# New Tax Act Has Meaningful Implications for Broad-Based Employee Benefit Plans

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On December 22, 2017, President Trump signed the **Tax Cuts and Jobs Act** (TCJA), which generally went into effect for tax years beginning on or after January 1, 2018. The TCJA provisions affecting executive compensation (for example, the elimination of the **performance-based compensation exception** to Section 162(m) of the Internal Revenue Code) have received signification attention, but the TCJA also has meaningful implications for broad-based employee benefit plans and programs. This memorandum provides an overview of the key TCJA provisions impacting employee benefits.

**Paid Family and Medical Leave Tax Credit**

The TJCA creates a new general business tax credit—new Section 45S of the Internal Revenue Code—for employers that offer paid family and medical leave programs that meet specified requirements. This new tax credit is notable because the TCJA primarily eliminates deductions and credits (as described below in this memorandum) rather than creating them. The tax credit equals a portion of the wages paid to qualifying employees during family and medical leave (in accordance with the Family and Medical Leave Act). To be eligible for the tax credit, employers must have a written policy that provides at least two weeks of annual paid family and medical leave to all qualifying full-time employees, as well as a *pro rata* amount of leave to part-time employees, and must pay at least 50% of the employees' regular salary or wages while on leave. If an employer pays the minimum 50% of salary or wages while employees are on family and medical leave, the amount of the credit equals 12.5% of the salary or wages paid, for up to 12 weeks of leave per year. The amount of the credit increases by 0.25% (but not above 25%) for each percentage point exceeding 50% of the employee's regular salary or wages paid during the leave.

- Example: If an employee earns $1,000 per week and the employer provides two weeks of leave at 50% of the employee's salary ($500 per week), the employer qualifies for the tax credit, provided that the employer's written policy fulfills the other criteria discussed above. For this employee's two weeks of leave, the employer receives a total tax credit of $125 (12.5% of the $1,000 of salary paid). If, on the other hand, the employer pays 80% of the employee's salary during the leave ($800 per week for two weeks), then the employer's credit increases to 20% of the $1,600 salary paid, or $320.

If an employer offers vacation, sick, personal or other types of paid leave, such leave does not qualify for the family and medical leave tax credit. The employee must also be employed for at least one year prior to the leave and earn no more than 60% of the compensation threshold for highly-compensated employees[1] in the preceding year for the employer to be eligible to receive a tax credit for that employee. Any leave paid by a state or local government or that state or local law (e.g., California, New Jersey, New York, Rhode Island) requires an employer to provide is not taken into account when determining the amount of paid family and medical leave provided by the employer.

[1] The 2018 threshold for highly-compensated employees is $120,000.

This provision includes a sunset and will not apply to wages paid in taxable years beginning after December 31, 2019.

**Non-Excludability and Non-Deductibility of Moving Expenses**

The TJCA provides that employees may no longer exclude the reimbursement of moving expenses from their taxable income or deduct unreimbursed moving expenses as itemized deductions. The TJCA includes a narrow exception for moving expenses incurred by active duty members of the armed forces in connection with a permanent posting change. It has been a relatively common business practice for employers to cover the costs that employees incur when they relocate. Employers may wish to consider these changes when deciding whether to reimburse employees for moving expenses.

This provision applies to taxable years beginning after December 31, 2017 and before January 1, 2026, meaning that starting with the 2026 year, employees will again be able to exclude reimbursed moving expenses from income or deduct unreimbursed moving expenses.

**Changes to Transportation Benefits**

The TCJA repeals the deduction to employers for the payment or reimbursement of expenses associated with qualified transportation fringe benefits, except as necessary to ensure employees' safety. It is unclear whether the limitation on "expenses" is intended to be sufficiently broad to cause wages paid to employees that are contributed pre-tax to a qualified transportation fringe benefit program to be non-deductible. Further guidance from the IRS is needed to fully understand how this provision will affect parking expenses and employee pre-tax contributions to qualified transportation programs (e.g., those offered via WageWorks). Regardless of where the IRS comes out on the interpretation of this provision, in certain jurisdictions (e.g., New York, Washington DC) employers are required under local laws to maintain qualified transportation programs and, as such, employers in those jurisdictions that are considering changes to their qualified transportation programs in light of the TCJA will need to be mindful of their programs' compliance with applicable local laws.

In addition, employees are no longer able to exclude reimbursements for qualified bicycle commuting expenses from gross income, effective through December 31, 2025. Bicycle commuting expenses had previously been excludible, up to $20 per month. Employers can continue to deduct qualified bicycle commuting expense reimbursements until 2026.

**Changes to Fringe Benefits**

*Meals*

Prior to the TCJA, *de minimis* business meals and meals provided on or near business premises (e.g., an on-site cafeteria) were fully tax deductible to the employer and excludible from income by the employee. The TJCA limits employers' deductibility of such meals to 50% beginning January 1, 2018, and the deduction is eliminated beginning January 1, 2026. Additional guidance from the IRS will be necessary to fully understand the deductibility of different categories of meals, such as overtime meals and meals provided at a subsidized on-site cafeteria. The TCJA did not change the 50% deduction for non-entertainment meal expenses (e.g., meals during business-related travel).

*Entertainment Expenses*

The TCJA disallows a deduction for entertainment, amusement or recreation expenses or facilities (including membership dues and on-premises gyms), even if directly related to the conduct of an employer's business. Companies may wish to consider their entertainment policies in light of these changes. Companies could choose to include entertainment expenses as taxable wages paid to participating employees, in which case the company could deduct the amounts as compensation.

*Employee Achievement Awards*

Certain employee achievement awards are tax deductible up to an annual per-employee cap ($400, or $1,600 if the awards are granted pursuant to an established written plan or program that does not discriminate in favor of highly-compensated employees). The TJCA provides that an award does not qualify as a tax-deductible employee achievement award if the award is intangible property (e.g., vacations, meals or stock) or a cash equivalent (e.g., gift cards or coupons). Tangible items, such as a watch or ring, are still deductible up to the caps.

**Changes to Retirement Savings Plans**

The TCJA makes several changes to retirement savings plans, the most notable of which are as follows:

- The TCJA extends the loan offset rollover period, providing employees with outstanding loans under qualified plans such as 401(k) plans with more flexibility. Loans typically become due when an employee terminates employment or a plan is terminated and, if not paid, the amount of the loan will be deducted from the employee's plan account (known as a loan offset). Previously, employees had 60 days to roll over a plan loan offset amount from their plan account to an eligible plan or individual retirement account (IRA) that accepts the rollover. Employees now have until the tax filing deadline (including extensions) for the year of the loan offset to contribute funds to another plan or IRA to roll over the loan offset tax free.
- The TCJA eliminates a specialized rule that allowed employees to recharacterize conversion contributions to a Roth IRA within the employee's tax filing deadline for that year; in other words, Roth conversions can no longer be unwound through recharacterization. However, recharacterization is still permitted for other contributions (e.g., recharacterizing regular contributions to a Roth IRA as contributions to a traditional IRA within the specified deadline, and vice versa). The IRS has provided a **list of frequently asked questions regarding the recharacterization of retirement contributions**.

**Denial of Deduction for Sexual Harassment Settlements**

The TCJA prohibits the deduction of settlements related to sexual harassment or abuse, including attorneys' fees, if the settlement is subject to a nondisclosure agreement. The prohibition applies to amounts paid or incurred after December 20, 2017, the date of the TCJA's enactment.

For more analysis on the effect of the TCJA on compensation and employee benefits, as well as on tax issues in general, please refer to **Davis Polk's Client Memorandum on the Tax Cuts and Jobs Act**.

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If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.


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