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Tax Reform and Accelerating Deductions: Payroll Tax Accruals and Permanent Tax Savings

Payroll Tax Liability and Deductions, and Impact on Current and Deferred Compensation

THURSDAY, JANUARY 25, 2018

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

Robert Delgado, Principal, **KPMG**, San Diego

Terri Stecher, Director, **KPMG**, Washington, D.C.

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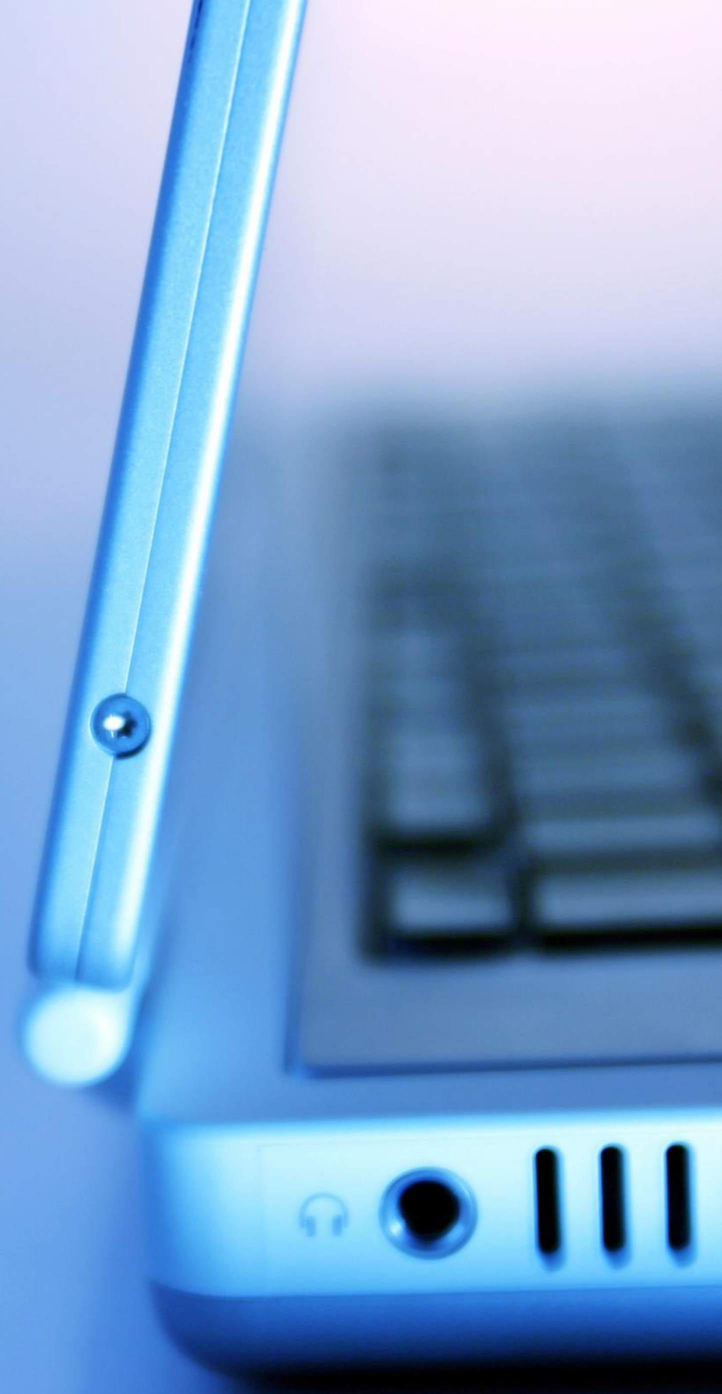


Robert Delgado and Terri Stecher

January 25, 2017

Notice

The following information is not intended to be “written advice concerning one or more Federal tax matters” subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

Presenters

—Robert Delgado, KPMG LLP

—Terri Stecher, KPMG LLP

Agenda:

- **Overview of Tax Reform**
- **Compensation Deduction Timing / All-Events Test**
- **Payroll Deductions Generally**
- **Recurring Item Exception and Safe Harbor**
- **Questions**

The path to tax reform

You are here

House

Bill introduced
11/02/17

Ways and Means Chairman releases mark
11/03/17

Markup by Ways and Means Committee
11/06/17

Markup
11/09/17

Ways and Means approves bill
11/09/17

House votes and passes
11/16/17

Senate

Senate Finance Chairman releases mark
11/10/17

Markup by Senate Finance Committee
11/14/17

Senate Finance Committee approves bill
11/16/17

Senate Budget Committee votes to send bill to Senate floor
11/28/17

Senate votes and passes by simple majority through “budget reconciliation”
12/02/17

