Patterson Belknap

Employee Benefits and Executive Compensation Alert
July 23, 2025

Highlights of the Employee Benefits Provisions in the One Big Beautiful Bill

On July 4, 2025, H.R. 1, also known as the One Big Beautiful Bill (the "OBBB") was signed into law. Compared to recent legislation, the OBBB does not contain a significant number of employee benefits provisions. However, there are provisions in the OBBB that will interest employers and plan sponsors. This alert is intended to highlight some of these provisions, which impact health plans, executive compensation, payroll administration, and fringe benefits.

Health Plans

Health Savings Accounts – Enhancements

Heath Savings Accounts ("HSAs") under Section 223 of the Internal Revenue Code (the "Code") are popular tax-advantaged[1] accounts to which individuals who are covered under a high deductible health plan ("HDHP") may contribute (subject to Internal Revenue Service ("IRS") limits, which for 2025 are $4,300 for individuals and $8,550 for families, with an additional $1,000 catch-up limit for individuals age 55 and older). In order to avoid losing eligibility to make contributions to an HSA, while an individual is covered under an HDHP, in addition to other requirements, they may not participate in any other health plan that is not an HDHP that provides benefits that are covered under the HDHP (such other health plan coverage is referred to as "disqualifying coverage"). HSA eligibility generally is determined on a month-by-month basis.

The OBBB makes several enhancements and liberalizations to Section 223 of the Code that will generally expand the population of individuals eligible to make contributions to HSAs.

- **Safe Harbor for Telehealth Made Permanent**. The CARES Act (passed during the COVID-19 pandemic) permitted, on a temporary basis through the end of 2024, HDHPs to cover telehealth services in the absence of a deductible (i.e., on a first-dollar basis) without causing individuals to be ineligible to contribute to an HSA. The OBBB permanently establishes the safe harbor for telehealth effective for plan years beginning after 2024 (i.e., with retroactive effect); thus individuals can now use telehealth benefits under an HDHP prior to meeting the applicable deductible under the plan. This is a welcome change for individuals with HDHP coverage, particularly as telehealth has increased in popularity in recent years.

- **Direct Primary Care Service Arrangements**. As noted above, individuals who are eligible to contribute to an HSA must not also have non-HDHP health plan coverage (i.e., disqualifying coverage). Effective for months beginning in 2026, the OBBB

[1] Generally speaking, the tax advantages of HSAs, if applicable requirements are met, are (i) contributions are tax deductible, (ii) earnings or investment are not subject to income tax, and (iii) withdrawals (of contributions and earnings) to pay for qualified medical expenses are not subject to income tax.

exempts direct primary care service arrangements ("DPCSAs") from being treated as health plans for purposes of the HSA rules in Section 223 of the Code (and therefore DPCSA coverage would not constitute disqualifying coverage). Generally speaking, a DPCSA is a service arrangement under which an individual is provided medical care consisting solely of primary care services[2] by primary care practitioners for a fixed periodic fee (not to exceed $150 per month for an individual, or $300 per month for more than one individual). Accordingly, employers can potentially consider offering a DPCSA to employees alongside their HDHP coverage in 2026, while still maintaining the employees' HSA eligibility.

In addition, while funds in HSA accounts are generally not permitted to be used to pay for insurance (with certain limited exceptions), effective in 2026, the OBBB will allow individuals to use funds in their HSA accounts to pay the fixed periodic fees for DPCSAs.

- **Bronze and Catastrophic Plans**. Effective for months beginning in 2026, the OBBB will treat all bronze and catastrophic plan coverage obtained on the Affordable Care Act healthcare exchanges as HDHP coverage. This expansion of the HSA rules will allow individuals who are enrolled in bronze or catastrophic plan coverage through the healthcare marketplace to be eligible to contribute to HSAs beginning in 2026.

Executive Compensation

Section 4960 – Expansion of Covered Employees for Non-Profit $1 Million and Parachute Excise Tax

The Tax Cuts and Jobs Act of 2017 (the "TCJA") created Section 4960 of the Code, which imposed a new 21% excise tax[3] on tax-exempt organizations that paid annual compensation over one million dollars, or certain severance payments (referred to as excess parachute payments), to the tax-exempt organization's "covered employees." Under the TCJA, "covered employees" were generally defined as the top five highest compensated employees in a given taxable year, and any person who was previously a covered employee for any taxable year after December 31, 2016 – the so-called "once-in-always-in" rule. The excise tax, if triggered, is payable by the tax-exempt organization and not the covered employee.

Effective for taxable years beginning in 2026, the OBBB expands the definition of "covered employee" by removing the "top five" limitation currently in Code Section 4960. As a result, beginning with the first taxable year in 2026, all employees of a tax-exempt organization may potentially trigger a Code Section 4690 excise tax if they are paid compensation over one million dollars (or certain excess parachute payments as severance in connection with a termination of employment). By eliminating the "top five" limitation of "covered employees," the "once-in-always-in" rule is also consequentially expanded to include any

[2] "Primary care services," for purposes of the DPCSAs, cannot include (i) procedures that require the use of general anesthesia, (ii) prescription drugs (other than vaccines), and (iii) laboratory services not typically administered in an ambulatory primary case setting.
[3] The rate of the excise tax is equal to the tax rate for corporations under Section 11 of the Code, which is currently 21%.

former employee of the tax-exempt organization who was an employee for any taxable year after December 31, 2016 (not just employees who were "covered employees" in those prior years under current law).

