GROOM LAW GROUP
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BENEFITS BRIEF

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Tax Reform Series I: Fringe Benefit and Health & Welfare Provisions

On December 22, 2017, President Trump signed into law H.R. 1, known as the "Tax Cuts and Jobs Act." The new law is an overhaul of the Internal Revenue Code and, as such, will have a significant impact on the rules governing the taxation of both employers and employees.

This is the first of a series of alerts in which we highlight the benefits-related tax provisions of H.R. 1. Below, we describe changes related to taxation of fringe benefits and health and welfare benefits, and we outline next steps that employers and employees should consider.

Fringe Benefit Provisions

1. Employers May No Longer Deduct Qualified Transportation Fringe Benefits and Certain Other Commuting Expenses

- Prior Law – Employers could generally deduct expenses for providing a qualified transportation fringe benefit. Qualified transportation fringe benefits are the provision of (or reimbursements or payments for) transportation in a commuter highway vehicle, transit passes, qualified parking, and qualified bicycle commuting reimbursements.
- What Changed – Employers may no longer deduct: (1) any expenses incurred in providing, paying, or reimbursing qualified transportation fringe benefits; or (2) any expenses for providing transportation for an employee to commute between his or her residence and place of employment, except as necessary for ensuring the employee's safety. Employers may continue to deduct qualified bicycle commuting reimbursements for eight years.
- When – Beginning in 2018, except for qualified bicycle commuting reimbursements, which are non-deductible beginning in 2026.

Next Steps:

- Employers
  - Consider restructuring non-bicycle transportation and commuting benefits with voluntary after-tax employee contributions.
  - Consider whether to replace these benefits with increased taxable wages or other fringe benefits that remain deductible by the employer.

Next Steps (Continued):

- Employees
  - These non-bicycle benefits are still excludable, so no changes are necessary unless the employer eliminates employer-paid benefits or restructures the program to be paid with after-tax employee contributions.

2. Tax-Exempt Employers Must Include Certain Fringe Benefits in Unrelated Business Taxable Income.

- Prior Law – Employers exempt under Code section 501(c) are subject to tax on unrelated business taxable income ("UBTI"), which generally means income derived from an unrelated trade or business regularly carried on by the employer that is not substantially related to the employer's exempt purpose. Fringe benefits provided by such employers would not constitute UBTI.
- What Changed – To provide parity with taxable employers, the definition of UBTI now includes the value of qualified transportation fringe benefits, any parking facility used in connection with qualified parking benefits, and on-premises athletic facilities if such benefits would not be deductible by a taxable employer.
- When – Beginning in 2018.

Next Steps:

- Tax-Exempt Employers
  - Consider restructuring transportation and commuting benefits with voluntary after-tax employee contributions to avoid unrelated business income tax ("UBIT").
  - Consider whether to tax the benefits to avoid UBIT.
  - Consider whether to eliminate these benefits altogether. If the employer continues to provide them, it may need to file Form 990-T to report and pay the UBIT.
  - Consider whether to replace these benefits with increased taxable wages or other fringe benefits that are not included in UBTI.
- Employees
  - These benefits are still excludable, so no changes are necessary unless the employer eliminates employer-paid benefits, taxes the benefits, or restructures the program to be paid with after-tax employee contributions.

3. Employees Cannot Exclude Qualified Bicycle Commuting Reimbursements.

- Prior Law – Employees could exclude from income the value of qualified transportation fringe benefits provided by his or her employer for qualified bicycle commuting reimbursements, up to certain monthly limits set forth by the IRS (for 2017, up to $20 per month).

- What Changed – Employees may not exclude any qualified bicycle commuting reimbursements from their income.
- When – 2018-2025 (beginning with the 2026 tax year, qualified bicycle commuting reimbursements will again be excludible from employees' income, but will no longer be deductible by employers.)

Next Steps:

- Employers
  - Can continue to deduct qualified bicycle commuting reimbursements until 2026.
  - Must include these reimbursements in employees' income and W-2 wages and withhold income and employment taxes accordingly.
  - Must be mindful that although these reimbursements are taxable at the federal level, state law may vary, especially in states that have special commuting ordinances.
- Employees
  - Consider whether to opt for another mode of commuting to avail themselves of the income exclusion for other non-bicycle commuting costs, to the extent available.

