Senate Approves Tax Reform with Differences from House Version

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On December 2, the Senate narrowly approved its own version of the Tax Cuts and Jobs Act (the "Senate Bill"). Earlier, the House approved a different version of this legislation, which was outlined and discussed in **theHRBenefitsAuthority on November 8** and **November 17** (the "House Bill"). The House has adopted a resolution to send the bills to a conference committee of members of both the House and Senate to resolve differences between the two versions. ***(You may click on any of the listed sections to go directly to that section.)***

I. **Executive Compensation**

II. **Special Provisions for Tax Exempt Entities**

III. **Qualified Retirement Plans**

IV. **Health, Welfare and Fringe Benefits**

Comparison of Key Benefits Provisions in the House and Senate Bills.

Tax Feature	Current Law	House Bill	Senate Bill	Observations
I. Executive Compensation				
Hard $1M Cap on Deductible Executive Compensation for Public Companies	A public corporation may deduct compensation expenses as ordinary and necessary business expenses, subject to the Section 162(m) maximum limit of $1 million on non-performance-based compensation for the CEO and 3 highest paid executive officers (other than the CFO). Performance-based compensation is not subject to the $1 million cap, and the CFO is not subject to the deduction cap.	The $1M maximum deductible compensation limit would apply to all compensation paid to the CEO, the CFO and the 3 highest paid executive officers, whether or not the compensation is performance-based. Once an employee qualifies as a "covered employee" in one year, the deduction limitation would continue to apply in all future years and would apply to compensation paid after termination of employment and payments made to the covered employee's beneficiaries.	Same as House Bill. The Senate Bill adds a transition rule, under which the proposed changes would not apply to compensation under a written, binding contract in effect on 11/2/17 and not modified after that date.	*The lost deductions for public companies would increase the cost of compensating their senior executives, although that impact would be mitigated by lower corporate tax rates. For reasons unrelated to deductibility, corporations are likely to continue to make performance-based compensation a significant component of executive pay, but compensation committees will no longer be constrained by the rigid requirements of the current rules for performance-based compensation under Section 162(m).*

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Deferral of Taxation for Certain Equity Compensation Arrangements	Income from stock acquired in connection with the exercise of nonqualified stock options or settlement of RSUs is taxable when exercised.	Qualified employees of a private company would be able to elect to defer inclusion of income from company stock acquired under options or RSUs for up to 5 years after vesting. The election would not be available to senior officers, highly compensated employees, and 1% owners. To qualify, the company must grant options or RSUs to at least 80% of full-time U.S. employees. The employees are not required to receive grants for the same number of shares, but they must receive more than a de minimis amount.	Same as House Bill.	*For a number of reasons, including the exclusion of senior management and the need to comply with federal and state securities laws, we expect that relatively few private companies will establish plans intended to comply with this provision.*
II. Special Provisions for Tax-Exempt Entities				
Tax on Executive Compensation Exceeding $1M for Tax-Exempt Entities	No specific restrictions exist on compensation in excess of $1 million paid by tax-exempt entities for executive compensation.	A 20% tax would apply to compensation exceeding $1 million paid by a tax-exempt entity to any of its 5 highest paid employees. The tax is imposed on the tax-exempt entity, not the employee. Once an employee qualifies as a "covered employee" in one year, the excise tax would apply in all future years and would apply to compensation paid after termination of employment and payments made to the covered employee's beneficiaries.	Same as House Bill.	*This excise tax would impact the cost structure of affected tax-exempt entities and could require additional disclosures to donors.*

