nonqualified deferred compensation amounts to be included in income by no later than 2025 (2026 in the Senate bill). Put simply, it would have radically transformed expectations regarding the taxation of past, present and future executive compensation arrangements. Fortunately, this onerous proposal was not included in the House and Senate Finance Committee bills.

Outlook

Senate leaders plan to begin debate on the Senate bill the week of November 27 after the Thanksgiving recess. Whether Senate leaders can corral the 51 (or 50 with Vice President Pence breaking the tie) votes necessary to pass the bill remains to be seen. Last week, Senator Ron Johnson (R-WI) said he opposes the Senate bill due to the treatment of pass-through entities. Meanwhile, Senators Susan Collins (R-ME) and Lisa Murkowski (R-AK) expressed concerns with the inclusion of the ACA individual mandate repeal, while Senators Bob Corker (R-TN) and Jeff Flake (R-AZ) expressed concerns about the use of the sunsets as budget gimmicks that would increase the debt an estimated $1.5 trillion. Meanwhile, the drama in the Alabama Senate race has increased the pressure on Congressional Republicans to pass the bill and get it to the President's desk in December.

Nevertheless, Republican Congressional leaders and the White House still appear to be optimistic that the Senate will find the votes necessary to pass the bill. After the Senate passes its bill, the two bills will need to be reconciled either in a formal conference committee or through a leadership-negotiated ping-pong strategy.