4. Employees Cannot Exclude or Deduct Qualified Moving Expense Reimbursements

- Prior Law – Employees could exclude from income the value of any qualified moving expense received as a payment or reimbursement. In addition, employees generally could deduct unreimbursed qualified moving expenses as itemized deductions, subject to certain limits.
- What Changed – Employees may not exclude from income the value of any qualified moving expense reimbursements or payments and these amounts are treated as taxable supplemental wages. In addition, employees may not deduct any unreimbursed qualified moving expenses.
- When – 2018-2025 (beginning with the 2026 tax year, employees can again exclude qualified moving expense reimbursements from income or deduct unreimbursed qualified moving expenses).

Next Steps:

- Employers
  - Consider whether to include a taxable gross up for moving expense reimbursements or payments or replace with additional taxable wages.
  - Can still deduct moving expense reimbursements or payments.
- Employees
  - Can no longer deduct moving expenses, and expenses reimbursed by the employer are taxable.

5. Codifies Definition of Items that Qualify for the Employee Achievement Award Deduction.

- Prior Law – Employers could deduct the cost of employee achievement awards, subject to certain limits, and employees may exclude such awards from income. Employee achievement awards are items of tangible personal property given to an employee in recognition of length of service or safety achievement, that are presented as part of a meaningful presentation, and that meet other requirements. "Tangible personal property" was not defined in the statute, but proposed IRS regulations defined it to exclude cash or certain certificates, vacations, meals, lodging, theater and sporting event tickets, stocks, bonds, and other securities.
- What Changed – Codifies a definition of "tangible personal property" similar to the definition in the proposed IRS regulations. The statutory definition excludes cash, cash equivalents, gift cards, coupons, gift certificates (with certain limitations), vacations, meals, lodging, theater or sporting event tickets, stocks, bonds, other securities, and other similar items.
- When – Beginning in 2018.

Next Steps:

- Employers
  - Consider whether to adjust employee achievement awards so that they continue to be deductible for the employer and excludible for the employee.
  - Consider whether to reduce the amount of the award so that it is deductible to the employer and excludable from the employee's income as a *de minimis* fringe benefit.
- Employees
  - No changes necessary.

6. Employers Generally Cannot Deduct Entertainment, Amusement, and Recreation Expenses (with Limited Exceptions for Employee Meals).

- Prior Law – Employers could deduct 50% of expenses for: (1) entertainment, amusement, recreation; (2) membership dues for clubs organized for business, pleasure, recreation or any other social purpose; and (3) a facility or portion of a facility used for a purpose in (1) or (2), but only if the expenses directly relate to the conduct of the employer's trade or business. There were certain exceptions that allowed an employer to deduct 100% of the expenses, however, such as if the employer included the value of the expense in the employee's income.

  In addition, employers could deduct 50% of the food and beverage expenses associated with their trade or business (*e.g.*, meals consumed by employees on work travel) and 100% of the expenses related to providing food and beverages to employees that meet the *de minimis* fringe benefit requirements.

- What Changed – Employers generally may not deduct expenses for: (1) entertainment, amusement, recreation; (2) membership dues for clubs organized for business, pleasure or any other social purpose; and (3) a facility or a portion of facility used for (1) or (2). The exceptions to the deduction limitations, such as where the employer includes the value of the expense in the employee's income, are retained.

  Employers may continue to deduct 50% of food and beverage expenses associated with their trade or business. Employers may also deduct 50% of expenses related to providing food and beverages on-premises that meets the requirements for *de minimis* fringe benefits or is for the convenience of the employer.

- When – Beginning in 2018 (expenses for on-premises meals are non-deductible beginning in 2026).

Next Steps:

- Employers
  - Review expense policies in light of the loss of deduction to see if any exceptions are available that would continue to allow the employer to deduct the expense.
  - Review the costs of meals and determine if changes need to be made to obtain a full deduction (such as taxing employees on meals).
- Employees
  - The income exclusion was not changed, to the extent the expense is a *de minimis* fringe benefit, or is for the convenience of the employer.

7. Employees Cannot Deduct Unreimbursed Trade or Business Expenses.

- Prior Law – Employees could generally take an itemized deduction for unreimbursed trade or business expenses, subject to certain limitations.
- What Changed – Employees can no longer take an itemized deduction for unreimbursed trade or business expenses. This may result in groups of workers being treated differently because independent contractors can generally still deduct trade or business expenses.
- When – 2018 – 2025 (beginning with the 2026 tax year, employees can again take an itemized deduction for unreimbursed trade or business expenses, subject to certain limitations).

Next Steps:

- Employers
  - Consider increasing working condition fringe benefits or accountable plan expenses to make up for the loss of the employee's deduction.
- Employees
  - Keep this loss of deduction in mind when completing their tax returns.

