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Eye On Washington

Legislative Update

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H.R. 1, Tax Cuts and Jobs Act, To Be Enacted December 22, 2017

Treasury Guidance for 2018 Withholding Calculations Expected Shortly

H.R. 1, the Tax Cuts and Jobs Act (the Act), was passed by both the House and Senate on December 20, 2017, and is expected to be signed into law on December 22. H.R. 1 includes several significant changes that are relevant to employers for payroll, employment tax and employee benefits purposes, and are generally effective on January 1, 2018. These provisions, as well as expected transition measures, are explained below.

Immediate Impact to Income and Employment Taxes

Although new federal income tax tables and rates will take effect on January 1, there may be a delay in release of withholding tax guidance from the U.S. Treasury Department for employers. In the meantime, the Internal Revenue Service (IRS) has explained that employers may use existing (2017) withholding tax tables and guidance until new guidance is released. According to a notice dated December 13, 2017, the IRS *"anticipates issuing the initial withholding guidance (Notice 1036) in January reflecting the new legislation, which would allow taxpayers to begin seeing the benefits of the change as early as February. The IRS will be working closely with the nation's payroll and tax professional community during this process."*

The Act authorizes the Treasury Department to permit employers to apply existing wage withholding rules and calculations throughout 2018, although this seems unlikely. According to H.R. 1 and the conference report:

"… the Secretary [of the Treasury] may administer the withholding rules under Section 3402 for taxable years beginning before January 1, 2019, without regard to the amendments made under this provision. Thus, at the Secretary's discretion, wage withholding rules may remain the same as under present law for 2018."

However, to avoid adversely affecting taxpayers, Treasury is likely to issue guidance as soon as possible, to align employer wage withholding calculations with the new income tax rates which will take effect on January 1, 2018.

Supplemental Wage Withholding Rate Unclear

For supplemental wages, such as bonuses and commissions, employers often use the optional flat rate of income tax withholding, which for 2017 is 25% for year-to-date supplemental wages under $1 million. H.R. 1 would change certain references such that it may be unclear what withholding rate would apply for 2018 supplemental wages. ADP has consulted with prominent Washington law firms, including several former Treasury Department officials, who agree that the result is unclear. Consequently, employers should await Treasury guidance if possible, or rely on IRS guidance from early December that employers may follow current withholding guidance (see 2017 Notice 1036) until revised guidance is published. In any event, employers may want to consult with their legal and tax advisors regarding withholding for supplemental wages.

Form W-4 Expected to Be Revised

H.R. 1 repeals the deduction for personal exemptions, which for 2017 is $4,050 per individual (i.e., employee, spouse, dependents). The number of personal exemptions is currently a key factor in withholding calculations. Employees establish withholding allowances on Forms W-4 based in part on the number of personal exemptions that they expect to report on their income tax returns. Withholding allowances may also be claimed based on estimated itemized deductions, such as for mortgage interest, so the concept of withholding allowances may not be entirely eliminated.

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It seems likely that Forms W-4 may need to be substantially revised and reissued by the IRS, which could take a number of weeks. In the meantime, the IRS expects to issue guidance permitting employers to continue relying on existing Forms W-4. It is also anticipated that the IRS will permit a reasonable transition period when the revised Form W-4 is issued.

Some employees may ask questions about the effect of the Act or may submit updated Forms W-4 to modify their withholding allowances for 2018. Employers should be prepared to accept updated Forms W-4 from employees, but may wish to advise employees that a revised Form W-4 will likely be issued by the IRS later in 2018, and that the employee may need to complete the revised form at that time.

State Forms W-4 May Also Change

Many states maintain tax laws that are closely aligned with federal law, and many states permit employers to rely on the federal Form W-4 for state income tax withholding purposes. The elimination of personal exemptions in federal law may cause several states to revise their equivalent withholding allowances forms and/or issue new guidance to employers. ADP has been in contact with a number of state taxing authorities; however, state decisions will likely come after the U.S. Treasury guidance and any revisions to the IRS Form W-4.