Joint Conference

Conferees reach an agreement on a conference report that reconciles differences
12/15/17

House passes conference agreement
12/19/17

Senate passes a revised version of the conference agreement
12/20/17

House passes revised conference agreement
12/20/17

White House

President signs into law
12/22/2017

Treasury and Internal Revenue Service begin process of implementing the new law

Deduction Timing in Tax Reform

Tax Rate Reductions

Considerations Regarding Accelerating Deductions

Generally, if a corporation realizes a deduction in a year before a rate reduction takes effect, that deduction may have a greater economic benefit than in a future year. Consider compensation and benefit related deductions where there *may* be an opportunity to accelerate (subject to special deduction provisions such as Sections 162(m), 162(m)(6), 280G, etc. where applicable):

- Qualified plan contributions
- Self-insured employee medical expenses (IBNR)
- Accelerate/restructure certain compensation & benefit related items…
  - Annual bonuses (fixed and determinable amounts paid within 2.5 months of year-end, etc.)
  - Deferred compensation short-term deferral exceptions
  - Other compensation arrangements and qualified plans
  - Vacation / PTO
  - Payroll taxes

Some plans must be amended by certain dates and certain payment procedures may need to begin a year in advance in some instances.

Note that it *may* be possible in some instances to take the deduction even though a payment is not made until a future year

Tax Rate Reductions

Special Considerations Regarding Accelerating Deductions

- What needs to occur by year-end?
  - Fix liability (must/will make payment versus “may”)
    - Determine the right amount
      - Consider bonus pools, etc.
        - Reallocate, but watch for covered employee Section 162(m) implications
      - Pay special attention to fixed and determinable matters with respect to vested RSUs where amount may vary.
    - Amend plan and/or resolution
    - Comp committee approval of Section 162(m) performance based compensation where appropriate
      - Put procedures in place
    - Inform participants

KPMG

Example (assuming potential 21 percent corporate rate enacted)

	Deductible Amount	Rate	Value
Pre-reform	$10,000,000	35%	$3,500,000
Post-reform	$10,000,000	21%	$2,100,000
Difference		14%	$1,400,000 loss/expense

Under this scenario, the company would face a remeasurement of its DTA and income tax expense of $1,400,000. Accelerating the deduction to a pre-reform tax year would mitigate the tax expense.

Tax Rate Reductions

Opportunity to Defer Distributions/Payments

Potential compensation and benefit related items where there *may* be an opportunity to defer (subject to compliance with Section 409A, etc.) include:

— Long-term deferred compensation arrangements
— Annual bonuses
— Deferred compensation short-term deferral exceptions
— Severance
— Settlement of equity related compensation

Early planning is key. Some arrangements must be amended by certain dates and procedures may need to begin a year in advance in some instances.

Note that it *may* be possible in some instances to recognize income in the next year although the employer recognizes a deduction in the current year

Example (assumes taxpayer marginal rate)

	Compensatory Incentive Amount	Rate	Applicable Tax
Pre-reform	500,000	39.6%	$198,000
Post-reform	500,000	35%	$175,000
Difference		6.6%	$23,000 decrease

Under this scenario, the individual's taxes would decrease by $23,000. Delaying a payment to a post-reform tax year would result in a net economic gain.

Simplified example does not account for marginal rates, individual deductions, state tax impact, phase outs, etc.

Payroll Tax Deductions

Payroll Taxes

Generally

Payroll taxes fall within the following:

—Section 162 deducted as a trade of business expense
—Section 469 treated as a passive expense
—Section 263A capitalized under the UNICAP rules

Payroll Taxes

Accrual Basis Taxpayers

- History
  - Rev. Rul 69-587 – Bonus and vacation pay
  - Rev. Rul. 74-50 – Wages accrued but unpaid at year-end
- *Eastman Kodak Co*., 534 F.2d 252 (Ct. Cl. 1976) – Payroll taxes deductible under the all-events test because automatic consequence of fixed and determinable wage payments
  - Bonus payment fixed 1964
  - Payment of bonus in March 1965
  - Payroll taxes uncertain when limits applied
- Rev. Rul 96-51

Recurring Items Exception

Recurring Items Exception

Generally

Treas. Reg. Section 1.461-5, a liability is respected as incurred in a tax year if:

- As of tax year-end, all events have occurred that establish the fact that the liability and amount can be determined with "reasonable accuracy",
- Economic performance occurs on the earlier of
  - Return filed or
  - 15th day of the 9th calendar month after the close of the tax year,
- The liability is recurring in nature, <u>and</u>
- Either the amount is not material or accrual results in better matching to income

Recurring Items Exception

Rev. Proc. 2007-12, Section 19.04

Account method change 45 applies where underlying compensation is paid within 2 and ½ months of year-end

Safe Harbor

Safe Harbor

Rev. Proc. 2008-25 Safe Harbor

Treated as satisfying Treas. Reg. Section 1.461-5(b)(1)(i) for payroll tax liability As of tax year-end, all events have occurred that establish the fact that the liability and amount can be determined with "reasonable accuracy"

Rev. Proc. 2017-30, Section 19.04 provides for automatic consent.

