

## UPDATE: Three Significant Takeaways from the Tax Cuts and Jobs Act

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This update to our [Tax Alert on Nov. 2nd](#) describes additional key provisions in the “Tax Cuts and Jobs Act” (H.R. 1), released by the Chairman of the House Ways and Means Committee on Nov. 2nd, as well as the Chairman’s substitute of the tax bill released on Nov. 3rd.

**45.6% Tax Bracket:** First, the Bill contains a “bubble” tax that will result in high-income taxpayers paying a 45.6 percent tax rate on a portion of their taxable income above \$1 million. Although all taxable income more than \$1 million is subject to a 39.6 percent marginal tax rate, the Bill imposes an additional 6 percent tax on taxable income between \$1 million and \$1.2 million for individuals (and \$1.2 million and about \$1.64 million for joint filers). **The purpose of this “bubble tax” is to eliminate the benefits these taxpayers received from the 12 percent tax rate that applies to the first \$45,000 of income for individuals and \$90,000 for joint filers.** Taxable income above \$1.2 million for individuals and about \$1.64 million for joint filers would be taxed at 39.6 percent, with no surcharge. **The result of the bubble tax could be additional tax of as much as \$12,000 for individuals and \$26,400 for joint filers.**

**Repeal of Section 409A:** Second, the Bill repeals prior rules regarding nonqualified deferred compensation under Section 409A, which allowed employees to defer income tax on certain deferred compensation arrangements. **Beginning in 2018, new section 409B provides that an individual would be taxed (both income and “FICA”) on compensation under a “nonqualified deferred compensation plan” as soon as there is no substantial risk of forfeiture regarding such compensation.** In addition to traditional deferred compensation plans, section 409B would also apply to equity-based compensation arrangements, including stock units (phantom stock), stock options and stock appreciation rights. The Bill also narrows the definition of a substantial risk of forfeiture so that the forfeiture relates only to the future performance of services, rather than to a covenant not to compete or the occurrence of some condition. Other types of popular forfeiture conditions, such as the occurrence of an IPO, a change in control or economic performance conditions, would no longer

qualify as a substantial risk of forfeiture for these purposes reporting and withholding requirements, along with income taxation, would apply when the substantial risk of forfeiture lapses. Generally, this occurs upon the “vesting” of the compensation.

**Transition Period Until 2026:** The Bill allows a transition period through 2025 for existing arrangements related to services performed by Dec. 31, 2017. Compensation for services performed before 2018 must be included in taxable income either in the year in which the compensation is no longer subject to a substantial risk of forfeiture (under the new definition) or in the taxpayer’s last tax year before 2026. The Bill also permits, subject to further guidance from the Treasury, a limited 120-day period to allow existing deferred compensation programs of all sorts to be amended without violating Section 409A.

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