



Tax on Fringe, Don't Cringe – Impact of Tax Reform on Compensation and Benefits Arrangements

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Notices

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The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

Agenda



Background



Highlights



Overview



Observations



What now?

1. Background





The path to tax reform



House

Bill introduced
11/02/17



Ways and Means
Chairman releases mark
11/03/17

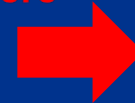
Markup by Ways and
Means Committee
11/06/17



Markup
11/09/17

Ways and
Means
approves
bill
11/09/17

You are here



Treasury and Internal
Revenue Service begin
process of implementing
the new law



President
signs into
law
12/22/2017

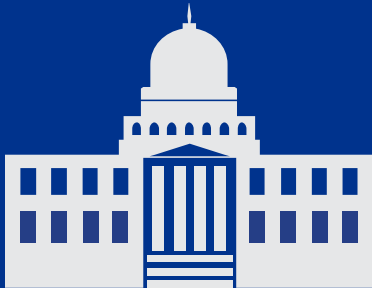


White House

House passes
revised conference
agreement
12/20/17

Senate passes a
revised version of the
conference agreement
12/20/17

House passes
conference
agreement
12/19/17



Senate



Senate
Finance
Chairman
releases
mark
11/09/17

House
votes and
passes
11/16/17



Markup by Senate
Finance Committee
11/14/17

Senate Finance
Committee
approves bill
11/16/17

Senate Budget
Committee votes
to send bill to
Senate floor
11/28/17

Senate votes and passes by
simple majority through
"budget reconciliation"
12/02/17



Conferees
reach an
agreement
on a
conference
report that
reconciles
differences
12/15/17



Joint Conference

Background on H.R. 1

- Compensation and benefit provisions that didn't make it:
 - Proposed Section 409B to eliminate deferred compensation
 - Individual taxation of most fringe benefits
 - Several qualified plan provisions
- Compensation and benefit provisions in H.R. 1:
 - Section 162(m) revised
 - Non-deductibility of many fringe benefits with some taxable
 - Section 4960 impacting non-profits
 - Carried interest rules
 - Section 83(i)
 - Zero ACA penalty
 - Section 45S family medical credit

2. Highlights of H.R. 1



Highlights of the new law beyond Compensation and Benefits

Individual:

- Rates and Brackets
- Standard deduction
- Itemized deductions
- Estate tax

Passthroughs:

- New 20% deduction regime
- Losses limited
- Carried interest rule

H.R.1

Corporate:

- Rate reduction
- Expensing
- NOL limitation
- Interest limitation
- Corporate AMT repeal

International:

- Participation exemption system
- Mandatory repatriation
- Minimum tax
- BEAT

3. An Overview of H.R. 1 Compensation and Benefit Provisions



Section 162(m) \$1 Million Deduction Limit

Prior Law	Current Law (P.L. 115-97)
<p>Limits compensation deductions to \$1,000,000 for NEOs (other than the CFO) of public companies as of the last day of the tax year, with an exception for qualified performance-based compensation</p>	<ul style="list-style-type: none">• Repeals the performance-based and commission exception.• Revises definition of “covered employee” 1) to include the CFO; 2) eliminate the “last day of the tax year” language; and 3) any individual who is a covered employee for a tax year beginning after December 31, 2016, will always be considered a covered employee (including retirement and death)• Expands 162(m) coverage to all domestic publicly traded corporations and all foreign companies publicly traded through ADRs.• A transition period provides that section 162(m) expansion will not apply to compensation under a written, binding contract in effect on November 2, 2017 that was not materially modified.

Stock Option and Restricted Stock Unit Deferrals

Prior Law	Current Law (P.L. 115-97)
No provision	<ul style="list-style-type: none">• New Section 83(i) will permit certain employees of privately held companies to elect to defer recognition of stock option income for up to a maximum of five years.• Election will be available for qualified stock from ISOs/ESPPs, but such options will no longer be treated as statutory options.• Income tax withholding will be required at highest individual rate.• Election will not change timing of FICA/FUTA withholding.• Form W-2 will have new reporting requirements related to deferral election.• 80% coverage requirement.• Excluded from section 409A coverage.