Changes to Certain Employee Benefits

H.R. 1 would make several significant changes affecting employee benefits, generally effective on January 1, 2018. These provisions are summarized below. Employers should review the relevant law in detail and consult with appropriate legal and tax professionals before taking any action.

Qualified Transportation Fringe Benefits

Currently, employers are able to offer qualified transportation fringe benefits, such as mass transit passes and qualified parking, on a pretax basis (i.e., excludable from an employee's taxable income and excluded from wages for employment tax purposes). For 2017, the maximum monthly exclusion for qualified parking, and for commuter highway vehicle transportation and transit passes is $255. Employers may generally deduct these expenses.

Effective for tax years beginning after December 31, 2017, H.R. 1 would repeal the employer deduction for expenses related to qualified transportation fringe benefits, or for any expenses incurred for providing, paying, or reimbursing any employee's expenses for travel between home and work except expenses deemed necessary for ensuring the safety of an employee. H.R. 1 is silent as to the tax treatment of transportation fringe benefits to employees, so qualified transportation fringe benefits will remain tax exempt to employees, and such benefits can still be offered to employees on a pretax basis (i.e., excluded from income for FIT, Social Security/Medicare, and FUTA purposes.)

Qualified Bicycle Commuting Expenses

In 2017, qualified bicycle commuting reimbursements of up to $20 per month could be offered as a tax-free benefit (i.e., excludable from an employee's taxable income and excluded from wages for employment tax purposes), for employees who regularly use a bicycle to travel to a place of employment, and during which the employee does not receive transportation via a commuter highway vehicle, a transit pass, or qualified parking from an employer.

H.R. 1 would repeal this provision, effective for taxable years beginning after 2017 and before 2026. For these years, qualified bicycle commuting expenses can no longer be offered on a pretax basis to employees, but employers can continue to deduct expenses for bicycle commuting expenses paid or incurred after December 31, 2017, and before January 1, 2026.

Employee Achievement Awards

Currently, an employer's deduction for the cost of an employee achievement award is limited to a certain amount. Employee achievement awards that are deductible by an employer are excludable from an employee's gross income. Amounts that are excludable from gross income under Section 74(c) for income tax purposes are also excluded from wages for employment tax purposes. 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.

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H.R. 1 adds a definition of "tangible personal property" that may be considered a deductible employee achievement award. It provides that tangible personal property shall **not include cash, cash equivalents, gift cards, gift coupons, or gift certificates** (other than arrangements conferring the right to select from a limited array of such items pre-approved by the employer), **or vacations, meals, lodging, tickets to theater or sporting events, stocks, bonds, other securities, and other similar items.**

This provision is effective for amounts paid or incurred after 2017. However, this definition is already considered to be in effect under proposed regulation 1.274-8, so H.R. 1 would codify the definition into statute. The Joint Committee on Taxation noted that "No inference is intended that this is a change from present law and guidance."

Business Entertainment, Amusement, and Recreational Activities

Currently, employers may deduct expenses for entertainment, amusement, recreational activities, and membership dues with respect to any club organized for business, pleasure, recreation or any other social purpose, if the expenses relate to the conduct of the taxpayer's trade or business. The deduction is generally limited to 50% of otherwise deductible expenses.

Beginning in 2018, H.R. 1 would eliminate the employer's deduction for entertainment, amusement, recreational activities or membership dues relating to a business, pleasure, recreation or other social purpose, or any facility used in connection with any of the above items. Employers may still deduct 50% of otherwise deductible food and beverage expenses (e.g., meals consumed by employees on work travel).

For amounts incurred and paid after December 31, 2017 and through December 31, 2025, H.R. 1 would expand the 50% expense limitation to employer expenses associated with providing food and beverages to employees through an on-premises eating facility that meets requirements for de minimis fringes, and for the convenience of the employer. No deduction will be permitted after 2025.