As a result of the OBBB modifications to Code Section 4960, tax-exempt organizations will need to monitor compensatory and severance payments to all employees of the organization starting in 2026, and may potentially be required to pay a greater amount of the Code Section 4960 excise tax than in prior years. In preparation for the increased monitoring under the revised rules, tax-exempt organizations will also need to identify individuals who may not have previously fallen under the definition of a "covered employee" due to the current "top five" limitation, including former employees, in order to prospectively apply the "once-in-always-in" rule to the expanded group of "covered employees." Additionally, moving forward, tax-exempt organizations (including certain related entities that are within the meaning of "applicable tax-exempt organization" as defined in Code Section 4960 and the tax regulations thereunder) may need to consider the impact of the OBBB modifications on executive compensation practices (including in employment contracts and offer letters).

Code Section 162(m) – Allocation of 162(m) Deduction Limitations to Controlled Group Members of Public Companies

For publicly held corporations, Code Section 162(m) generally disallows a tax deduction for remuneration paid to covered employees in excess of one million dollars in a taxable year. For purposes of Section 162(m), covered employees generally include the principal executive officer and principal financial officer of the company and the next three highest compensated officers for the taxable year (the "Current Covered Employees"). The "once-in-always-in" rule also applies to the Current Covered Employees. Under the American Rescue Plan Act of 2021 ("ARPA"), starting with taxable years beginning in 2027, the definition of "covered employee" will be expanded to also include the next five most highly compensated employees (even if not officers) of the corporation. (Note, however, that the once-in-always-in rule does not apply to this expanded group of the next five most highly compensated employees, the "ARPA Covered Employees").

Effective for taxable years beginning in 2026, the OBBB modifies Code Section 162(m) to provide for an entity aggregation rule, which would generally take into account remuneration paid by any member of a publicly held corporation's controlled group[4] to "specified covered employees" (which include the Current Covered Employees of the public corporation, and employees who would constitute the ARPA Covered Employees of any member of its controlled group).[5] The law also contains a pro-rata allocation mechanism for the deduction limitation among the members of the controlled group that pay remuneration to the specified covered employees. Public companies with covered employees receiving compensation from

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[4] The controlled group rules for employee benefit plan purposes under Code Section 414(b), (c), (m), and (o) are applied to determine the controlled group of the publicly held corporation for these purposes.

[5] One apparent nuance under the specified covered employee definition is that while Current Covered Employees are still determined by reference solely to the publicly held corporation, the group of the next five most highly compensated employees (the ARPA Covered Employees) will be determined on a controlled group-wide basis for publicly held corporations that are in a controlled group.

different members of the controlled group will have to track 162(m) deduction limitations under these new rules beginning in 2026.

Payroll Administration

Temporary Deductions on Qualifying Cash Tips and Overtime Pay

The OBBB has created two temporary deductions for individual taxpayers earning certain types of wages. Effective January 1, 2025 through December 31, 2028, qualifying cash tips ("qualified tips") and overtime pay (as determined under the Fair Labor Standards Act ("FLSA")) that are both generally taxable under current law, will be deductible from gross income up to specified limits[6].

Additionally, for employers these temporary deductions mean compliance with additional reporting requirements. On Form W-2s and Form 1099s, as applicable, employers will need to separately report the amount of overtime pay, and employers with employees who are tipped will need to separately report the amount of qualified tips and the employee's occupation (which must be consistent with an occupation that customarily and regularly received tips on or before December 31, 2024, to be further defined under IRS guidance). Because both temporary deductions are effective in the year the OBBB was enacted, the OBBB provides a transition rule allowing an approximation to be made of amounts designated as qualifying cash tips and overtime compensation earned in 2025 pursuant to reasonable methods to be specified under IRS guidance. Although a transition rule is in place for 2025 and employers can continue to use current IRS withholding tables, employers should monitor forthcoming guidance from the IRS and prepare to make any adjustments to tax withholding and reporting on their payroll systems for 2026.

Employers may also consider the impact of these temporary deductions on their business practices for determining exempt/non-exempt classification, and for managing tipped employees' reporting of qualified tips, and related employee policies, particularly as the OBBB contemplates potential abuse under both temporary deductions and regulations to prevent abuse.

Fringe Benefits

Exclusion of Employer Paid Student Loan Payments - Extended

Under current law, until the end of 2025, employers may exclude certain payments related to employees' student loans from the employees' gross income. These payments must be made under an educational assistance program as defined in Section 127(b) of the Code, and are limited to annual payments of up to $5,250 for qualified educational loan expenses.