Fringe Benefits – Deductions Limitations

More phantom income for partners at the Fund/Management Co level?

Prior Law	Current Law (P.L. 115-97)
<p>Entertainment/Membership Dues: Entertainment, amusement, and recreation activities as well as related facility expenses are 50% deductible if directly related to conduct of a trade or business.</p>	<p>No deduction allowed for amount paid or incurred after December 31, 2017; 50% deduction rule repealed.</p>
<p>De minimis fringe: Certain de minimis fringe benefits are excluded from employee income and generally deductible by the employer</p>	<p>From January 1, 2018 through December 31, 2025, deduction limited to 50% for meals provided for the convenience of the employer or through an employer-operated eating facility that qualified as a de minimis fringe benefit; not deductible after December 31, 2025.</p>

Fringe Benefits – Deductions Limitations

Prior Law	Current Law (P.L. 115-97)
<p>Qualified transportation fringe benefits and commuting (including cost of qualified parking facility)</p>	<p>No deduction allowed, except when related to safety of the employee</p>
<p>On premises athletic facility: Athletic facilities located on employer’s business premise, operated by the employer for use by employees are excluded from employee income and deductible.</p>	<p>Remains unchanged.</p>
<p>Employee Achievement Awards: Excludes awards of tangible personal property from income. Currently no definition of tangible personal property.</p>	<p>Provides that cash, cash equivalents, gifts cards, tickets, etc. cannot be treated as tangible personal property, regardless of value. As a result, these awards are not excludable from income.</p>

Moving Expenses

Any moving expenses incurred in 2017, but after the last payroll /expense report cut off in 2017?

Prior Law	Current Law (P.L. 115-97)
Qualified moving expense deduction (other than military)	Suspended until 2026.
Qualified moving expense reimbursements excluded from gross income	Suspended until 2026

The suspension of the moving expense deduction/qualified reimbursements increases the cost of moving employees domestically or internationally after taking into account the gross-up for taxes.

On the other hand, lack of a tax deduction could simplify administration for employers. Going forward, it may be feasible to simply provide employees with a moving allowance and forego the requirement that assignees account for their moving expenses.

4. Observations





Amendments to Section 162(m)

Section 162(m) – Prior Law

- Section 162(m) limits compensation deductions for publicly held corporations to \$1M for amounts paid to covered employees
 - “Covered employees” limited to the CEO and the next three highest compensated officers; excludes the CFO and any officers not employed on last day of tax year
 - Exceptions: Performance-based compensation, commissions, and post-employment payments are not subject to the deduction limitation

Section 162(m) Amendments

- Expands definition of publicly held corporation
- Expands covered employees to include CFO; individuals remain “covered employees” after leaving the position, even if they terminate employment
- Repeals exceptions for performance-based compensation and commissions
- Generally effective for taxable years beginning after (TYBA) December 31, 2017
- Exception for written binding contracts effective 11/2/2017 (See Notice 2018-68)

Expansion of publicly held corporation

- Prior law limited the definition to companies “required” to register their common stock under Section 12 of the Securities and Exchange Act
- New law expands the definition to also include companies that are “required” to file reports under Section 15(d) of the Securities and Exchange Act
 - Publicly issued debt
 - Status of foreign private issuers
 - Other filers

For purposes of this subsection, the term “publicly held corporation” means any corporation ~~issuing any class of common equity securities required to be registered under which is an issuer (as defined in section 12 13~~ of the Securities Exchange Act of 1934 (15 U.S.C. 78c).—

(A) the securities of which are required to be registered under section 12 of such Act (15 U.S.C. 78l), or

(B) that is required to file reports under section 15(d) of such Act (15 U.S.C. 78o(d)).

