M Benefit Solutions
Bank Strategies®
An M Financial Group Company

The Bottom Line

Executive and Director Benefits and BOLI

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Highlights of this Issue

A Brief Overview of Changes to Tax Law under the TCJA

On December 22, 2017, President Trump signed the Tax Cuts and Jobs Act (TCJA) into law, bringing a two-month legislative sprint to a close. This article summarizes some of the impacts that the TCJA may have on M Benefit Solutions' clients. Fuller treatment of the one million dollar ($1 million) deduction limitation for compensation paid to certain executives is set out in a separate article.

The Removal of Section 3801

Fortunately, the biggest impact TCJA would have had for most of our clients was avoided. In early drafts of the bill, Section 3801 contained language that essentially ended the use of nonqualified deferred compensation as an executive benefit. All existing nonqualified benefit plans would have had seven years to unwind. Legislators removed the language when the full scope of its impact became clear.

Tax Rate Changes

The most visible changes in the TCJA are the decreases in the corporate and individual tax rates. The corporate tax rate has been decreased to 21% and no longer has brackets. Individual rates did not receive as drastic a decrease but went down across most income levels. The highest individual rate was reduced to 37%. The overall effect of the change is to lower the marginal tax rate of many taxpayers, though the loss of personal exemptions may have a negative effect on some large families and the loss of state tax deductions above $10,000 will affect many in high tax states such as New York, California, and Oregon. Changes to the corporate rate are permanent. Changes to individual rates will end December 31, 2025.

Removal of Corporate AMT

As part of the consolidation of corporate tax brackets into a single flat rate of 21%, the TCJA eliminated the 20% corporate alternative minimum tax. The individual alternative minimum tax was not eliminated and still applies to some individuals.

Changes to Pass-Through Taxation

Pass-through entities, such as subchapter S Corporations and partnerships, may now claim a 20% deduction on qualified business income. Pass-through entities are taxed at the individual level. Pass-through income thus has a top marginal rate of 37%, while C Corporations now

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have a flat rate of 21%. The new deduction is meant to put pass-throughs and C Corporations on a more even footing.

This deduction has the potential for abuse, and Congress has already created an income limitation on the use of the deduction for personal service businesses. The limitation applies to owners of all pass-throughs that provide personal services, except engineering and architecture firms. Owners with income exceeding the limit are subject to a pro-rata phase-out of the deduction and lose it entirely at upper-income levels.

The deduction is also limited to the greater of the owner's allocable share of 50% of W-2 wages or 25% of W-2 wages and 2.5% of the unadjusted basis of the pass-through's qualified business property. This limit is subject to a pro-rata phase-in similar to the service provider limitation.

Estate Tax Changes

Estate taxes are rarely a concern for institutional plan sponsors. However, the TCJA made changes to the estate tax, and the magnitude of these changes may make them relevant for some entities with high wealth stakeholders. The estate tax exemption has been, roughly, doubled. Individuals may now exempt $11.2 million. Couples may exempt $22.4 million. Unused spousal exemptions remain portable and step-up in basis remains in place. As with the changes to the individual tax rates, these provisions will sunset in 2025.

U.S. Life Insurance Sector Outlook Stable for 2018

"Operating performance has surpassed expectations over the past year thanks to favorable equity and credit markets," according to Douglas Meyer, managing director of Fitch Ratings. Fitch expects these favorable trends to continue into 2018.

Fitch notes that in 2017, a number of U.S. life insurers took significant steps to exit and/or reduce exposure to underperforming legacy interest-sensitive business. Fitch states that mergers and acquisitions contributed to the few rating changes that occurred in 2017, which Fitch expects will continue into this year due to the low interest rate environment.

Source: Fitch Ratings: 12/6/17

SSAE 18 Audit Report

In light of the increased financial controls being placed on corporations, M Benefit Solutions made a corporate commitment in 2003 to begin providing a SAS 70 for our clients. Beginning in 2011, we obtained a SSAE 16, and beginning in 2017, a SSAE 18, the successors to the SAS 70.

The SSAE 18 report represents that a service organization has been through an in-depth audit of their control activities which generally include controls over information technology and processes which relate to the data belonging to their clients.

In 2017, M Benefit Solutions received a clean opinion without exception on our SSAE 18 SOC I Type II report, an indication of our ongoing success in assessing and improving our internal control activities for the benefit of our clients.

Changes to Code Section 162(m) Compensation Deduction Limitations

The TCJA made significant changes to Internal Revenue Code Section 162(m) and its limits on compensation paid to certain executives of public companies.

Prior to January 1, 2018, a public company was limited to $1 million for each covered employee. However, qualified performance-based compensation and commissions were exempt from the deduction limit. Covered employees included the CEO on the last day of the taxable year, plus the three highest paid officers (other than the CEO and CFO) serving on the last day of the taxable year.

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The TCJA makes three primary changes to the prior law:

- It removes the exemption for performance-based compensation and commissions.
- It expands the definition of public company.
- It expands the definition of covered employee.

Compensation Covered

Generally, all deductible compensation for services will be subject to the $1 million limit, whether performance-based or not. However, contributions to and distributions from a qualified retirement plan are not subject to the limit, nor are amounts reasonably expected to be excludible from the covered employee's gross income. Distributions from a nonqualified plan are subject to the limit.

