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## Regulatory Update

### Initial IRS Guidance on Expansion of Section 162(m) Deduction Limitations

Internal Revenue Code Section 162(m) limits deductions for certain compensation over \$1 million paid by publicly held companies to covered employees. The Tax Cuts and Jobs Act, Public Law 115-97 (2017) (the “Act”) expanded the deduction limitations under Section 162(m). Specifically, the Act:

- Expanded the definition of compensation subject to the limitations (“applicable employee remuneration”) to include commissions and performance-based pay, which were previously exempted
- Expanded the definition of “publicly held corporation”
- Expanded the definition of “covered employee”

- Provided a grandfathering rule that exempts certain remuneration from the application of the new rules

This update discusses IRS Notice 2018-68 (Notice), which the IRS released to provide initial guidance on certain aspects of the amendments to Section 162(m). The Notice covers the expansion of the definition of “covered employees” and outlines the operation of the Act’s grandfathering rule for compensation provided pursuant to written binding contracts in effect on November 2, 2017. This update addresses the effects the Act and the Notice have on the grandfathering of payments under nonqualified deferred compensation plans (NDCPs).

### Application of Section 162(m) to Deferred Compensation

Prior to the changes made by the Act, most payments under NDCPs, even payments over the \$1 million threshold, were not subject to the limitations of Section 162(m) because such payments occurred after termination of employment, when employees were no longer considered “covered employees” under Section 162(m). However, the Act amended Section 162(m) to provide that once an individual is considered a “covered employee” that individual continues to be a “covered employee” for the rest of their employment. This status now continues after the individual terminates employment and even after the individual’s death. As such, payments of deferred compensation will be subject to the deduction limitations of Section 162(m) with greater frequency.



## Notice 2018-68

### Covered Employees

Notice 2018-68 explains the expanded definition of covered employee to include the following employees of a public company:

- An employee who was the principal executive officer or principal financial officer of the taxpayer, or acted in such a capacity, at any time during the taxable year.
  - (The Act added the principal financial officer and removed the requirement that the employee be the chief executive officer at the close of the year.)
- An employee who was required to be reported for the taxable year to shareholders under the Securities Exchange Act of 1934 by reason of such employee being among the three highest compensated officers for the taxable year (excepting any individual described in the bullet above).
  - (Prior to the Act, this included the four highest compensated officers, excepting the principal executive officer.)
- An employee who was a covered employee of the taxpayer (or any predecessor) for any prior taxable year beginning after December 31, 2016.

The Notice clarifies that an individual is a covered employee regardless of whether the individual is employed at the end of the taxable year, and regardless of whether disclosure of his or her compensation is required under SEC rules.

### Grandfathering Rule—Payment of Deferred Compensation

The general provision for the grandfathering of compensation under the Act states that the amendments of the Act do not apply to compensation payable under a written binding contract that was in effect on November 2, 2017, and which is not modified in any material respect on or after such date. The Notice provides helpful details and explains what this means in practice.

The grandfathering rule provides protection to:

- Compensation subject to a written binding contract on November 2, 2017, which compensation was not previously subject to Section 162(m), and
- All compensation subject to a written binding contract on November 2, 2017, when a covered employee would not have been a covered employee under pre-Act rules.

Generally, the grandfathering protection given under the first bullet will not apply to NDCP payments because such payments were not performance-based and were subject to the pre-Act provisions of Section 162(m). However, NDCP payments were not subject to pre-Act Section 162(m) when paid to employees after termination of employment. Such payments can benefit from grandfathering under the second bullet, though it is necessary to determine whether any amount of the post-termination payment is grandfathered and not subject to Section 162(m).

### Determination of Grandfathered Amount

Under the Notice:

*“... [T]he amendments to section 162(m) made by the Act apply to any amount of remuneration that exceeds the amount of remuneration that applicable law obligates the corporation to pay under a written binding contract that was in effect on November 2, 2017, if the employee performs services or satisfies the applicable vesting conditions.”*

The amount under such a binding contract would include the amount owed on November 2, 2017. The primary question is whether any amounts paid or credited after November 2, 2017, would also be grandfathered.

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Under the Notice, once a contract is considered “renewed” the contract becomes subject to the expanded provisions of Section 162(m). In addition, a “written binding contract that is terminable or cancelable by the corporation without the employee’s consent after November 2, 2017, is treated as renewed as of the date that any such termination or cancellation, if made, would be effective.”

Most NDCPs are terminable by employers at any time. Presumably under the rules set out by the Notice, most NDCPs would be considered renewed as of November 3, 2017 because of the ability of the employer to have terminated the NDCP on such date. As such, most NDCPs will have grandfathered amounts equal to the amounts owed to participants as of November 2, 2017.

