Compensation and Benefits

Human capital challenges remain at the forefront as public companies look to retain and attract talent and leverage tax rules to efficiently offer competitive equity and benefit programs. This year companies will need to navigate several important new tax considerations. The OBBBA makes significant changes to compensation and benefit rules and imposes new reporting. The challenge will be even greater for companies with a global footprint, as they may need to adjust tax equalization payments to account for the individual tax changes in the new legislation.

New Employer Reporting Requirements on Tips and Overtime

Employers will be required to report qualified tips and qualified overtime compensation to both employees and the IRS beginning in 2025 to facilitate new individual deductions under the OBBBA. The deductions are effective from 2025 through 2028.

Businesses will have to make a number of important determinations to properly report tips, including:

- Identifying employees in occupations that customarily and regularly received tips before December 31, 2024
- Determining whether the tips are earned in a disqualified specified service trade or business
- Verifying that the tips are voluntary

For overtime reporting, employers will report only the additional compensation premium due to the higher overtime rate (the “half” in “time-and-a-half”). This includes only federal Fair Labor Standards Act (FLSA) required overtime premiums (not state/local or contractual overtime). Employees cannot use the same compensation as the basis for a deduction on their Form 1040 for both qualified tips and qualified overtime.

Planning Considerations

The IRS announced that it will not revise the 2025 Form W-2 or update 2025 withholding tables for qualified tips or qualified overtime, and it has not yet made clear the form and manner of reporting. Despite the current lack of clarity, employers will still be required to report qualified tips and qualified overtime to employees in 2025.Companies should update payroll and recordkeeping for the new reporting, which requires tracking data points that previously have never been separately identified. There will be transition relief in 2025 whereby the employer can approximate a separate accounting of amounts designated as qualified tips and qualified overtime using any reasonable method specified by the IRS. Qualified tips and qualified overtime remain subject to federal withholding and benefit plan compensation rules.

For 2026, the IRS released a draft Form W-2 that adds a new Box 14b for the tipped occupation code, which will be used to report the deduction for qualified tips on Form 1040, Schedule 1-A. Box 14 (Other) has been renumbered as Box 14a on the draft 2026

Form W-2. However, there are no new boxes for qualified overtime or qualified tips. Instead, there are new codes for Box 12 for those items, as well as a new code for contributions to a "Trump account."

OBBBA Enacts Significant Payroll & Benefits Changes

The OBBBA introduced numerous changes that may affect organizations' management of payroll and employee benefits and compliance obligations.

Higher 1099-NEC & 1099-MISC Reporting Threshold for 2026 Onward. For payments made after December 31, 2025, the threshold for providing a Form 1099-NEC (non-employee compensation, which is used for independent contractors) and Form 1099-MISC (used for amounts not reported on 1099-NEC or W-2) increases from $600 to $2,000. Starting in 2027, the $2,000 threshold will be indexed for inflation. This threshold has not changed since 1954.

Compensation Over $1 Million. Publicly traded companies and their affiliates cannot deduct annual compensation over $1 million paid to "covered employees" (generally, the CEO, CFO, and the next three highest paid executive officers, with covered employees expanding to cover additional employees for tax years beginning after 2026). For tax years beginning after December 31, 2025, the OBBBA expanded the aggregation rules so that the identification of covered employees and the calculation of compensation is made on a controlled group basis, which can now include entities other than corporations, such as partnerships.

Employer Tax Credit for Paid Family & Medical Leave (PFML). For tax years beginning after December 31, 2025, the Section 45S employer tax credit for PFML becomes permanent and will include amounts paid for state-mandated paid leave and insurance premiums. The credit broadens the eligibility of part-time employees, clarifies the aggregation rules, and provides flexibility for multistate employers who operate in states where PMFL is not required even if the employer operates in other states that require PFML. These expansions are expected to make the credit more widely available to employers.

Employer Tax Credit for Employer-Provided On-Site Child Care. For tax years beginning after December 31, 2025, the Section 45F employer tax credit for on-site employer-provided child care increases from $150,000 to $500,000 ($600,000 for small businesses), indexed for inflation, up to 40–50% of expenses (increased from 25%). The definition of qualified expenditures will expand to include costs of third-party arrangements and jointly owned or operated child care facilities.

Employer Student Loan Debt Payments. The OBBBA made permanent the $5,250 annual amount that employers can pay or reimburse tax-free to employees for student loan debt payments if the employer has a written education assistance plan that complies with Section 127. Starting in 2026, the $5,250 will be indexed for inflation.

