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# Tax Reform and the HR Department:

## What You Need to Know Even If You Don't Really Like Anything That Contains the Word TAX[1]

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On December 22, 2017 President Trump signed into law H.R. 1 — the Tax Cuts and Jobs Act — a sweeping tax reform law that promises to entirely change the tax landscape. Because no description of tax is ever free from abbreviations that make tax geeks geekish, we call this new law the *TCJA* and are offering a prize to anyone who can pronounce that.[2]

This article describes key tax changes in TCJA relevant to employers and those involved in HR (that is the Human Resources Department, not the disturbing coincidence that the title of the law contains the House of Representatives designation H.R. 1).

But first, some context. Even though you might not want to know a lot about the TCJA unrelated to HR functions, everyone should be aware that this new law changed the business landscape in material ways, including:

1. The corporate-tax rate dropped from a high of 35 percent to a high of 21 percent. In addition, accelerated cost recovery now makes investment in new plant and equipment cheaper than ever on a net present value basis. Limitations on interest deductions could prove a challenge for some corporate taxpayers.

*Some corporations will share the legislative largess with their employees, especially those who were involved in the lobbying process and made commitments to legislators.* Individual rates changed, mostly downward, though the change in deductions means that some individuals will see an increase in federal income taxes in the short run.

*Most will see their taxes increase in the long run, but who worries about the long run?*

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[1] This summary was prepared with the help of several sources in addition to the actual law, including some material borrowed from Thompson Reuters articles because they seem to be written by people who spoke English as well as tax: https://tax.thomsonreuters.com/media-resources/news-media-resources/checkpoint-news/daily-newsstand/2017-tax-reform-checkpoint-special-study-on-business-tax-changes-in-the-tax-cuts-and-jobs-act/

[2] In order to comply with Senate rules for the bill to qualify as a budget reconciliation bill, the short title "Tax Cut and Jobs Act" was actually deleted from the final bill but the name seems to have lingered in local parlance.

*Expect many questions from employees about what they should do with respect to their withholding, and be cautious when advising them because they will not be happy if they owe taxes in April of 2019.*

2. A special deduction is provided for sole proprietors (those independent contractors), owners of S corporations, partnerships and business trusts.

*The deduction could depend on the extent of the company's aggregate W-2 wages. So expect questions from such employers about whether independent contractors can be moved to payroll.*

*Expect questions from some employees who would now prefer to qualify as independent contractors.*

3. The entire world of international taxation has been turned on its head. Depending on whom you believe, that will either create jobs in the U.S. or encourage more businesses to move jobs offshore.

*Expect to hear the TCJA blamed if jobs get moved offshore.*

## NOTABLE CHANGES AFFECTING EMPLOYEE RELATIONSHIPS

**No Deduction for Amounts Paid for Sexual Harassment Subject to Nondisclosure Agreement**

A taxpayer generally is allowed a deduction for ordinary and necessary expenses paid or incurred in carrying on any trade or business. However, among other exceptions, there's no deduction for: any illegal bribe, illegal kickback or other illegal payment; certain lobbying and political expenses; any fine or similar penalty paid to a government for the violation of any law; and two-thirds of treble damage payments under the antitrust laws.

Under the TCJA, no deduction is allowed for any settlement, payout or attorney fees related to sexual harassment or sexual abuse if such payments are subject to a nondisclosure agreement. This rule is effective for amounts paid or incurred after December 22, 2017 (the enactment date).

## Employee Achievement Awards

Employee achievement awards are excludable to the extent the employer can deduct the cost of the award — generally limited to $400 for any one employee or $1,600 for a "qualified plan award." An employee achievement award is an item of *tangible personal property* given to an employee in recognition of either length of service or safety achievement and presented as part of a meaningful presentation.

TCJA defines "tangible personal property" to expressly exclude cash, cash equivalents, gifts cards, gift coupons, gift certificates (other than from where the employer pre-selected or pre-approved a limited selection), vacations, meals, lodging, tickets for theatre or sporting events, stock and bonds (or similar items), and other non-tangible personal property. No inference is intended that this is a change from present law and guidance though many of us in the tax world already thought these items didn't qualify as tangible personal property.

## Limitation on Excessive Employee Compensation

Until the beginning of this year, compensation paid or accrued with respect to a covered employee of a publicly traded corporation was limited to no more than $1 million per year. However, under pre-Act law, material exceptions applied for: (1) commissions; (2) performance-based remuneration, including stock options; (3) payments to a tax-qualified retirement plan; and (4) amounts that are excludable from the executive's gross income.

The TCJA repeals the exceptions to the $1 million deduction limitation for commissions and performance-based compensation for tax years beginning after December 31, 2017. The definition of "covered employee" is revised to include the principal executive officer, the principal financial officer and the three other highest paid officers. If an individual is a covered employee with respect to a corporation for a tax year beginning after December 31, 2016, the individual remains a covered employee for all future years.

Under a transition rule, the changes do not apply to any remuneration under a written binding contract which was in effect on November 2, 2017, and which was not modified in any material respect after that date. Compensation paid pursuant to a plan qualifies for this exception if the right to participate in the plan is part of a written binding contract with the covered employee in effect on November 2, 2017. The fact that a plan was in existence on November 2, 2017 isn't by itself sufficient to qualify the plan for the exception. The exception ceases to apply to amounts paid after there has been a material modification to the terms of the contract. The exception does not apply to new contracts entered into or renewed after November 2, 2017. A contract that is terminable or cancelable unconditionally at will by either party to the contract without the consent of the other, or by both parties to the contract, is treated as a new contract entered into on the date any such termination or cancellation, if made, would be effective. However, a contract is not treated as so terminable or cancellable if it can be terminated or cancelled only by terminating the employment relationship of the covered employee.