This principle is illustrated by Example 4 of Section III.B of the Notice, its grandfathering discussion, in which an employee has an accrued benefit of \$100,000 on November 2, 2017, under a plan which provided that the employer could, at any time, amend the plan to either stop or reduce the amount of future contributions to the account balance in its discretion. After November 2, 2017, the account is credited with additional contributions and earnings. The ultimate payout is \$350,000. In this case, only \$100,000, the accrued benefit on November 2, 2017, is grandfathered. No contributions and no earnings credited after November 2, 2017, are grandfathered because the employer could have stopped contributions and earnings at any time after November 2, 2017.

For account balance plans, calculation of this November 2, 2017 amount should be relatively easy to determine though there may be assumptions that need to be made with respect to accounts that are not normally valued on a daily basis. For defined benefit plans, the amount will be less easily determined though an estimate of the amount should be determinable using reasonable assumptions with respect to the factors that are normally used to determine such benefits. Such a calculation is not addressed in the Notice.

For NDCPs or other deferred compensation agreements which cannot be terminated either by the employer or the employee except by termination of employment (assuming the agreement has not been materially modified), all amounts under the NDCP or agreement including earnings should be grandfathered.

This is illustrated by Example 2 in Section III.B of the Notice, which posits a contract requiring the employer to pay a bonus that was deferred by the employee and credited with earnings based on a predetermined actual investment upon separation from service. The agreement was not terminable except by termination of employment. The amount deferred and all earnings credited from deferral of a 2016 taxable year bonus until 2020, the year of termination, would be grandfathered.

## Material Modifications

The grandfathering provisions available under the Act’s modifications to Section 162(m) become inapplicable if the parties materially modify the contract after November 2, 2017. A material modification occurs when a contract is amended to increase the amount of compensation payable to the employee. A materially modified written binding contract is treated as a new contract entered into on the date of the material modification. A modification that accelerates payment of compensation is a material modification unless the modification discounts the amount of compensation paid to reasonably reflect the time value of money. To defer compensation without a material modification of the contract, it is necessary to base any additional compensation received on either a reasonable rate of interest or a predetermined actual investment.

## Additional Guidance

It is anticipated that the guidance in this Notice will be incorporated in future regulations that would apply to any taxable year ending on or after September 10, 2018. The IRS and Treasury Department are seeking

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comments regarding a number of other rules under Section 162(m) changed by the Act, including:

- The application of the definition of “publicly held corporation” to foreign private issuers,
- The application of the definition of “covered employee” to covered employees of a predecessor publicly held corporation,
- The application of Section 162(m) to corporations immediately after they become publicly held, and
- The application of the SEC executive compensation disclosure rules for determining the three most highly compensated executive officers for a fiscal year.

M Benefits Solutions will continue to monitor the guidance and provide updates as they arise.

## Data Security— Client-Facing Systems

*This article is the latest in our series about data security at M Benefit Solutions. In the previous article, we discussed the human element of our security procedures. In this article, we discuss the security measures we have in place to keep our client-facing data safe and accessible.*

Good security begins with the basics. At M Benefit Solutions, our websites make secure connections using the Hypertext Transfer Protocol Secure (HTTPS) transfer protocol. HTTPS creates a secure channel over an insecure network. This ensures adequate protection from eavesdroppers and secures the privacy and integrity of the exchanged data while in transit. HTTPS is an industry standard and increasingly represents a baseline level of security that all web sites should provide.

In recent years, it has become all too common for distributed denial of service attacks (DDoS) to impact web services for minutes, hours, or in extreme cases multiple days. If the target of the DDoS is a datacenter

or other major service provider, the potential for collateral impact to unintended targets is significant. To safeguard against collateral impacts, we work with an ISP that provides DDoS prevention capabilities.

With the continuous emergence of new threats, we also work with a managed security service provider. This firm tracks ingress into and egress out of our network and notifies us of questionable activity. Our MSSP provides comprehensive visibility into the security activity on our network and is able to proactively mitigate real time events.



Our systems undergo annual penetration testing. The results of this testing allow us to prioritize security risks based on their criticality, probability, and impact. A third party performs these tests, and results are reported directly to our Board of Directors as part of our internal auditing process.

In addition to our internal audits, M Benefit Solutions participates in the SSAE 18 audit process. The audit assesses the adequacy of our processes and considers whether we are acting as good stewards of the data entrusted to us. The change in the industry standard from SSAE 16 to SSAE 18 represents a shift to a more extensive and holistic assessment of our processes.

We engage in all these processes because we care about the safety of our client’s data. Plan participants make sensitive financial decisions while using our systems. We want those plan participants to feel comfortable and secure when they entrust that information to us. That means making sure that our websites are secure and available whenever a user needs them.