Companies Covered

Public companies covered by the law now include foreign corporations publicly traded through American depository receipts and private corporations and S Corporations required to file reports under Section 15(d) of the Exchange Act, which includes corporations that have issued equity or debt securities to the public in a registered offering but has not listed on a securities exchange.

Employees Covered

Anyone who was CEO and CFO at any time and for any length of time during the taxable year is covered. CEOs and CFOs do not need to hold their position on the last day of the taxable year to be covered. The three highest paid officers (other than the CEO and CFO) serving on the last day of the year (determined under SEC proxy disclosure rules) are covered. If an individual is a covered employee in any tax year beginning after December 31, 2016, he or she will remain a covered employee for all future years, even after termination. Thus, large distributions from nonqualified deferred compensation plans in the year of or following retirement can be subject to the deduction limitation.

Grandfathering

There is a provision that says the new rules do not apply to written binding contracts in effect on November 2, 2017. This provision could save certain performance-based compensation and nonqualified plan distributions in the year of retirement or in following years. The grandfathering is lost when a plan or agreement is materially modified.

The Joint Explanatory Statement of the Committee of Conference for TCJA provides for an example of the grandfathering provision that says the grandfathering provision would apply to a covered employee when:

- The right to participate in the plan is part of a written binding contract on November 2,
- Amounts payable under the plan are not subject to discretion, and
- The corporation does not have the right to amend materially the plan or terminate the plan (except on a prospective basis before any services are performed with respect to the applicable period for which such compensation is to be paid).

The Explanatory Statement goes on to say that grandfathering does not apply to new contracts entered into or renewed after November 2, 2017. For purposes of the rule, the Explanatory Statement says any contract that is entered into on or before November 2, 2017 and that is renewed after such date is treated as a new contract entered into on the day the renewal takes effect. A contract that is terminable or cancelable unconditionally at will by either party to the contract without the consent of the other, or by both parties to the contract, is treated as a new contract entered into on the date any such termination or cancellation, if made, would be effective.

Grandfathering Questions

There are a number of questions raised by the Explanatory Statement as to how broadly the grandfathering provision will be applied and when will its benefits be lost. For example, will any discretion to change contributions or payments under a plan disqualify the plan from grandfathering? Will grandfathering apply to benefits already accrued under a plan as of November 2, 2017 if the plan can be terminated by the company without affecting accrued benefits? What constitutes a material modification of a plan?

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The IRS is planning on providing further guidance but we do not know when that guidance will be issued. M Benefit Solutions will continue to monitor developments.

Data Security: The Human Element

We do business in an era where corporate security breaches regularly make news. M Benefit Solutions works with some of our clients' most sensitive information, storing, and protecting data about employees' finances as well as their health. We take this responsibility seriously. What follows is a discussion, the first in a series, of some of the measures we undertake to ensure our client's data remains secure. In this issue, we focus on the human element of our security measures.

M Benefit Solutions has always believed and continues to believe that employees are the first, best line of defense. To that end our employees, regardless of their position, regularly attend cyber security awareness training. Some of the most infamous security failures of the past few years could have been avoided if a single person had not clicked on a suspect link. M Benefit Solutions trains its employees to notice suspicious links, identify questionable emails, and avoid suspect file packages.

Employees who travel and require the use of a laptop, are issued laptops with whole disk encryption enabled by default. We also have the capability to remotely wipe a laptop drive of all data if it is reported lost or stolen. These measures prevent unauthorized users from booting the operating system or accessing the data contained on a hard drive.

M Benefit Solutions and its employees are conscientious about client data security. We take great pride in knowing that we are a company that clients can trust to keep their data safe. In the next article, we will discuss the electronic measures M Benefit Solutions uses to safeguard data when transmitting it.

Update to Disability Claims Regulations

ERISA requirements with respect to establishment and maintenance of reasonable claims procedures apply to all employee benefit plans including nonqualified deferred compensation plans. Late in 2016, the Employee Benefits Security Administration of the Department of Labor (the DOL) issued final regulations updating the benefit claims process for disability claims.

The amended regulations effective date was delayed to April 1, 2018 and are now effective. The intent of the amendments is to provide enhancements in procedural safeguards and to increase the fairness of disability claim and appeal processes. Plan sponsors with benefit plans that contain provisions for disability claims will want to consider what amendments or adjustments are necessary to ensure their processes remain compliant.

Written claim procedures and denial notices with respect to disability claims should be revised to comply with the new rule. Internal rules and guidelines should also be reviewed, revised, and/or developed as necessary.

Upcoming Events

2018 FMS Forum

June 10–12, 2018
Orlando, FL

2018 ABA Annual Convention

October 21–23, 2018
New York Hilton Midtown
New York, NY

Advisor Firms

M Benefit Solutions - Bank Strategies is structured to provide our clients with consistent nationwide coverage. We have identified several Advisors with extensive experience in bank executive and director benefits and BOLI to provide consulting services to clients nationwide.*

Distributed throughout the country, these Advisors work with M Benefit Solutions and bank clients to design programs which meet each bank's specific needs and to ensure high quality administrative and compliance services.

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**These Advisors represent independently operated firms and are registered with M Holdings Securities Inc. a registered Broker/Dealer, Member FINRA/SIPC. M Benefit Solutions and M Holdings Securities, Inc. are affiliated companies.*

About M Benefit Solutions - Bank Strategies

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