Health & Welfare Provisions

1. Indexing for Health FSA, HSA, and Cadillac Tax Dollar Thresholds is Changed from CPI-U to Chained CPI-U.

- Prior Law –The dollar thresholds for employee contributions to health flexible spending arrangements ("FSAs"), contributions to health savings accounts ("HSAs"), and the 40% excise tax on high cost coverage (the "Cadillac Tax") were adjusted annually for inflation based on the consumer price index ("CPI-U").
- What Changed – The dollar thresholds are adjusted annually for inflation based on "Chained CPI-U" rather than CPI-U. Chained CPI-U is expected to result in relatively reduced inflation adjustments compared to CPI-U. This means that the dollar thresholds will likely increase at a slower rate than under prior law.
- When – Unclear, but it appears to be effective beginning in 2018.

Next Steps:

- Employers
    - Be on the lookout for guidance from the IRS regarding the 2018 thresholds for FSAs and HSAs. The IRS released the 2018 thresholds in 2017 based on prior law, not on chained CPI-U, and employers set maximum FSA and HSA contribution limits accordingly. It is unclear whether the IRS will continue to apply the already announced maximum limits in 2018 or will announce new 2018 limits sometime in 2018. Accordingly, employers may need to adjust employees' FSA and HSA elections for 2018 and make any necessary corrections.
- Employees
    - Depending on future IRS guidance, may need to adjust their FSA and HSA elections for 2018.

2. Employers May Claim a Tax Credit for Certain Paid Family and Medical Leave Provided to Employees.

- Prior Law – Employers could not take a tax credit for compensation paid to employees during family and medical leave.
- What Changed – Employers that pay employees during family and medical leave and meet certain requirements may temporarily claim a tax credit of 12.5% of the amount of wages paid for 12 weeks, increased by .25% for each percentage point by which the rate of payment exceeds 50% (not to exceed 25% of the wages paid). To qualify for the credit, the employer generally must have a leave policy that allows all qualifying full-time employees at least 2 weeks of annual family and medical leave and pay at least 50% of the wages normally paid to the employee during the leave (and have commensurate policies for part-time employees). Certain types of leave, such as leave paid by a state or local government or required by state or local law, are not considered family and medical leave for this purpose.

A qualifying employee is one who has been employed for at least a year and, for the preceding year, had compensation less than $72,000 (for 2018) – i.e., 60% of the Code section 414(q) compensation threshold for highly compensated employees.

- When – 2018 and 2019.

Next Steps:

- Employers
    - Determine whether it is feasible (and desirable) to implement a leave policy that satisfies the criteria to claim the credit. If so, review current leave policies and determine if any changes are necessary to be able to claim the credit. Because certain types of leave don't count towards the 2 week threshold, this may require that an employer provide more than 2 weeks of paid family and medical leave.
    - Certain controlled group rules apply, and thus, coordination with other controlled group members may be necessary.

3. No Individual Mandate Penalties.

- Current Law – Most individuals must have minimum essential coverage ("MEC") or be subject to a penalty.
- What Changed – The penalty for not having MEC is reduced to zero.
- When – Beginning in 2019.

Next Steps:

- Employers
    - The employer mandate penalties were not repealed, but the elimination of the individual mandate penalties could result in fewer employees triggering potential employer mandate penalties because fewer employees may purchase coverage through an exchange and receive a premium tax credit.
    - Employer mandate reporting and MEC reporting were not repealed, and thus, absent IRS guidance, employers must continue to file the Forms 1094-B/C and 1095-B/C.
- Employees
    - Might drop their coverage beginning in 2019.

4. Medical Expense Deduction is Reduced from 10% to 7.5% of AGI for 2017 and 2018.

- Prior Law – Individuals could deduct medical expenses to the extent the expenses exceed 10% of adjusted gross income ("AGI").
- What Changed – The 10% threshold is temporarily reduced to 7.5%.
- When – 2017 and 2018.

Next Steps:

- Employers
  - No action necessary.
- Employees
  - May be able to deduct medical expenses that they previously could not deduct because the expenses were between the 7.5 – 10% threshold.

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Although H.R. 1 was signed into law on December 22, 2017, it has significant impacts on taxation of benefits for both employers and employees beginning with the 2018 tax year. As such, employers should closely evaluate current fringe benefit and health and welfare offerings to understand how they are impacted by the new tax law and consider whether changes may be necessary.

Please contact any of the attorneys listed here or your regular Groom Law Group attorney for further information or to discuss next steps.