Safe Harbor

Rev. Proc. 2008-25 Safe Harbor

Example 1: X uses an accrual method of accounting, including the use of the recurring item exception, and files its returns on a calendar year basis. X properly changes to the safe harbor method of accounting described in section 4.01 of this revenue procedure for its payroll tax liabilities. During Year 1, A, an employee of X, earns $10,000 of vested vacation compensation for services performed during Year 1. X pays the vacation compensation to A in February and May of Year 2. X incurs a payroll tax liability for the $10,000 vested vacation compensation payment. Assume that, as of December 31 of Year 1, all events have occurred to establish the fact of X's vested vacation compensation liability and the amount of the liability is determinable with reasonable accuracy. Under the provisions of this revenue procedure, and solely for purposes of applying the recurring item exception, all events necessary to establish the fact of X's payroll tax liability for the $10,000 vested vacation compensation will be treated as having occurred in Year 1 and the amount of the payroll tax liability will be treated as being determined with reasonable accuracy in Year 1.

Safe Harbor

Rev. Proc. 2008-25 Safe Harbor

Example 2: Y uses an accrual method of accounting, including the use of the recurring-item exception, and files its returns on a calendar-year basis. Y properly changes to the safe-harbor method of accounting described in Rev. Proc. 2008-25 for its payroll tax liabilities. On Dec. 28 of year 1, Y 's board of directors approves a bonus pool of $1 million to be paid to Y 's employees for services provided during year 1. The $1 million in bonuses is paid to Y 's employees on Jan. 5 of year 2. Y incurs a payroll tax liability as a result of the $1 million in bonuses paid to its employees. Assume that, as of Dec. 31 of year 1, all events have occurred to establish the fact of the bonus compensation liability, and the amount of the liability is determinable with reasonable accuracy. Under the provisions of Rev. Proc. 2008-25, and solely for purposes of applying the recurring-item exception, all events necessary to establish the fact of Y 's payroll tax liability for the $1 million in bonuses will be treated as having occurred in year 1, and the amount of the payroll tax liability will be treated as being determined with reasonable accuracy in year 1.

Other Guidance

Peterson, 148 T.C. No. 22 (2017)

In a case of “first impression” concerning application of section 267(a) to S corporation employers and ESOP participants—concluded that an employee stock ownership plan (ESOP) formed by an S corporation and the ESOP participating employees are “related persons” for purposes of section 267. As such, the court held that deductions for accrued but unpaid payroll expense must be deferred until the pay was received by the employees and includible in their gross income.

Other Guidance

Rev. Proc. 2016-29

If the UNICAP rules require the taxpayer to capitalize the payroll taxes, the taxpayer must also use the automatic-consent procedures to make corresponding and concurrent changes to its UNICAP method.

Compensation and Benefits Provisions in the 2017 Act

Section 162(m)

Prior Law	Current Law
Limits compensation deductions to $1,000,000 for NEOs (other than the CFO) of public companies as of the last day of the tax year, with an exception for qualified performance-based compensation	➢ **Expands scope to include CFOs in addition to CEOs and the next three highest compensated named executives.** ➢ **Extends application to both current and former covered employees** ➢ **Public companies within the purview of Section 162(m) also includes foreign companies traded through ADRs.** ➢ **Repeals the often relied upon performance-based compensation exemption.** ➢ **Transition rule provides for "grandfathering" such that expanded provisions do not apply to written, binding contracts in effect on November 2, 2017 (and not materially modified on or thereafter).**

Fringe Benefits – Income Exclusions (nontaxable)

Prior Law	Current Law
Adoption: Exclusion of up to $13,570 for qualified adoption expenses paid or reimbursed by an employer	➢ **Remains unchanged**
Commuting: Exclusion of certain limited benefits as well as bicycle commuting reimbursements	➢ **Remains unchanged except for bicycle commuting, which is suspended/taxable until 2026**
Dependent Care: Exclusion of up to $5,000 annually for employer-provided dependent care assistance	➢ **Remains unchanged**
Education: Exclusion of up to $5,250 of employer-provided educational assistance from gross income.	➢ **Remains unchanged**

