US tax reform

Payroll implications for businesses

Overview

The employment tax impact of US tax reform

December 22, 2017 saw the passage of the US tax reform legislation—formally referred to as "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018" (the Act)—following successful reconciliation of the House and Senate versions of the bill. As the changes come into effect on January 1, 2018, employers must understand what they need to address beginning in 2018 and develop a plan of action.

This document provides a consolidated summary of the changes impacting payroll based on known legislation and guidance as of December 29, 2017.

What's changing?

The Act is expected to impact the following payroll items:

- Withholding amounts (personal exemptions eliminated, standard deductions doubled, and tax rates—both supplemental and brackets—adjusted); and
- Repeal of the exclusion from income tax for certain noncash fringe benefits, the most significant (by dollar amount) being the change in the tax treatment of employer paid or reimbursed moving expenses.

Employers will initially be most concerned with the withholding changes they need to adopt and when they need to adopt them. The Internal Revenue Service (IRS) has stated that it will issue withholding guidance in early January, which employers will be expected to implement by February. Pending the issuance of this guidance, existing 2017 withholding tables and systems should continue to be used, according to a late-December statement provided by the IRS.

Forms W-4

The Act repealed individual income tax exemptions effective from January 1, 2018. The withholding regime takes these exemptions into account through Forms W-4 in order to arrive at the correct amount of withholding each pay period.

The withholding guidance to be issued by the IRS in early January (to reflect the US tax reform changes) will be designed to work with the existing Forms W-4 that employees have previously provided to employers. Employees will not need to complete new forms W-4 for 2018 to accommodate the US tax reform changes.

Supplemental rates

US tax reform includes revisions to individual income tax rates, which will have a direct impact on supplemental wage tax rates.

The mandatory flat rate of withholding for supplemental wage payments exceeding $1 million USD will be reduced to the highest rate of 37%, effective January 1, 2018. However, the issue of the rate for supplemental wage payments less than $1 million USD requires further clarification from the IRS.

The Act, by virtue of how it amends the Internal Revenue Code as of its date of enactment, returns the sub-$1 million USD wage supplemental withholding rate to its prior 28% from 25%. However, there is speculation in the tax community at large that this may be an unintended consequence rather than actual intent and that the IRS may issue official guidance in January 2018 to set the supplemental rate for wages less than $1 million USD. For instance, the IRS has previously set the rate at the third individual tax bracket, which would correspond to 22% under the new individual tax regime.

Pending further clarification, employers are reminded that the IRS has stated that no deviation from current practice is required until guidance is released in early 2018. In the interim, employers need to decide if they will continue to use the 25% rate or apply the 28% withholding to the first $1 million USD of supplemental wages and 37% thereafter, recognizing that the 28% rate may be reduced by guidance in early 2018 and that the 25% rate could result in under withholding depending on final IRS guidance.

Fringe benefits and expenses

US tax reform has repealed the exclusion from income tax for employer-paid or reimbursed moving expenses for employees (with an exception for members of the armed forces on active duty), as well as the exclusion for bicycle commuting expenses.

Beginning January 1, 2018, employers should include in income relocation costs paid on behalf of employees, as well as any reimbursement for bicycle commuting expenses. This will require payroll departments to:

1. Adjust payroll codes for taxable earnings and apply withholding taxes (with or without gross up, depending on how the tax costs will be met).
2. Create processes to capture the compensation as it is earned and process to payroll (either as manual payments or via an interface).
3. Consider if any new imputed wages should be considered for 401K deferral purposes under qualified plan rules.
4. Discuss with HR/international mobility departments how the tax and FICA costs on these reimbursements will be withheld from employee wages and/or grossed up by the company. These discussions should also include an employee communications strategy in the event questions arise when employees receive their paychecks.

Deloitte's view

Following the passing of the Act, the most important and immediate steps for employers include:

- Implement withholding guidance for normal wages once it is issued by the IRS in January 2018.
- Adjust supplemental withholding rates and determine your company's withholding position for supplemental wages of less than $1 million USD, pending clarification from the IRS.
- Implement a strategy for relocation expenses and other fringe benefit items no longer exempt from income tax. Make adjustments to payroll wage codes for items that are no longer exempt from income or employment taxes.

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