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New Tax Plan Changes Rules on Health Coverage, Employee Benefits and Executive Compensation

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While primarily focused on individual and business tax cuts and reform, the final Republican tax cut bill includes several provisions expected to impact health care coverage and expenses. First, the bill effectively repeals the Affordable Care Act's (ACA) individual mandate by eliminating the tax penalty starting in 2019. The Congressional Budget Office and Joint Committee on Taxation estimates that repealing the mandate will increase the number of uninsured individuals by four million in 2019, and 13 million by 2027. Second, the bill expands the medical expense deduction, which allows individuals to deduct out-of-pocket expenses in excess of 10 percent of adjusted gross income, by reducing the threshold to 7.5 percent of income for 2017 and 2018 only. Beyond those provisions, the bill does not include direct changes to health care or employer coverage requirements, including policies affecting the ACA's employer mandate and tax exclusion of employer-sponsored insurance.

Changes Affecting Health Coverage

While no provisions in the final tax cut bill directly address employer-sponsored health coverage or the employer "shared responsibility" rules under the ACA, the new legislation does eliminate the individual shared responsibility penalty effective January 1, 2019. How this may affect employers and their health plans is yet to be seen. However, without a removal of the employer shared responsibility penalties, applicable large employers should continue to assure compliance both in offers of coverage and IRS reporting on Forms 1094 and 1095.

Changes Affecting Retirement Plans and IRAs

While earlier versions of the House and Senate bills contained many provisions affecting retirement plan benefits, ultimately the final tax cut bill makes only minor changes to the laws impacting retirement benefits. There are no changes in the final tax cut bill that revise the basic provisions governing qualified retirement plans and nonqualified deferred compensation plans.

Recharacterization of Certain IRA and Roth IRA Contributions

There are two basic types of individual retirement arrangements (IRAs) under present law: traditional IRAs, to which both deductible and nondeductible contributions may be made, and Roth IRAs, to which only nondeductible contributions may be made. At present, if an individual makes a contribution to an IRA (traditional or Roth) for a taxable year, the individual is permitted to recharacterize the contribution as a contribution to the other type of IRA (traditional or Roth) by making a trustee-to-trustee transfer to the other type of IRA before the due date for the individual's income tax return for that year. Effective January 1, 2018, the new law prohibits the use of recharacterization to unwind a Roth conversion. However, recharacterization will still be permitted with respect to other contributions.

Rollovers of Plan Loan Offsets

Participants in 401(k), 403(b) and 457(b) plans who have outstanding plan loans have historically faced negative tax consequences when the plan terminated or they terminated employment as the outstanding

balance, unless immediately repaid or contributed to an IRA or new plan, would result in current tax to the participant. New rules will extend the period of time a person has to contribute the outstanding loan balance (plus 20 percent withholding) to an IRA or other plan. Effective January 1, 2018, this period of time is extended from 60 days to the due date (including extensions) for filing the participant's federal income tax return for the taxable year in which the distributable event occurs.

Changes to Executive Compensation

Elimination of "Performance-Based Compensation" Exemption

IRC Section 162(m) limits to $1 million the amount of compensation a publicly-traded employer can deduct for certain high level executives, called "covered employees." At present, this limit excludes commissions and performance-based compensation. Effective January 1, 2018, the new law will change the definition of "covered employee" and eliminate the performance-based compensation exemption. There is a transition rule to grandfather certain written plans which provide for performance-based compensation if they were in place by November 2, 2017, and are not materially altered.

Tax-Deferral of New Qualified Equity Grants

Under current tax law, an employee generally must recognize income from a grant of employer stock in the taxable year in which the employee's right to the stock is transferable or is not subject to a substantial risk of forfeiture, whichever occurs earlier. The new law will allow employees to elect to defer tax on certain "qualified equity grants" for up to five years with the deferred amounts exempt from IRC Section 409A. In order to allow this deferral, the equity grants must be uniform and broad-based among all employees, excluding 1 percent owners and the top four most highly paid. The rules are set to become effective January 1, 2018.

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