## BOLIPRO Enhancements

M Benefit Solutions is pleased to announce that the BOLIPRO® website has a new look and feel. This is the beginning of a series of enhancements planned to improve the experience accessing information on BOLI and related benefit programs.

### What's New

There is a new home page, with quadrants providing a snapshot of information. Navigation on the site has also been updated. Menu items will now be found solely through the top navigation bar, and some menu items have been re-categorized.

### What Stays the Same

In addition to the changes highlighted above, BOLIPRO continues to provide the same information on BOLI and benefit plans as provided on the current site. Please let your M Benefit Solutions contact know if you have questions or comments.

The screenshot shows the BOLIPRO website home page with several callouts:

- Home page provides quick access to information including 12-month rolling cash surrender values, statistics, BOLI holdings and carrier ratings.** This callout points to the main dashboard area.
- New Library section provides access to newsletters and legislative updates.** This callout points to the 'Library' tab in the top navigation bar.
- Carrier information and Due Diligence Documentation (Pre-Implementation Analysis) are now under Risk Evaluation.** This callout points to a dropdown menu under the 'Risk Evaluation' tab, which lists items like 'Concentration Analysis', 'Peer Analysis', 'Carrier Information', 'OCC Bulletin', 'SSAE 18', 'Securities Documents', and 'Due Diligence Documentation'.

The dashboard itself is divided into four quadrants:

- Cash Surrender Value:** A bar chart showing values from July 2017 to June 2018. The y-axis ranges from \$5,500,000 to \$7,500,000.
- Statistics:** A table of key metrics:
 

Number Of Insureds:	5
Average Age Of Insured:	58
Number of Policies:	15
Cash Surrender Value:	\$7,301,944
Death Benefit Coverage: *As of 12/31/2017	\$25,610,000
Additional BOLI Capacity: *As of 6/30/2018	\$1,904,000
- Life Insurance Holdings:** A pie chart showing the distribution of holdings across three carriers: CARRIER A, CARRIER B, and CARRIER C.
- Insurance Carrier Ratings:** A bar chart comparing AM Best and Comdex ratings for three carriers (Carrier A, Carrier B, Carrier C). Carrier A has an AM Best rating of A+ and a Comdex score of approximately 85. Carrier B has an AM Best rating of A++ and a Comdex score of approximately 85. Carrier C has an AM Best rating of B and a Comdex score of approximately 40.





## IRS Announcement—Qualified Pension Plan Limitations for 2019

The Internal Revenue Service recently announced cost-of-living and statutory dollar limitations for qualified pension plans for 2019. Some of the changes are listed below.

Provision	2018 Limit	2019 Limit
<b>401(k) Elective Deferral Limit</b>		
Annual employee contribution to 401(k) plans	\$18,500	\$19,000
Additional 401(k) contributions for employees age 50 or over	\$6,000	\$6,000
<b>Maximum Compensation Limit</b>		
The amount of annual compensation that can be taken into account when determining plan benefits	\$275,000	\$280,000
<b>Defined Benefit Limit</b>		
The maximum annual straight-life benefit at age 65 (not to exceed 100% of average annual compensation)	\$220,000	\$225,000
<b>Defined Contribution Limit</b>		
The maximum annual contribution to a defined contribution plan (not to exceed 100% of compensation)	\$55,000	\$56,000
<b>Highly Compensated Employee Definition</b>		
Dollar limit on who is considered a highly compensated employee	\$120,000	\$125,000

## Social Security Facts

The combined tax rate for Social Security and Medicare for an employee is 7.65%. The Social Security portion (OASDI) is 6.20% on earnings up to the applicable taxable maximum amount.

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The Medicare portion (HI) is 1.45% on all earnings. There is an additional 0.9% Medicare tax on all earnings above certain threshold amounts (\$250,000 in wages for married filing jointly and \$200,000 for single taxpayers). These thresholds are not indexed for inflation. For a married couple, filing a joint return, the additional 0.9% tax is on the combined earnings of the employee and the employee's spouse.

Tax Rates	2018	2019
Employee	7.65%	7.65%
Self-Employed	15.30%	15.30%

Maximum Taxable Earnings	2018	2019
Social Security (OASDI only)	\$128,400	\$132,900
Medicare (HI only)	No Limit	No Limit

## Upcoming Events

### 2019 ICBA Community Banking LIVE®

March 18–22, 2019

Music City Convention Center  
Nashville, TN

[icba.org/LIVE19](http://icba.org/LIVE19)



### The FMS Forum

June 23–25, 2019

The Westin Boston Waterfront  
Boston, MA

[fmsinc.org](http://fmsinc.org)



## 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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