MEMORANDUM

FROM: Kirk D. Sherman and James S. Patterson
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DATE: November 7, 2017
RE: House Tax Cuts and Jobs Act

If the US House of Representatives' Tax Cuts and Jobs Act were passed in its current form,[1] some key rules for executive compensation in tax-exempt employers would change, as follows:

<u>Nonqualified Deferred Compensation – Accruals after 2017</u>

Current Law	**House Bill**
457(b) – up to $18,000 in vested deferred compensation can accrue each year, with taxes deferred until the benefit is paid	Repeals 457(b).[2] No more vested pre-tax deferrals
457(f) – accruals in excess of the 457(b) limits are taxed as soon as no longer subject to a "substantial risk of forfeiture" (SRF)	Adds 409B – All accruals are taxed as soon as no longer subject to an SRF
SRF – remaining employed to vesting date, not competing with the employer, and/or achieving performance-related objectives	SRF – remaining employed to the vesting date
After-Tax Deferrals – interest credited to vested and taxed deferrals is not taxed until paid even though not subject to an SRF	After-Tax Deferrals – vested interest is taxed as soon as credited to the account
Benefits that vest in one year can be paid and taxed in the following year if paid by March 15	Same

[1] A big assumption. We will have a better idea of likelihood once we have the Senate bill.
[2] Retained for governmental employers.

Current Law	House Bill
409A – unless exempt under the short-term deferral exemption, 409A penalties are imposed on the participant if the plan violates the rules	409A does not apply

Nonqualified Deferred Compensation – Pre-2018 Accruals

Deferred compensation that accrued prior to 2018 is not immediately subject to 409B. Instead:

- 457(b) and (f) and 409A continue to apply until the earlier of 2025[3] or when vested and paid.
- Any deferred compensation that remains unpaid in 2025 becomes subject to the new 409B tax rules described above.

Excess Executive Compensation Excise Tax

- A tax-exempt *employer* must pay a 20% excise tax on compensation in excess of $1 million paid to a covered employee.
- Covered employees are the top five highest-compensation employees. Once a covered employee, always a covered employee (even if the employee falls out of the top five highest-compensated).[4]
- Compensation is Form W-2 Box 1 Gross Wages.
- Deferred compensation counts in the year it vests and is reported in Box 1, even though it may have accrued over many years.
- Loan regime split dollar (with accrued interest paid from the death proceeds) does not appear to be included in compensation for this purpose.

Golden Parachute Excise Tax

- If the tax-exempt employer pays severance compensation of three times annual compensation or more, to a covered employee (as defined above), the *tax-exempt employer* must pay a 20% excise tax on all of the severance compensation in excess of one times annual compensation.

[3] First tax year beginning prior to 2026.

[4] 2017 counts for determining who is a covered employee, but the tax does not apply to 2017 compensation. This prevents "stuffing" extra compensation into 2017 to avoid covered employee status in future years.

- Unlike the golden parachute rules applicable to taxable employers, the severance does not have to be paid in connection with a change of control to be subject to the penalty.

Summary

If passed in its current form, tax-exempt employers would need to bring their nonqualified deferred compensation plans into compliance with the House bill and consider how to avoid, or budget for, the 20% excise taxes on compensation in excess of $1 million and excess parachute payments.