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LEGAL UPDATE

PRACTICAL INSIGHTS ON TAX REFORM: IMPACT ON EMPLOYEE AND FRINGE BENEFITS

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On December 22, 2017, President Trump signed into law legislation, known as the Tax Cuts and Jobs Act ("TCJA"), which is the most extensive overhaul of the United States Internal Revenue Code (the "Code") in 30 years. In December, we issued a general advisory outlining the major changes to the Code made by TCJA. This advisory focuses on the provisions of TCJA that affect employee and fringe benefits. Unless otherwise noted, the changes described below are effective for taxable years beginning on or after December 31, 2017.

EXTENDED PERIOD FOR ROLLOVER OF RETIREMENT PLAN LOAN REPAYMENTS

Beginning in 2018, TCJA provides relief for participants of tax-qualified retirement plans with outstanding loans. Prior to TJCA, most 401(k) plans provided that outstanding plan loans must be repaid upon a separation from service (or plan termination). If the loan was not repaid, the outstanding balance was treated as an "offset" against the participant's outstanding account place – meaning the loan would be treated as a distribution resulting in immediate taxation and, in most cases, a 10% early withdrawal penalty. Participants could previously avoid this deemed distribution and penalty by making a rollover contribution to an IRA within 60 days, essentially requiring a participant to repay the loan. That approach, however, provided little relief because participants seldom had the liquid assets necessary to repay the loan offset within the 60-day window.

TCJA extends the time period to complete the direct rollover of a loan offset in the event of separation from service or plan termination from 60 days to the due date (including extensions) for filing the participant's federal income tax return for the year of the offset. This extension of time provides participants with an opportunity to avoid early distribution penalties and a permanent reduction to their tax-sheltered retirement savings by giving them a longer period of time to repay the loan offset.

Employers should review the loan procedures of their tax qualified plans and any related participant communications to determine what changes should be made to provide participants with this additional relief.

IRA RECHARACTERIZATIONS

Effective for any Roth IRA conversions made in 2018 or later, TCJA precludes individuals from unwinding those Roth IRA conversions to revert to a traditional IRA. Prior to TCJA, individuals who contributed to a traditional IRA could convert that IRA to a Roth IRA and then undo that original conversion by recharacterizing the Roth IRA back to a traditional IRA if the first conversion resulted in unfavorable tax consequences (often the tax consequences of the initial conversion would not be known for months). Under prior law, the recharacterization had to occur before the due date for the individual's income tax return for the year of conversion.

TJCA now precludes the recharacterization back to a traditional IRA for conversions occurring in and after 2018 (i.e., taxpayers will no longer be able to unwind a conversion to a Roth IRA). Thus, even though taxpayers are still permitted to convert a traditional IRA to a Roth IRA, they will not be able to undo that conversion if it results in unfavorable tax consequences. Conversions made during 2017, however, may still be recharacterized through October 15, 2018.

Administrators of IRA accounts should take notice of this change.

AFFORDABLE CARE ACT – INDIVIDUAL MANDATE

Effective in 2019, TCJA amends the Code by reducing to zero the penalty for failing to comply with the individual mandate under the Affordable Care Act ("ACA"). Prior to TCJA (and in 2018), the ACA required individuals to purchase a minimum level of health care coverage or be subject to a tax. While TCJA did not repeal the individual mandate altogether, it reduced to zero the penalty for failing to comply with the mandate. Also, it is important to note that the employer shared responsibility rules are still in place. Therefore, employers could still be subject to the employer shared responsibility payment if they do not continue to offer health coverage to employees meeting the requirements of the ACA.

QUALIFIED TRANSPORTATION AND CERTAIN OTHER COMMUTING EXPENSES

Beginning in 2018, employers may no longer deduct qualified transportation fringe benefits expenses (excluding qualified bicycle expense reimbursements), or 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. Previously, employers were able to deduct these expenses and the expenses were excludible from the employee's income. While TCJA changed the employer's ability to deduct the expenses, there was no change in an employee's ability to exclude the expenses from his or her income.

Reimbursements for qualified bicycle expenses paid on or after January 1, 2018 are deductible by the employer, but employees must include the reimbursement in the recipient's income. 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.

Employers should review their fringe benefit programs and analyze the impact that the loss of these deductions will have on the bottom line. If an employer wants to maintain these deductions, it could provide the benefits to its employees on a taxable basis (assuming the resulting compensation is reasonable).

CHANGE IN THE DEDUCTIBILITY OF ENTERTAINMENT, AMUSEMENT, AND RECREATION EXPENSES

Beginning in 2018, TCJA eliminates the employer deduction for (i) expenses associated with entertainment, amusement, or recreation; (ii) membership dues for clubs organized for business, pleasure, recreation, or any other social purpose; and (iii) a facility or portion of a facility used for a purpose described in (1) or (2). Also beginning in 2018, TCJA limits to 50% the amount an employer may deduct for food or beverages provided to employees for the employer's convenience (and that deduction is eliminated completely beginning in 2026). Prior to TCJA, employers could generally deduct up to 50% of certain entertainment, amusement, and recreation expenses, and 100% of employee meals provided for the employer's convenience, and such amounts were excludible from the employee's income. While TCJA drastically changed the deductibility of these expenses for the employer, the amount attributable to employee meals is still excludible from an employee's income.

Employers should review existing arrangements to ensure the desired tax treatment is achieved. For example, employers could revise existing arrangements to achieve full deductibility of these expenses by providing such reimbursements to employees on a taxable basis.

MOVING EXPENSES

Effective for 2018 through 2025, TCJA precludes employees from excluding from income the value of any qualified moving expense reimbursement or deducting any such unreimbursed expenses (with an exception for certain members of the U.S. Armed Forces). Under previous law, employees could either exclude the value of any such reimbursement from income or deduct the value of any such unreimbursed expenses. Absent any future changes, beginning with the 2026 tax year, employees may revert back to the pre-TCJA rules.

As noted above, arrangements providing these types of benefits should be reviewed to ensure the desired tax treatment is achieved and if necessary consider alternative arrangements.

THIS ADVISORY WAS PREPARED BY CRESCENT MORAN CHASTEEN OF NUTTER'S TAX DEPARTMENT. PLEASE STAY TUNED FOR THE NEXT ADVISORY IN OUR *PRACTICAL INSIGHTS ON TAX REFORM* SERIES. LEARN MORE ABOUT THIS LEGISLATION BY CONTACTING A MEMBER OF OUR TAX DEPARTMENT AT 617.439.2000.

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