Expansion of covered employees

For purposes of this subsection, the term "covered employee" means any employee of the taxpayer if-

(A) ~~as of the close of the taxable year, such employee is the chief principal executive officer or principal financial officer of the taxpayer or is at any time during the taxable year, or was~~ an individual acting in such a capacity, ~~or~~

(B) the total compensation of such employee for the taxable year is required to be reported to shareholders under the Securities Exchange Act of 1934 by reason of such employee being among the ~~3~~ **4** highest compensated officers for the taxable year (other than ~~the chief executive officer~~ any individual described in subparagraph (A)), or

(C) was a covered employee of the taxpayer (or any predecessor) for any preceding taxable year beginning after December 31, 2016.

Such term shall include any employee who would be described in subparagraph (B) if the reporting described in such subparagraph were required as so described.

CFO is now a covered employee

Covered employees are now:

- CEO,
- CFO, and
- Next three highest paid executive officers on the SEC compensation disclosure table (or who would be on the table if one were required)

"Last day" rule for CEO and CFO is eliminated

Once a covered employee (for TYBA 2016), always a covered employee

Expansion and Grandfathering

The H.R. 1 amendments generally apply to TYBA December 31, 2017.

But, the H.R. 1 amendments do not apply to “binding contracts” in effect on November 2, 2017 if not “materially modified” thereafter.

Binding contract exception may protect:

- Performance-based compensation
- CFO compensation
- Post-employment compensation
- Compensation paid by foreign private issuers or others that were not previously treated as “publicly held” companies
- Performance-based compensation for non-proxy officers if they become covered employees in the future

IPO transition rule still applies for

- Grants and payment during reliance period

(e) EFFECTIVE DATE.—

(1) **IN GENERAL.**—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 2017.

(2) **EXCEPTION FOR BINDING CONTRACTS.**—The amendments made by this section shall not apply to remuneration which is provided pursuant to a **written binding contract** which was in effect on November 2, 2017, and which was not modified in any material respect on or after such date.

Binding contract analysis is relevant only to the extent that a grant would have been deductible under prior law.

Section 162(m) Considerations

- How to analyze comp committee “negative discretion” and rights to terminate or amend? [See Notice 2018-68](#).
- To what extent may future lump sum payments be “spread” to maximize deductions?
- 409A regulations allow for elections to defer compensation to a period in which it is deductible under 162(m)
- To what extent will certain regulatory exceptions under 162(m) continue to apply?
 - Ex: IPO transition rule
 - Ex: 1504 controlled group rules
- What compensation designs will be preferable in light of the elimination of performance-based compensation?



Business Entertainment and Meals

Amendments to entertainment deduction disallowance

Under existing regulations, entertainment is determined objectively and generally includes:

- Golf
- Fishing
- Sightseeing
- Tourist Activity
- Movies and Theater Events
- Concerts

§ 274(a)(1) In general. No deduction otherwise allowable under this chapter shall be allowed for any item—

(A) Activity. With respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, ~~unless the taxpayer establishes that the item was directly related to, or, in the case of an item directly preceding or following a substantial and bona fide business discussion (including business meetings at a convention or otherwise), that such item was associated with, the active conduct of the taxpayer's trade or business,~~

Section 274 previously allowed otherwise deductible entertainment is associated with the active conduct of business. Business entertainment is now nondeductible.

A meal can be a form of entertainment subject to the § 274(a) disallowance.

Amendments to 50% deduction disallowance

§ 274(n) Only 50 percent of meal ~~and entertainment~~ expenses allowed as deduction.

(1) In general.

The amount allowable as a deduction under this chapter for-

(A) any expense for food or beverages, ~~and~~

~~(B) any item with respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, or with respect to a facility used in connection with such activity,~~

shall not exceed 50 percent of the amount of such expense or item which would (but for this paragraph) be allowable as a deduction under this chapter.

As statutory housekeeping, entertainment removed from 50% disallowance, leaving entertainment items with exceptions from general disallowance with 100% deduction (although this increased deductibility is unlikely to have been intended by the legislative drafters).

