



## Employer New Year Resolution: Use the Tax Benefits

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The Tax Cuts and Jobs Act (TCJA) made direct changes, good and bad, to employer's compensation deductions, but also made changes to individual taxation which has an indirect effect on employment. The tax attorneys at Winston & Strawn describe some employer strategies which can make 2019 a more tax favorable year for the employer, for the employee, or for both.

### 1. Pass Through Deductions for Independent Contractors

For individuals, the TCJA enacted a brand new 20% deduction for Qualified Business Income as described in Section 199A of the Internal Revenue Code. This new tax break can affect attractiveness of worker classification. Independent contractors can use this deduction to decrease taxable income, but employees receiving a Form W-2 cannot. While the IRS is strict about independent contractor classification and requires such workers to meet certain standards, given the right circumstances, independent contractor status may be a good fit. The employer may save on the cost of employment taxes and employee benefits and the worker may have a 20% lower tax rate (dependent upon the type of work and the individual's total taxable income). It may be appropriate to communicate the existence of this tax benefit to workers considering independent contractor or employee status.

### 2. Public Company Deferred Compensation

Public companies face a harsh new world where compensation paid to named executive officers is completely non-deductible to the extent exceeding \$1,000,000 per year. However, since this is a yearly deduction limit, a strategy to circumvent the limit in the year compensation is earned is the implementation of a nonqualified deferred compensation plan which delays payment until the employee is no longer working. To the extent the retirement compensation is paid out at a rate of less than \$1,000,000 per year, the compensation is fully deductible to the employer company. The "win-win" is that some employees may be in a lower tax bracket at that time, e.g. move to Florida, and thus benefit from the delayed payments as well as having a "forced" savings for those years.

### 3. Expense Reimbursements

More and more state labor laws—Illinois, California, New York, Iowa, Massachusetts, Montana, Pennsylvania, and Washington, D.C.—are requiring employers to fully reimburse employee business expenses such as cell phone, telecommuter internet charges, and business travel expenses. However, in order to obtain an employment tax-free reimbursement, the IRS impose strict substantiation requirements, e.g. an actual receipt and statement of the business purposes in most cases, which the state labor laws may not require in order to obtain reimbursement. For example, the new Illinois labor law requires an employer to reimburse for cellphone usage where the employee provides a statement that the expense was incurred, even though no other documentation or substantiation is provided. Employers are well advised to implement a clear employee business expense reimbursement policy which is compliant for tax purposes and which at the same time can decrease exposure for non-compliance with state labor laws. An employer may wish to include in such a policy that there are monetary limits on the type of cellphone plans or hotel stays that are subject to reimbursement, and that providing actual receipts will assure that the employee will receive the reimbursement from the employer income and the Federal Insurance Contributions Act (FICA) tax free. This strategy saves employment taxes for the employer and generally Federal and State income and FICA taxes for the employee.

## 4. Credit for Paid Leave

Enacted in 1993, the Family and Medical Leave Act (FMLA) requires certain employers to provide up to 12 weeks for birth or adoption of a child, foster care, serious illness of the employee or family member, or family military leave, but the leave does not need to be paid. Now employers can receive a 25% nonrefundable tax credit ranging from 12.5% to 25% of wages paid to employees earning \$72K or less in the prior year for any one or more of the types of paid family or medical leave required under the FMLA for employer fiscal years beginning in 2018 and 2019. The employer can have unequal rates of paid leave for different groups of employees and for different types of paid leave, e.g. only paid maternity leave. The employer must implement a written program but the paid leave language can also be inserted in to a pre-existing employer plan. To qualify, the employer must pay at least 50% of wages normally paid for at least two weeks disregarding state or local required or provided compensation, and up to a maximum of 12 weeks of paid leave can qualify for the credit. The leave program must cover even part time employees which are not required to have unpaid leave pursuant to the FMLA. However, because employees with less than a full year of service do not need to be covered, the part-time requirement may not be as onerous as it first appears and the paid leave need not be communicated. Payments under an employer disability program made directly or through insurance may qualify for the credit. In summary, an employer may wish to review its paid leave programs and perhaps expand just a little while adding the requisite policy language to obtain a significant tax credit. A regular tax deduction is still available for any wages above the amount of the credit. Although the tax credit helps fund the cost of the paid leave, the positive effect on employee morale may be priceless.