**Qualified Equity Grants**

Section 83(i) was added to the Code, which allows private companies to offer employees the opportunity to defer income tax inclusion on compensatory stock options or restricted stock units for up to five years if certain requirements are met. To be eligible for this provision, a corporation must be privately held and have a written plan under which at least 80 percent of all U.S. employees are granted "qualified stock." The special rule is not available to 1 percent owners, current or former CEOs and CFOs, or certain highly compensated officers. If a recipient elects to defer taxation under this provision, the deferred amounts will not be subject to Code Section 409A.

**Nondeductible Penalties and Fines**

For many years, no deduction was allowed for fines or penalties paid to a government for the violation of any law.

TCJA: Now deductions are denied for any otherwise deductible amount paid or incurred (whether by suit, agreement or otherwise) to, or at the direction of, a government or specified nongovernmental entity in relation to the violation of any law *or the investigation or inquiry by such government or entity into the potential violation of any law*. Think EEOC claim here.

An exception applies to payments that the taxpayer establishes are either restitution (including remediation of property) or amounts required to come into compliance with any law that was violated or involved in the investigation or inquiry, but only if the item is expressly identified in the court order or settlement agreement as restitution, remediation or required to come into compliance. Of course, the IRS can challenge the characterization of an amount so identified (paid or incurred after December 22, 2017). An exception also applies to any amount paid or incurred as taxes due.

Government agencies (or entities treated as such) must report to the IRS and taxpayer, the amount of each settlement agreement or order entered into where the aggregate amount required to be paid or incurred to, or at the direction of the government is at least $600 (or such other amount as may be specified by the IRS). The report must separately identify any amounts that are for restitution or remediation of property, or correction of noncompliance. The report must be made at the time the agreement is entered into, as determined by IRS.

The provisions don't apply to amounts paid or incurred under any binding order or agreement entered into before December 22, 2017. However, this exception would not apply to an order or agreement requiring court approval unless the approval was obtained before the enactment date.

**Deduction for Local Lobbying Expenses Eliminated**

Under prior law, businesses generally could deduct ordinary and necessary expenses paid or incurred in connection with carrying on any trade or business. An exception to the general rule, however, disallowed deductions for lobbying and political expenditures with respect to legislation and candidates for office, but that rule did not apply to lobbying expenses with respect to legislation before *local* government bodies (including Indian tribal governments).

Under the TCJA, the deduction for lobbying expenses with respect to legislation before local government bodies (including Indian tribal governments) is eliminated after December 22, 2017. Accordingly, expenses incurred, for example, to influence legislation on local employment rules may no longer be deductible.

**New Credit for Employer-Paid Family and Medical Leave**

Under pre-Act law, employers didn’t receive any extra credit for compensation paid to employees while on leave.

The TCJA provides a general business credit, between 12.5 percent and 25 percent, for *qualifying* wages paid during any period in which such employees are on family and medical leave (FMLA) if the rate of payment is at least 50 percent of the wages normally paid to an employee. The credit is increased above 12.5 percent by 0.25 percentage points (but not above 25 percent) for each percentage point by which the rate of payment exceeds 50 percent. All qualifying full-time employees have to be given at least two weeks of annual paid family and medical leave (all less-than-full-time qualifying employees have to be given a commensurate amount of leave on a pro rata basis). Payment must be made in tax years beginning after December 31, 2017 but before December 31, 2019.

Significantly, in what might be interpreted by some as another political attack on blue states that have more “progressive” family leave laws, the credit for paid family and medical leave ONLY applies if the paid leave is NOT mandated by state or local law — i.e., to the extent state or local law requires the employer to provide paid family or medical leave, the credit does NOT apply.

**Business Deductions Eliminated for Employee Commuting and Parking Benefits**

Except when necessary to ensure the safety of an employee, TCJA removes the deductions businesses can take when providing qualified mass transit and parking benefits to their employees. Employees can still pay for these expenses using pre-tax dollars. Of course, employers can still pay for or subsidize employee parking and use of mass transit — they simply can’t deduct the cost of doing so in computing their federal taxable income.

**Business Deductions Curtailed for Entertainment and Some Meals**

Until the TCJA, a taxpayer could deduct up to 50 percent of expenses related to meals and entertainment. Housing and meals provided for the convenience of the employer on the business premises of the employer were excluded from the employee's gross income. Various other fringe benefits provided by employers were likewise excludable from the employee's gross income, such as qualified transportation fringe benefits

Under the TCJA, businesses can no longer deduct expenses related to employee meals. Employees, however, can still exclude the benefit from their income.

If an employer provides food and beverage to employees through an on-site cafeteria or other facility, the existing 50 percent limit to this fringe benefit for onsite eating is extended until the end of 2025. After that date, employer costs related to onsite food and beverage will no longer be deductible.

In general, employer tax deductions for all business *entertainment* expenses are eliminated, but employers can still deduct up to 50 percent of specific counted expenses, like *non-entertainment* client dinners.

**No Exclusion for Qualified Moving Expense Reimbursements**

From 2018 until 2025, any qualified moving expense reimbursements or payments from employers are treated as supplemental wages for employees who receive them. In addition, employees may no longer deduct any unreimbursed moving expenses. Employers may still deduct the reimbursements or payments.

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Should you have any questions regarding the new tax law, we strongly encourage you to consult legal counsel.