Exceptions	General disallowance exception	50% disallowance exception
Substantial and bona fide business discussion	✗	
Included in compensation	X	X
Reimbursed	X	X
Nondiscriminatory recreational expenses of employees	X	X
Items available to the general public	X	X
Entertainment sold to customers	X	X
Food or beverages on business premises for employees	X	
Business meetings of employees, stockholders, agents or directors	X	
Business meetings of tax-exempt business associations	X	
Expenses for de minimis fringe meals		✗

Meals provided for the convenience of the employer

- Excluded from employee income
- Subject to 50% disallowance (unless provided at employer-operated eating facility)

Meals provided at an employer-operated eating facility

- Excluded from income as de minimis fringe if requirements are satisfied:
 - Located on or near business premises of employer
 - Employer-operated facility
 - During workday
 - Revenue \geq costs
 - If meal is provided for the convenience of the employer, revenue is deemed to equal cost
 - Nondiscriminatory
- Prior to H.R. 1, 100% deductible as a de minimis fringe

- **Pre-H.R. 1, 100% deduction for employer-provided eating facility and employees could exclude the value of the meal from income**
- **Under H.R. 1, 50% deduction for food or beverages provide at an employer-operated eating facility between January 1, 2018 and December 31, 2025**
- **After December 31, 2025, no deduction for costs associated with the operation of an employer-operated eating facility**

Meal	Pre-2018 deductibility	2018-2026 deductibility	2026- deductibility
Convenience of the employer meals (unless provided at an employer-operated eating facility)	50%	50%	0%
Employer-operated eating facility meals	100%	50%	0%

Example	2017	2018
Meals for employees who are traveling on business	<ul style="list-style-type: none"> • Excludable from income • 50% deductible 	No change
Overtime meals (not from employer-operated eating facility) for employees on site at company office	<ul style="list-style-type: none"> • Excludable from income • 50% deductible 	No change
Catered meals (not from employer-operated eating facility) for business meetings on site at company office	<ul style="list-style-type: none"> • Excludable from income • 50% deductible 	No change
Off-site meetings to discuss company business (employees and non-employees)	<ul style="list-style-type: none"> • Excludable from income • 50% deductible 	No change
Company-wide holiday parties or picnics for employees	<ul style="list-style-type: none"> • Excludable from income • 100% deductible 	No change
De minimis coffee/snacks in breakrooms	<ul style="list-style-type: none"> • Excludable from income • 100% deductible 	<ul style="list-style-type: none"> • Excludable from income • 50% deductible
Meals associated with entertainment (baseball game, theatre, etc.) – No business discussion	<ul style="list-style-type: none"> • Included in income • Nondeductible 	No change
Meals associated with entertainment (baseball game, theatre, etc.) – Business discussion	<ul style="list-style-type: none"> • Excludable from income • 50% deductible 	<ul style="list-style-type: none"> • Excludable from income • Deductible or nondeductible?



Travel and Transportation

Qualified Transportation Fringes

- Up to annual limit, employers can exclude from employee income four types of qualified transportation fringe
- May be funded by employee pre-tax salary reduction
- H.R. 1 suspends bicycle reimbursement exclusion until 2026 but leaves other three exclusions intact

Benefit	2017 monthly income exclusion limit	2018 monthly income exclusion limit
Commuter highway vehicle	\$255	\$260
Transit pass	\$255	\$260
Parking	\$255	\$260
Bicycle	\$20	\$0

H.R. 1 change to deductibility of employee commuting costs

Employer may no longer deduct expense of qualified transportation fringe provided to employee of taxpayer, but subject to existing exceptions.

Deduction applies to *expense* of providing the benefit, not *value* that is excluded from income.

For qualified parking, could include:

- lease payments,
- depreciation,
- interest on debt,
- maintenance costs

§ 274(a)(4) No deduction shall be allowed under this chapter for the **expense** of any qualified transportation fringe (as defined in section 132(f)) provided to an employee of the taxpayer.

IRS Publication 15-B clarifies that “expense” includes employee’s pre-tax salary reduction.

Additional disallowance for any commuting

Not subject to § 274(e)(2) compensation exception

Not limited to qualified transportation fringe

Subject to exception for the safety of the employee

§ 274(l)(1) No deduction shall be allowed under this chapter for any expense incurred for providing any transportation, or any payment or reimbursement, to an employee of the taxpayer in connection with travel between the employee's residence and place of employment, except as necessary for ensuring the **safety** of the employee.