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Tax on Excess Severance Payments to Executives	There are no specific restrictions on severance benefits payable to executives of tax-exempt entities.	A 20% tax would apply to any "excess parachute payment" paid by a tax-exempt entity to any of its 5 highest paid employees. A parachute payment is a payment contingent on the employee's separation from employment. The tax applies to parachute payments that exceed 3 times the employee's average taxable wages over the preceding 5 years.	Same as House Bill.	*This tax resembles the tax imposed on employees of taxable corporations under Section 280G on excess parachute payments that are conditioned upon a change in control of the corporation, and both the House Bill and the Senate Bill incorporate concepts from Section 280G. However, the tax is not related to a change in control and is imposed on the tax-exempt entity, not the employee.*
III. Qualified Retirement Plans				
Reduced Age for In-Service Withdrawals from Pension Plan	While most defined contribution plans can permit in-service distributions at age 59½, defined benefit plans may not permit in-service distributions prior to age 62.	Defined benefit plans could allow in-service distributions beginning at age 59½.	No change to current law.	
Simplification of Hardship Withdrawal Rules	Unless special action is taken, employees who receive hardship withdrawals may be required to wait 6 months after the distribution to recommence contributions. Hardship withdrawals may not be made from (i) investment earnings on employee elective deferrals, or (ii) qualified nonelective contribution accounts. Also, employees must first take any available loan before being eligible to receive a hardship distribution.	Employees who receive a hardship withdrawal could continue making contributions to the plan without a 6-month suspension. Hardship distributions could also include (i) earnings on elective deferrals, and (ii) qualified nonelective contributions. The requirement to take any available loan before taking a hardship distribution would be eliminated.	No change to current law.	*Under the House Bill, these rule changes would ease the ability of employees to take hardship withdrawals and would reduce some of the complexity in administering hardship withdrawals. Employers would need to work with recordkeepers to update their systems and communications. While not required, employers could continue to impose some limits on hardship withdrawals to help protect employees' retirement savings.*

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Rollover of Loan Offset Amounts	If a participant defaults on a plan loan, that loan becomes immediately taxable to the participant. The participant may avoid taxation by making a contribution to an IRA or a qualified employer plan in an amount equal to the defaulted loan. This contribution is treated as a rollover of the loan offset amount, so it must be made within 60 days of the loan default.	The contribution deadline would be extended to the latest date for the participant to file his or her tax return for the year of the loan default.	Same as House Bill.	
Relief for Frozen Pension Plans	Employers who freeze their pension plans will often allow a grandfathered group to continue to accrue benefits. As this group naturally shrinks and becomes more highly paid over time, the coverage and nondiscrimination requirements that apply to the pension plan become harder and harder to satisfy.	Frozen pension plans would get automatic relief from some coverage and nondiscrimination requirements. In addition, for purposes of satisfying other nondiscrimination requirements, it would be easier to count replacement defined contribution plan benefits along with frozen defined benefit accruals.	No change to current law.	
Recharacterizing Roth Contributions and Conversions	Individuals who make IRA contributions may choose to recharacterize those contributions as either traditional contributions or Roth contributions. Similarly, an individual who elects to convert a traditional IRA into a Roth IRA may also recharacterize that conversion. Recharacterizations are generally permitted as late as October 15 of the year following the year of contribution or conversion, as applicable.	Recharacterization would no longer be allowed. IRA contributions would need to retain their original characterization, and Roth conversions could not be undone.	Same as House Bill.	