Qualified Moving Expense Reimbursements

Currently, qualified moving expense reimbursements are excluded from an employee's gross income for income tax purposes, and are excluded from wages for employment tax purposes. Qualified moving expense reimbursements are defined as any amount received directly or indirectly from an employer as payment for (or reimbursement of) expenses which would be deductible as moving expenses under Section 217, if directly paid or incurred by the employee.

H.R. 1 would repeal the exclusion from gross income and wages for qualified moving expense reimbursements, 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. This provision is effective for tax years beginning after December 31, 2017.

Elimination of the ACA Individual Mandate (aka Penalty for Failing to Maintain Minimum Essential Coverage)

The Affordable Care Act (ACA) requires that individuals maintain health coverage that provides at least minimum essential coverage (MEC) or be subject to a penalty (commonly referred to as the "individual mandate" provision). The penalty generally is imposed for any month that an individual does not have MEC unless the individual qualifies for an exemption for the month. Currently, the annual penalty amount is the greater of a flat dollar amount (currently $695 per adult) or a percentage (currently 2.5%) of household income over a threshold amount. The Act reduces the amount of the individual responsibility penalty to zero, effective in 2019. The "individual mandate" remains in effect through 2018.

The elimination of the ACA individual mandate penalty has **no effect on the ACA employer mandate** (Section 4980H of the Internal Revenue Code (Code)). Applicable Large Employers (generally those with 50 or more full-time employees and full-time equivalent employees in the prior year), continue to be subject to the ACA coverage, reporting, and other applicable obligations.

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Treatment of Private Company Stock options

Effective January 1, a new subsection (i) of Code Section 83 is established for the deferral of broad-based, private company stock options and restricted stock units from wages subject to federal income tax and tax withholding of rank-and-file employees. The provision establishes new reporting requirements, which will be defined through regulations.

New Tax Credit for Paid Family and Medical Leave

For taxable years beginning after January 1, 2018, eligible employers may claim a general business credit equal to 12.5% of wages paid to qualifying employees during any period in which such employees are on paid family and medical leave, if the rate of payment under the program is at least 50% of the wages normally paid to an employee. The credit is increased by 0.25 percentage points (but not above 25%) for each percentage point by which the rate of payment exceeds 50%.

- For example, if an employee on FMLA leave is paid 60% of their normal wages, the credit would increase to 15% of the wage amount (12.5% plus (10% x 0.25 = 2.5%), which equals 15%).
- An employee paid 100% of their normal wage amount would generate a credit equal to 25% of the wage amount (12.5% plus (50% x 0.25 = 12.5%), which equals 25%).

The maximum amount of family and medical leave that may be taken into account with respect to any employee for any year is 12 weeks. An eligible employer is one who has in place a written policy that allows all qualifying full-time employees not less than two weeks of annual paid family and medical leave, and who allows all less-than-full-time qualifying employees a commensurate amount of leave on a pro rata basis.

A "qualifying employee" is any employee who has been employed for one year or more, and who, for the preceding year, had compensation not in excess of 60 percent of the compensation threshold for highly compensated employees (i.e., $72,000 for 2018 (60% of $120,000)).

If an employer provides paid leave as vacation leave, personal leave, or other medical or sick leave, this paid leave would not be considered to be family and medical leave. Leave paid for or required by a state or local government is also not taken into account.

There are many details to be determined through regulations, which are likely to take several months to complete. Employers who wish to take advantage of the new tax credit should consult with their legal and tax advisors. This tax credit would not apply to wages paid in taxable years beginning after 2019.

ADP Compliance Resources

ADP maintains a staff of dedicated professionals who carefully monitor federal and state legislative and regulatory measures affecting employment-related human resource, payroll, tax and benefits administration, and help ensure that ADP systems are updated as relevant laws evolve. For the latest on how federal and state tax law changes may impact your business, visit the ADP *Eye on Washington* Web page located at **www.adp.com/regulatorynews**.

If you have any questions regarding our services, please call 855-466-0790.

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