Corporate Aircraft

—Tax implications where an employee uses an employer-provided aircraft:

- Income inclusion for employee
- Disallowance of employer's deduction for personal entertainment use

—Business entertainment

- Flights with respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation are not deductible
- Same treatment as personal entertainment
- Unclear how IRS will view flights with entertainment and business element

—Commuting

- Any expense for employee travel from a personal residence to a place of employment is no longer deductible
- Commuting disallowance is not subject to compensation exception so imputed income for commuting is not deductible (i.e. no SIFL add-back)

Business and Transportation Fringes

Usage	Example	2017	2018
Personal entertainment	Travel to Aspen for personal ski trip	<ul style="list-style-type: none"> Included in income Nondeductible (except SIFL amount) 	No Change
Personal non-entertainment	Travel to Michigan for prospective visit to college campus for executive's child	<ul style="list-style-type: none"> Included in income Deductible 	No Change
Business entertainment	Travel to Pebble Beach with client to golf and engage in business discussions	<ul style="list-style-type: none"> Excluded from income Deductible 	<ul style="list-style-type: none"> Excluded from income Nondeductible
Business	Travel to Ohio for business conference	<ul style="list-style-type: none"> Excluded from income Deductible 	No Change
Commuting	Travel from executive's secondary residence in Cape Cod to office in Milwaukee	<ul style="list-style-type: none"> Included in income Deductible 	<ul style="list-style-type: none"> Included in income Nondeductible



Qualified Moving Expenses

Pre-H.R. 1 treatment of moving expenses

Prior to H.R. 1, individual taxpayers could deduct moving expenses incurred in connection with commencement of work by taxpayer at new principal place of work.

§ 217(a)(1) There shall be allowed as a deduction moving expenses paid or incurred during the taxable year in connection with the commencement of work by the taxpayer as an employee or as a self-employed individual at a new principal place of work.

Moving expenses generally include costs of moving household belongings and travelling between former residence to new residence

Section 217 is an individual deduction. An employer who reimburses the costs has a deduction under § 162, not § 217.

§ 132(g)(1) The term “qualified moving expense reimbursement” means any amount received (directly or indirectly) by an individual from an employer as a payment for (or a reimbursement of) expenses which would be deductible as moving expenses under section 217 if directly paid or incurred by the individual. Such term shall not include any payment for (or reimbursement of) an expense actually deducted by the individual in a prior taxable year.

Prior to H.R. 1, an employer’s reimbursement of moving expenses that would be deductible under § 217 is excludable from income under § 132(g).

H.R. 1 treatment of moving expenses

From 2018 through 2025, qualified moving expense deduction and reimbursement exclusion is suspended.

§ 217(k) Except in the case of an individual to whom subsection (g) applies, this section shall not apply to any taxable year beginning after December 31, 2017, and before January 1, 2026.

Exception for member of the Armed Forces of the United States on active duty who moves pursuant to a military order and incident to a permanent change of station.

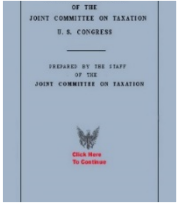
Suspension of § 217 does not affect employer's deduction for reimbursement of employee's moving costs.

§ 132(g)(2) Except in the case of a member of the Armed Forces of the United States on active duty who moves pursuant to a military order and incident to a permanent change of station, subsection (a)(6) shall not apply to any taxable year beginning after December 31, 2017, and before January 1, 2026.

5. What Now?



What's Next: Clarifications and Changes



Legislative history

- Additional explanation and clarification could be included in a “Bluebook” published by Joint Tax
- The bluebook could be used to clarify Congressional intent in drafting the legislation



Treasury regulations

- H.R. 1 is likely to require many new regulations to implement the law
- Generally Treasury has 18 months to issue regs retroactive to enactment
- In the interim, Notices could be issued
- Treasury’s reg authority is limited



Other Legislation

- Some areas will require enactment of additional law
- Technical corrections may be needed to clarify the law where Treasury does not have adequate authority
- Substantive changes may also be made to the law to clarify, correct, or modify



Thank you



Presenter

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