## 5. Deferred Stock Opportunity

Another unique, but likely not popular, employee benefit provided by the TCJA is Section 83(i) stock gain deferral which allows employees to defer income recognition after the date the value of stock would normally be taxable and at the same time receive capital gain on subsequent appreciation when the income is finally recognized. Section 83(i) applies to the transfer of vested stock received on stock option exercise or distribution from a restricted stock unit (RSU) and defers the gain until the earliest of certain events such as when the stock can be sold back to the employer or five years. The employer must be non-publicly traded, generally 80% of all employees must be offered the stock awards, and pursuant to recently issued Notice 2018-71, the employer must arrange for an escrow arrangement to provide for withholding on the value of the stock at the highest rate, e.g. 37%. The rules require notice to be given to employees and information reporting on Form W-2 with attendant significant monetary penalties for failure to do so. Employers may be relieved to know that if any of the Section 83(i) rules are not met, e.g. the employer is not publicly traded, then none of the new reporting and withholding requirements apply. For private companies, Notice 2018-71 makes clear that the employer can cause its stock grants to not meet the section 83(i) rules by simply not establishing an escrow arrangement for withholding purposes. Because many incentive stock options, employee stock purchase plans, and other stock option or RSU plans of private companies may at first blush appear to employees to be eligible for the Section 83(i) deferral election, an employer may be well

advised to add to these plans the fact that the Section 83(i) election is not available, and of course, not establish an escrow arrangement to provide assurance of that position.

## 6. Meals and Entertainment

The tax deductions for meals and entertainment was always limited, but the TCJA made further cut-backs so that most business entertainment is completely non-deductible and meals, including now de minimis, cafeteria meals, and meals for the convenience of the employer, are only 50% deductible. Employers should be aware that a 100% deduction remains for entertainment in conjunction with employee, stockholder, director, and partner meetings. In other words, a ball game in conjunction with an employee business meeting is fully deductible. Employers should also be aware that restaurant and country club meals that might normally be viewed as entertainment and thus not deductible at all, will remain 50% deductible if clients or customers are in attendance, at least for the time being, pursuant to Notice 2018-76. Finally, employers should be aware that both meals and entertainment are 100% deductible if provided to employees generally, e.g. on a non-discriminatory basis. For example, the full costs of dinners, parties, entertainment facilities, and retreats, are all 100% deductible if provided to a broad based group of employees.

## 7. Qualified Charitable Distributions Age 70.5

The TCJA cut back significantly on itemized deductions while at the same time increasing the standard deduction. As a result, less individuals can obtain a tax benefit for charitable contributions. A Qualified Charitable Distribution (QCD) for individuals 70.5 or older from an IRA decreases taxable income dollar for dollar, and in all respects is more beneficial than first including the distribution in income and then seeking a charitable deduction. While QCD cannot be made from a qualified plan such as 401(k), an employee can transfer otherwise distributable amounts from a 401(k) and then make the QCD from the IRA, thus obtaining significant tax benefits.

## 8. Company Jet Travel

Employers which provide air travel to an executive must impute income for any personal use by the executive or the executive's personal guest. Almost all companies impute incorrectly when a multi-leg flight occurs by labeling one entire leg as personal rather than calculating the comparison travel of the trip excluding the personal destination which the regulations specifically permit. For example, using the standard industry fare level rates (SIFL), an executive traveling from Teterboro (TEB) to Los Angeles (LAX) for business, then to Palm Beach (PBI) for a personal reason, then back to Teterboro for business, might label the leg from LAX to PBI as personal with resulting \$1,796.78 included in income. The correct and more favorable calculation would be to add the two legs from LAX to PBI, and PBI to TEB, then subtract the leg which would have been had there only been the business destination, LAX to TEB, with resulting income inclusion of only \$806.12. Public companies should be aware that this same method applies for SEC perquisite reporting as well except that the value of the extra duration of the trip is at the incremental fuel and out of pocket costs rather than the SIFL.

## 9. Security Study

The TCJA now disallows any deduction for commuting unless there is a concern for the safety of the employee. This disallowance would cover both commuting by an employee by ground transportation or by aircraft. An independent security study, as described in Section 1.132-5(m) of the regulations, should qualify to secure the full deduction for the employer incurring or reimbursing the cost of the commuting travel. In addition, a security study may allow for a lesser amount of imputed income to the employee commuting. Two examples of the lower imputed income: 1) where the employee travels by car and has a chauffeur bodyguard, the entire cost of the chauffeur may be excluded from the employee's imputed income, and 2) where travel is on a company jet, the imputed income is only 50% of the amount otherwise included, e.g. if \$200,000 would otherwise be taxable to the employee for the commuting flights for the year, only \$100,000 would be included if a security study was in place. Thus, obtaining the

independent security study increases the employer deduction and can decrease the taxable income to the employee.

Winston & Strawn's employee benefits and tax lawyers have model language and additional information on all of these tax strategies for employers.

8 Min Read

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