Fringe Benefits – Income Exclusions (nontaxable)

Prior Law	Current Law
Housing: Exclusion for employer housing (convenience of the employer)	➢ **Remains unchanged**
Qualified Moving Expenses: Qualified moving expense reimbursements excluded from gross income	➢ **Suspended/Taxable until 2026**

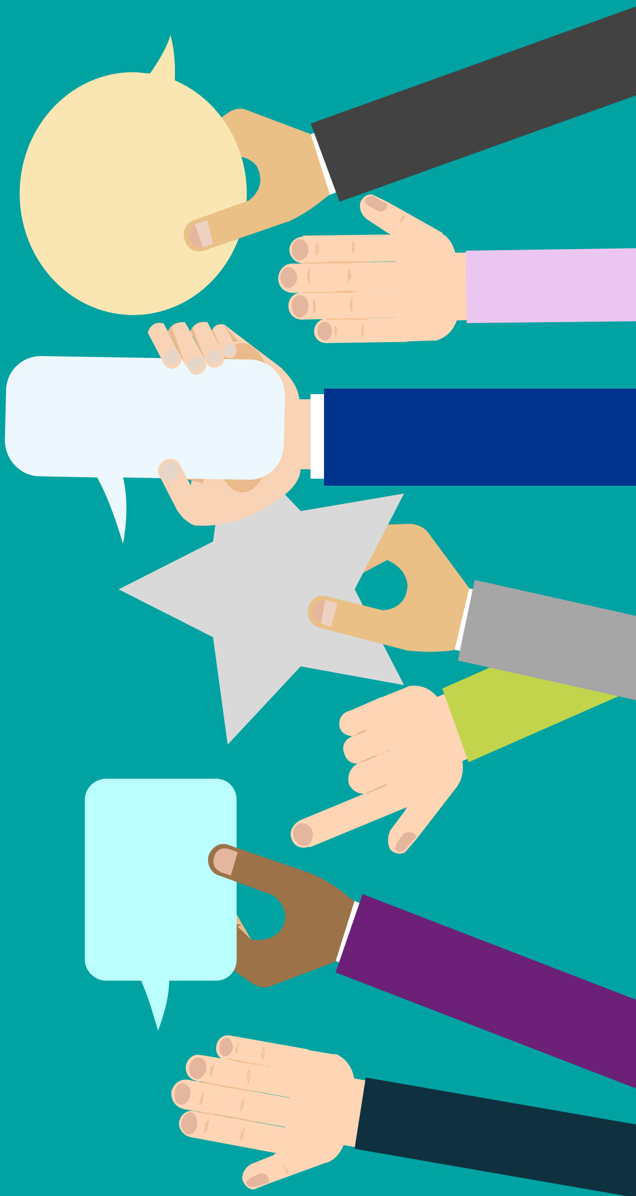
Fringe Benefits – Deductions Limitations

Prior Law	Current Law
Employee Achievement Awards: Employer may deduct a limited amount of the costs associated with providing an employee achievement award that is tangible personal property.	➢ **Provides that "tangible personal property" does not include cash, cash equivalents, gift cards, gift coupons or certain gift certificates, or vacations, meals, lodging, tickets to theater or sporting events, stocks, bonds, other securities, and other similar items.**
Entertainment/Membership Dues: Entertainment, amusement, and recreation activities as well as related facility expenses are 50% deductible if directly related to conduct of a trade or business.	➢ **No deduction allowed for amount paid or incurred after December 31, 2017; 50% deduction rule repealed.**

Fringe Benefits – Deductions Limitations

Prior Law	Current Law
Meals at Employer Facility and De minimis fringe Meals: Certain de minimis fringe benefits are excluded from employee income and generally deductible by the employer	➢ **From January 1, 2018 through December 31, 2025, deduction limited to 50% for meals provided for the convenience of the employer or through an employer-operated eating facility that qualifies as a de minimis fringe benefit under 132(e); not deductible after December 31, 2025.**
Qualified transportation fringe benefits: Deduction allowed for expenses for qualified transportation fringe benefits	➢ **No deduction allowed, except when related to safety of the employee**

Questions?



Q&A (continued)

Today's Presenters

Presenter 1	Robert Delgado	rdelgado@kpmg.com
Presenter 2	Terri Stecher	tstecher@kpmg.com

Thank you

Robert Delgado
rdelgado@kpmg.com

Terri Stecher
tstecher@kpmg.com

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