Planning Considerations

All employers should update their tracking and reporting for Form 1099-NEC and 1099-MISC, based on the significantly higher threshold for issuing those forms for 2026 and beyond.

Publicly traded companies should verify proper reporting and tracking across all entities in the controlled group for compliance with the new disallowed deduction rules for amounts paid over $1 million annually.

Employers may want to revisit their eligibility for the expanded PFML and on-site child care tax credits.

Now that Section 127 permanently allows employers to make tax-free payments of student loan debt for employees, employers may want to look into adopting a written education assistance plan. The IRS recently published a model plan document, making it easier for employers to satisfy the written plan requirement.

IRS Issues Guidance for State Paid Family and Medical Leave Programs

The IRS recently issued its first-ever guidance on the federal income and employment tax treatment of contributions made to, and benefits paid from, a state-run paid family and medical leave (PFML) program, as well as the related reporting requirements. This had become an area of concern for many employers since more than a dozen states have enacted PFML laws without any federal guidance on how to tax the premiums paid to and benefits paid from such programs.

Rev. Rul. 2025-4 provides rules for employers operating in the states (and the District of Columbia) that have mandatory PFML programs and for employees working in those states. These state programs pay employees who can't work because of non-occupational injuries to themselves or family members, as well as sickness and disabilities. While the details of the programs vary substantially from state to state, PFML programs generally operate as social insurance programs, with premium contributions from both employers and employees and benefits paid at a fixed rate, based on the employee's wages.

2025 Transitional Relief

The ruling is effective for PFML benefits paid by a state on or after January 1, 2025. However, it provides transition relief for states and employers for calendar year 2025 from withholding, payment, and information reporting requirements for state PFML benefits. For 2025 only, employers who voluntarily "pick up" the required employee contribution into a state PFML fund are not required to treat those amounts as wages for federal employment tax purposes.

Key Points

The guidance draws important distinctions on how contributions and benefits are treated for federal income and employment tax purposes. Employers will need to pay careful attention to these new rules. The guidance clarifies the following key points:

- Employers can deduct their contributions to state mandatory PFML programs as a payment of an excise tax.

- Employees can deduct their contributions to such programs as a payment of state income tax, if the employee itemizes deductions, to the extent the employee's deduction for state income taxes does not exceed the state income tax deduction limit. However,

required employee contributions to the state PFML program are not excludible from income under Section 106 (i.e., the contributions are after-tax, not pre-tax).

- Employees who receive state-paid *family* leave payments must include those amounts in the employee's gross income. Generally, the IRS considers benefits that replace wages during an employee's leave as wages for income and employment tax purposes, unless the benefits qualify for an exclusion. Paid family leave is generally not eligible for any exclusion. Employees also do not have a "tax basis" in employee or employer pick-up contributions previously treated as taxable wages.

- Employees who receive state paid *medical* leave payments must include the amount attributable to the *employer's* portion of the contributions in the employee's gross income and such amount is subject to both the employer and employee share of Social Security and Medicare taxes. The amount attributable to the *employee's* portion of the contributions is excluded from the employee's gross income and is not subject to Social Security or Medicare taxes.

Thus, except for leave for the employee's own injury or illness, PFML is not accident or health insurance, so most PFML benefits will be taxable to the employee.

Planning Considerations

Employers should update their payroll systems to come into compliance with the new rules starting with the 2026 calendar year. Such changes often take significant time to implement.

Failure to accurately reflect amounts on an employee's Form W-2 can subject the employer to IRS penalties. The guidance places new administrative burdens on employers (and their payroll systems) to understand the income and employment tax consequences of such state PFML programs, and to coordinate with the states to obtain information that may be required to correctly report taxable benefits (in a manner similar to that which exists for employers that utilize a third-party insurer to administer short-term or long-term disability). Thus, employers will be expected to correctly determine the taxable and nontaxable contributions and benefits for payroll processing and W-2 reporting purposes. Employers should proactively review their payroll practices to achieve compliance.

Global Mobility Provisions Will Impact Tax-Equalized Employees

The OBBBA will also have a significant impact on the global mobility programs of public companies with employees working outside their home country. Some of the individual changes are immediately effective for 2025, so employers should quickly assess the implications for any tax equalization programs. The key changes most likely to affect global mobility programs and employees are outlined below.

Moving expenses: For tax years beginning after 2025, the OBBBA permanently suspends the moving expense deduction for employees (except for active-duty military members and those in

the intelligence community) and the income tax exclusion for most taxpayers, which had been previously suspended under the TCJA from 2017 to 2025. Employers who pay employees' moving expenses must report those amounts as taxable wages on Form W-2, making the amounts subject to income, Social Security, and Medicare taxes. Employers can deduct these amounts as compensation expenses.