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Special Disaster Relief	Distributions from eligible retirement plans are included in income for the year distributed. In addition, unless an exception applies, a distribution received before age 59 ½ is subject to a 10% additional tax.	No change to current law.	The 10% early withdrawal tax does not apply to qualified distributions received in connection with areas damaged by federally declared 2016 disasters. Such qualified 2016 disaster distributions may be repaid within 3 years and income recognition from such distributions can be spread over 3 years.	*This is similar to the recent relief that Congress enacted for federally declared 2017 disasters.*
IV. Health, Welfare and Fringe Benefits				
ACA changes	Individuals must be covered by a health plan that provides at least minimum essential coverage or be subject to a tax (the "ACA Individual Mandate"). The tax is imposed for any month that the individual does not have minimum essential coverage unless an individual qualifies for an exemption.	No change to current law.	The ACA Individual Mandate is eliminated by reducing the tax to zero beginning in 2019.	*Although the Senate Bill eliminates the penalty for individuals who do not purchase health insurance beginning in 2019, it does not affect the employer mandate. Therefore, because the employer mandate requirement remains unchanged, employers must still provide affordable minimum essential coverage to full-time employees or face potential penalties, and they must complete mandatory ACA reporting.*
Dependent Care FSAs	Employees can use a Dependent Care Flexible Spending Account (FSA) to set aside on a tax-free basis up to $5,000 per year to help pay for childcare or dependent care expenses to enable the employee to work or look for work.	Contributions to a Dependent Care FSA would be taxable beginning in 2023.	No change to current law.	*Under the House Bill, these arrangements would be effectively eliminated in 2023 as they would have no value to employees. Both employees and employers would have an increase in Social Security and Medicare tax expenses, since Dependent Care FSA contributions currently are exempt from those taxes. Neither the House Bill nor the Senate Bill eliminates Health Care Flexible Spending Accounts.*

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Adoption Assistance Programs	Employers can provide up to $13,570 in tax-free adoption assistance to employees for amounts paid (or deemed paid for special-needs adoptions) or expenses incurred for the adoption of a child.	Adoption assistance payments would be taxable to the recipient.	No change to current law.	
Qualified Moving Expense Reimbursement	Certain moving expenses provided by an employer are excluded from an employee's income.	Moving expenses received by an employee from an employer as payment or reimbursement would be taxable to the recipient, except in the case of a member of the Armed Forces on active duty who moves pursuant to a military order.	Same as House Bill. However, this provision applies only to taxable years 2018-2025.	
Employee Achievement Awards	Qualified service awards are excludable from employees' taxable compensation up to certain amounts.	These service awards would be fully taxable to the recipient.	The exclusion for some employee achievement awards would be preserved. However, awards of cash, gift cards, and other non-tangible personal property would no longer be excluded from income.	
Tuition Reimbursement and Education Assistance	Amounts received from an employer under a qualified educational assistance program are excluded from taxable income up to $5,250 per year.	Amounts received from the employer for educational assistance programs would be fully taxable to the recipient.	No change to current law.	
Housing Allowances	The value of housing and meals provided to an employee, spouse and/or dependents for the convenience of the employer are excluded if certain requirements are met.	The exclusion for housing would be limited to $50,000, phased out for highly compensated employees, and limited to one residence.	No change to current law.	
New Credit for Employer-Paid Family and Medical Leave	An employer cannot claim a deduction or credit for granting paid FMLA leave.	No change to current law.	An employer would be able to claim a credit during any period in which employees are on paid FMLA if the rate of payment is at least 50% of wages normally paid to employees.	

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Employer-Provided Child Care Credit	Employers may claim a credit for qualified expenses for employee child care and child care resource and referral services.	This credit would be eliminated.	No change to current law.	

It is important to note that neither the final House Bill nor the final Senate Bill include the sweeping changes to nonqualified plans proposed in the original versions of both bills.

Effective Date and "Sunset" Provisions. Unless noted above, the provisions in both bills are generally effective for taxable years beginning in 2018. However, many individual provisions in the Senate Bill are scheduled to "sunset", or expire, at the end of 2025 barring future legislative action.

Next Steps. Members of the conference committee will now work to resolve differences and produce a final bill. Once finalized, the legislation will go directly to the floor of the House and Senate for a vote, where both chambers must pass the bill as is. When the vote is complete, the final version of the Tax Cuts and Jobs Act will then be presented to the President for signature. We will continue to monitor the progress of these bills closely and will update you on important developments.

Contact Information. For more information, please contact Don Mazursky (404.888.8840), David Putnal (404.888.8836), Glenn Infinger (404.888.8845), Toby Walls (404.888.8870), Teri King (404.888.8847), Kelly Meyers (404.888.8838), Angela Roberts (404.888.8822), Alex Smith (404.888.8839), or Chandra Burns (404.888.8834).