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Employee Benefits Update

December 2017

TAX PLANNING

Six Tax Strategies to Accelerate Employee Benefit Deductions in 2017

With the corporate tax rate reduced to 21% effective for tax years on and after January 1, 2018, some companies have expressed interest in accelerating a deduction at a 35% tax rate. There are a number of possibilities and most will require action by tax year-end:

1. Pre-fund future severance pay. Severance benefits that are attributable to future involuntary terminations of employment can be pre-funded in a VEBA or a taxable trust. The limit is 75% of the employer's severance pay costs in any two of the last seven years. The severance costs can include the cost of any medical or other benefits payable to the severed employees.

A VEBA may only pay severance benefits if they qualify for the ERISA exception for severance pay plans. That limits the severance to an amount not in excess of two times the employees' pay and for a period that does not exceed two years. *See Labor Reg. section 2510.3-2(b).*

The normal 12-month prepayment limit under Code Section 263 does not apply to VEBA contributions under the temporary Code Section 419 regulations. *See Treas. Reg. § 1.419-1T, Q-10(d).* (This also applies to items 2 and 3, below.)

2. Pre-fund LTD or STD benefits. Self-insured long-term disability (LTD) benefits can be pre-funded in a VEBA or a taxable trust. The pre-funded LTD benefits are those that have lasted at least five months and that are expected to last for at least 12 months. The deduction limit for LTD is the amount necessary to fund the entire expected future stream of payments to the disabled person. The amount of LTD benefit taken into account cannot exceed the lower of (1) 75% of the participant's average annual compensation for the three highest years, or (2) $215,000 (the 2017 limit on benefits payable under Code Section 415(b)). Short-term disability (STD) benefits also can be pre-funded, subject to certain limits.

3. Pre-fund retiree health benefits. Retiree health benefits can be pre-funded under a VEBA or taxable trust up to the present value of the entire future liability for the already-retired participants,

and ratably over the remaining working lives of the current employees. The pre-funding of retiree medical benefits in a VEBA has unrelated business taxable income (UBTI) implications so the investment consequences have to be taken into account.

4. Accelerating bonus accruals. Many performance-based bonuses generally could be accrued at year-end. Exceptions apply if payment of the bonuses require employment on the future payout date, or involve company discretion, or if the applicable plan has a broad company amendment power in which case the accrual is delayed until payment. These bonuses can be accrued in 2017 before payment, however, if the company overrides the normal pre-conditions by announcing that bonuses of a fixed total amount will be paid to the plan participants as a group, even though the liability with respect to any individual within the group is not fixed. (*See Chief Counsel's Advice memo 200949040.*) Changing the terms of a bonus plan to add this kind of group liability would be considered a change in facts, not a change in accounting method.

5. Contribute to the pension plan before the end of 2017. Pre-year-end contributions are deductible under Code Section 404. Any additional contributions will be treated as 2017 contributions for minimum funding purposes.

6. Treat certain 2018 pension contributions as 2017 contributions. This deduction acceleration will not require funding by the end of 2017. Under Code Section 404(a)(6), contributions as late as the extended due date of a corporation's income tax return (October 15, 2018 for a calendar year corporation) might be able to be treated as 2017 deductible contributions.

The basic requirements of utilizing Code Section 404(a)(6) are spelled out in *Revenue Ruling 76-28*. Despite its longstanding status, there are a number of questions regarding the application of Code Section 404(a)(6) to defined benefit plans. These are: (i) whether the post-year-end contribution must be accrued by the 2017 year-end, (ii) whether the treatment of the contribution for 2017 income tax deduction purposes means that the contribution also must be counted as a 2017 contribution for Code Section 430 funding purposes, and (iii) whether the first-time utilization of Code Section 404(a)(6) is a change of accounting method requiring IRS approval.

(i) The IRS authorities on the accrual question are inconsistent, but the better analysis of the law is that a 2017 year-end accrual is not necessary to use the Code Section 404(a)(6) relation-back rule.

(ii) The guidance is unclear as to whether a 2018 contribution can count as a 2017 income tax deduction but as a 2018 Code Section 430 minimum contribution requirement. Although recent rulings may raise some doubt, there is a substantial line of IRS authority treating a post-year end contribution as a prior year contribution only for deduction purposes; the deduction attribution does not have to match the funding attribution. *See, e.g., Revenue Ruling 77-82*; *Treas. Reg. §1.404(a)-14(d)(2)(ii); Treas. Reg. § 11.412(c)-12; Prop. Treas. Reg. § 1.412(e)(10)-1(c); PLRs 7945115 (8/28/79)* & *9107033 (11/21/90).*

(iii) The Service has ruled multiple times that the initial use of Code Section 404(a)(6) does not involve a change in accounting method because it is really just a change in the timing of the payment. *See, e.g., PLR 8526068 (4/04/85); PLR 8303002 (undated); PLR 8227068 (4/09/82).* More recent authority on this issue involving 401(k) plans can be distinguished based on a unique fact pattern. *See Rev. Rul. 2002-46, 2002-2 C.B. 117*.

The bottom line is that current law strongly supports the use of the Code Section 404(a)(6) relation-back rule without the need of any 2017 accrual, without regard to consistency between the deduction and funding rules, and without the need for any accounting method change approval.

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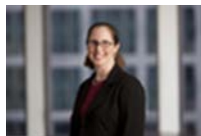

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IPB In The News

Kevin O'Brien and Spencer Walters interviewed by Tax Notes on 162(m) transition rule in Tax Cuts and Jobs Act (Dec. 20, 2017)

Carroll Savage profiled by D.C. Bar as 401(k) Plan pioneer, in member spotlight (Dec. 11, 2017)

Ivins selected as one of the Best Law Firms in America for 2018 by U.S. News & World Report (Nov. 2017)

Steve Witmer, Robin Solomon, Ben Grosz and Doug Andre taught an EBEC half-day seminar for the Tax Executives Institute, Los Angeles CA chapter (Nov. 3, 2017)

Robin Solomon and Jodi Epstein spoke on fiduciary best practices at "Best of" Plan Sponsor National Conferences in Chicago IL and New York NY (Oct. 24 & 26, 2017)

Ben Grosz shared insights at the 2017 Healthcare & Retirement Plan Summit in Baltimore MD (Oct. 24, 2017)

Doug Andre presented on global mobility at the Tax Executives Institute Annual Conference in Toronto Canada (Oct. 23, 2017)

Robin Solomon and Jodi Epstein led a panel on IRS/DOL Audits at fifth annual Women, Influence & Power Conference (WIPL) in Washington, DC (Oct. 12, 2017)

Jodi Epstein served as a panelist at the Pensions & Investments West Coast Defined Contribution Conference in San Diego CA (Oct. 9, 2017)

EB Update Archives

November 2017: Tax Cuts and Jobs Act

March 2017: American Health Care Act

March 2017: HSAs

Sept 2016 EB Update

June 2016: DOL Fiduciary Rule

May 2016: Wellness Plans

March 2016 EB Update