A Code Section 127(b) educational assistance program must generally be a written plan for the exclusive benefit of employees that does not discriminate in favor of highly compensated

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[6] The deduction is generally capped at $12,500 per year ($25,000 for joint filers) for overtime wages and $25,000 for tips. The deduction phases out at higher income levels for both types of compensation.

employees or principal shareholders and owners. Employees must be given reasonable notice of the availability and terms of the program.

The OBBB makes this exclusion permanent. In addition, starting in 2026, the $5,250 cap will be indexed for inflation. (Note that this increase will apply to all qualified educational assistance under Code Section 127(b), and will not be limited solely to student loan repayments.)

Creation of Trump Accounts

The OBBB established so-called "Trump accounts" for the benefit of children under the age of 18.[7] Trump accounts share certain similarities with other existing tax-advantaged savings vehicles for the benefit of minors, such as "529 plans," to which individuals and employers may also make contributions. However, while in some states, employer contributions to 529 plans on behalf of employees' children/grandchildren are eligible for tax incentives (such as tax credits), there does not appear to be comparable employer state tax incentives for employers to make contributions to Trump accounts for the benefit of their qualifying employees' or employees' dependents.

Employers who wish to make contributions to Trump accounts will be required to establish a separate written plan that meets requirements similar to the requirements of Code Section 129 dependent care assistance programs (including the non-discrimination requirements). Employer contributions to Trump accounts may begin July 4, 2026 (along with contributions from other sources) and are limited to annual contributions of up to $2,500 per employee (excludable income to the employee), which will count to the aggregate contribution limit of $5,000[8] (both limits will be indexed for inflation).

Commuting Expense Reimbursement

Prior to 2018, employers were permitted to reimburse employees for certain bicycle commuting expenses on a tax advantaged basis. However, that benefit had been suspended through 2025, and thus has not been available for several years. The OBBB permanently eliminates this benefit effective as of January 1, 2026. In addition, calculation of the cost-of-living adjustments to the cap on the remaining transportation fringe benefits provided under Code Section 132(f) is adjusted under the OBBB (to include one additional year which could result in a slightly higher cap going forward).

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[7] A detailed summary of Trump accounts is beyond the scope of this alert, particularly as we expect additional guidance to be published to further define features such as utilization of contributions for qualified expenses, which may include certain educational or credentialing expenses, small business or farm expenses, and first home purchases, and only after the account beneficiary attains age 18 (other distributions may be permitted but may be subject to less desirable tax rates and/or withdrawal penalties.). In addition, the type of investment permitted for assets in Trump accounts is specifically defined in the OBBB.

[8] For children born in the years 2025 through 2028, the total contribution limit in their birth year is up to $6,000 due to the $1,000 contribution from the federal government under the new Code Section 6434 Trump Accounts Contribution Pilot Program.

Moving Expenses Reimbursement

Prior to 2018, employees were permitted to deduct certain moving expenses incurred when transitioning to a new principal place of employment. This deduction was generally suspended from 2018 through 2025 for employees who were not part of the U.S. armed forces. Effective as of January 1, 2026, the OBBB terminates the deduction permanently for employees other than certain individuals who are part of the U.S. armed forces and, as a new addition, some members of the U.S. intelligence community.

Enhancement of Dependent Care Assistance Program

Current law provides that an employee may exclude from gross income certain dependent care assistance amounts that are provided pursuant to a dependent care program as defined under Code Section 129(d), and which do not exceed the then applicable limit, which is currently $5,000 (or $2,500 for a married individual filing separately).

A Code Section 129(d) dependent care assistance program must generally be a written plan for the exclusive benefit of the employees that does not discriminate in favor of highly compensated employees with respect to benefits or eligibility. In addition, employees must be given reasonable notice of the availability and terms of the dependent care assistance program.

Effective as of January 1, 2026, the OBBB increases the dependent care assistance limit to $7,500 (or $3,750 in the case of married individuals filing separately). Note, however, that these amounts will not be indexed for inflation.

Takeaways

Although some of the OBBB's benefits provisions simply make permanent existing temporary suspensions in the Code, others will provide opportunities for enhancement or expansion of employee benefit programs. For example, the new provisions related to HSAs may make them a more attractive option to both employers and employees, and employers who may have been hesitant to provide loan repayment benefits due to the impending sunset of the applicable Code provisions may now choose to offer them. Conversely, the OBBB also presents some challenges for employers, who must now revise how they monitor certain executive compensation amounts, and make operational changes to their payroll administration systems for certain wages such as overtime pay.

Employers should review existing plan documents because plan amendments may be required to implement certain changes under the new law. Employers should also review employee handbooks and written policies, which may require updates to reflect certain changes.

The OBBB is very new law, and as with most new legislation, we expect the IRS to issue regulations and other guidance relating to the benefits provisions highlighted above.

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Douglas L. Tang	212.336.2844	dtang@pbwt.com
Jessica S. Carter	212.336.2885	jcarter@pbwt.com
JoAnn Kim	212.336.2221	jokim@pbwt.com

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Patterson Belknap Webb & Tyler LLP
1133 Avenue of the Americas
New York, NY 10036–6710
212.336.2000
www.pbwt.com