Individual SALT limitation: The OBBBA temporarily increases the limit on the federal deduction for state and local taxes (the SALT cap) to $40,000 in 2025 (from the current $10,000) and adjusts it annually through 2029. In 2026, the cap will be $40,400, and then will increase by 1% annually, through 2029. Starting in 2030, the SALT cap will revert to the current $10,000.

The deduction amount available phases down for taxpayers with modified adjusted gross income (MAGI) over $500,000 in 2025. The MAGI threshold will be increased by 1% each year from 2026 to 2029. The phasedown will reduce the taxpayer's SALT deduction by 30% of the amount the taxpayer's MAGI exceeds the threshold amount, but the limit on a taxpayer's SALT deduction could never go below $10,000.

Limitations on itemized deductions: The OBBBA permanently repeals the Pease limitation, which had been suspended under the TCJA, but introduces a new rule: starting after 2025, the value of itemized deductions will be reduced by 2/37 of the lesser of the allowable itemized deductions or the excess of taxable income over the 37% tax rate threshold, effectively capping the benefit of itemized deductions at 35% for taxpayers in the highest tax bracket. The legislation also makes permanent the repeal of miscellaneous itemized deductions.

Excise tax on certain remittance transfers: The OBBBA imposes a 1% excise tax on electronic fund transfers of cash, money order, cashier's check, or similar instrument from U.S. senders to foreign recipients, effective for transfers after December 31, 2025. Exemptions apply for transfers from certain financial institutions or those funded by U.S.-issued debit or credit cards. No tax credit is available for this tax.

Deduction for qualified residence interest: For tax years after 2025, the OBBBA makes permanent the limit on the mortgage interest deduction to acquisition debt of $750,000 ($375,000 if married filing separately), with the $1 million cap still applying to debt incurred on or before December 31, 2017.

Planning Considerations

The OBBBA provisions affecting global mobility deserve careful review and modeling of the cost implications for both global businesses and their mobile employees.

The greatest impact of the increased SALT cap for tax-equalized employees is that it will affect the employees' actual and hypothetical tax liabilities, particularly for those who reside in high-tax states. However, high-income taxpayers may not fully benefit from the increased SALT cap because of the limitations on itemized deductions. In addition, because the SALT deduction is an add-back for alternative minimum tax (AMT) purposes, it may render some taxpayers subject to AMT.

With the OBBBA making permanent the repeal of miscellaneous itemized deductions, employees repaying income of $3,000 or less will not be entitled to a deduction. Consequently, tax-equalized employees who repay tax settlement balances to their

employers cannot receive a tax benefit for this repayment. However, repayments exceeding $3,000 may still be claimed as a credit or deduction on the tax return, since they are eligible for claim of right treatment.

Because itemized deductions, such as the mortgage interest deduction, directly impact a tax-equalized employee's hypothetical and actual tax liability, global mobility programs should work with their tax advisors to determine how program costs may be impacted.

IRS Instructed to Phase Out Paper Refund Checks

An executive order signed on March 25, 2025, instructs the IRS to discontinue issuing paper checks for tax refunds. After September 30, 2025, a taxpayer who is expecting a tax refund from the IRS will generally receive the refund via direct deposit to a U.S. bank account. This could present a problem for global mobility programs and their cross-border employees.

Because the IRS limits the number of refunds that can be deposited into a single financial account, many global mobility programs are unable to directly receive U.S. tax refunds for their equalized cross-border employees. Consequently, these employees must first receive their tax refunds in their U.S. bank account and subsequently remit the funds to the company.

The absence of paper refund checks creates a challenge for foreign nationals without a U.S. bank account because tax refunds can only be deposited into an account with a routing number linked to a U.S. bank. In addition, those foreign nationals who do have a U.S. bank account will need to maintain their account after departing the U.S. in order for any forthcoming tax refunds can be received.

Non-U.S. individuals who do not have a U.S. bank account may now need to rely on other options, such as international wire transfers, credit cards, debit cards, or digital wallets.

Planning Considerations

While additional guidance is expected from the IRS, global mobility programs should proactively prepare for these changes. Preparations may include making changes to the program's current procedures regarding the receipt of tax settlement payments and exploring alternative digital payment options for their cross-border employees.

Exceptions for those who do not have a U.S. bank account were not defined in the executive order, but this and other unresolved issues are expected to be addressed in regulations or other forthcoming guidance.