Legal Developments

2018 Brings New Mortality Tables and Tax Reform

The year 2018 brings new mortality tables for defined benefit plans that will make annuity-based plans more expensive to maintain and de-risk. It also brings tax reform, which will take priority over other items listed on the Service's guidance plan. Below we summarize the new mortality table guidance, and take a look into changes to qualified plans embodied in the tax reform legislation.

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Mortality Tables

The Pension Protection Act of 2006 (PPA) mandated that the Treasury provide updated mortality tables at least every 10 years for defined benefit pension plans. These mortality tables are used for calculating lump-sum benefits (and other accelerated distribution options) and for minimum funding purposes. As the last mortality table was effective for 2008, it is time for a new table, which the IRS and Treasury recently issued in Treasury Decision 9826. [82 Fed. Reg. 46388 (Oct. 5, 2017)]

The new table reflects pension plan experience and projected trends in experience, which have resulted in lower mortality rates. This means that participants and beneficiaries are living longer and, therefore, the lump sum equivalents are higher. This need for more money to fund the benefit results in an increase in the minimum funding requirements.

There are three pieces to the IRS guidance that should be reviewed: (1) the final regulations; (2) Notice 2017-60; and (3) Revenue Procedure 2017-55. We take each in turn below.

(1) Final Regulations (TD 9826)

For the most part, the final regulations mirror the proposed regulations that were issued on December 29, 2016. The base mortality tables are derived from the tables contained in the RP-2014 Mortality Tables Report issued in 2014 by the Society of Actuaries.

These regulations require the use of a new mortality table and mortality improvement scale, which, as we indicated, generally provides for lower mortality rates than the current table. This increases the calculated present value of plan liabilities for traditional pension plans that define accrued benefits as annuities. It also increases the minimum funding requirements, and lowers the funding levels for such plans.

Importantly, the final regulations permit plan sponsors to implement the new tables in 2019 (rather than 2018) for funding purposes, provided that certain requirements are met. Otherwise, the table is required for the 2018 plan year. For a plan sponsor to make an election to defer the new tables for minimum funding purposes until the 2019 plan year, the plan sponsor must conclude that using the new table in 2018 is either: (1) administratively impractical; or (2) would result in an "adverse business impact that is greater than de minimis." The plan sponsor must also inform the plan's actuary that it is making this election, but there is no filing requirement with the IRS or the PBGC.

Lastly, the final regulations relax the requirements for use of a plan-specific substitute mortality table for funding purposes. These tables, however, cannot be used for Code Section 417(e) minimum benefit calculations.

(2) Notice 2017-60

Notice 2017-60 sets forth the new static mortality table for 2018 under Code Section 417(e), which could also extend to plan provisions that apply these factors (even if not otherwise required by law, such as conversion from a single to a joint life annuity). For calendar year plans, the new table applies to distributions made on or after January 1, 2018. For traditional plan formulas, the new mortality tables typically will increase the lump sum (and other accelerated distribution options available under the plan). Conversely, for cash balance

and other hybrid plans, lump-sum benefits should not be impacted (as lump sums typically are based on the participant's hypothetical account balance), but the new tables may decrease the amount of annuity distributions available under the plan if the plan uses Section 417(e) mortality tables for such calculations.

(3) Revenue Procedure 2017-55

Revenue Procedure 2017-55 provides step-by-step procedures a plan sponsor must follow if it wants to elect to use plan-specific substitute mortality tables for funding purposes. Notably, these new procedures are intended to be easier to use and to facilitate use for smaller plans. These procedures are effective for plan years beginning on or after January 1, 2018.

Tax Reform

The final version of tax reform that was passed by Congress and signed into law by President Trump did not include any "Rothification" requirements as a "pay for" provision (which would have generated a sizable amount of tax income due to the after-tax nature of Roth contributions). This mandatory Roth deferral notion was a concern for many, as it would have replaced the historic 401(k) benefit of pre-tax deferrals. The final version of the tax bill also did not include a number of other relief provisions, including relief for closed defined benefit plans and hardship relief.

The final bill leaves us with the following key changes:

- *Loan Offsets*. Permits a participant to roll over a loan offset amount as a result of plan termination or the failure to meet the loan repayment terms because of the participant's severance from employment through the participant's tax filing deadline (plus extensions) for the tax year of the distribution.
- *2016 Disaster Relief*. The provision provides relief similar (but not identical, *e.g.*, no loan relief) to the 2017 congressional relief for hurricanes Harvey, Irma, and Maria for disaster victims residing in any area with respect to which a major disaster has been declared by the President under Section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act during calendar year 2016.
- *Safe Harbor Hardship Withdrawals More Restrictive*. The bill restricted a casualty loss deduction to amounts attributable to a Presidentially declared disaster, which results in limitation of a hardship withdrawal for damage to the participant's principal residence, which must now meet this requirement (through 2025).
- *Fringe Benefit Changes May Impact Plan Compensation*. The bill makes a number of changes to the taxation of certain fringe benefits, and the available employer deductions regarding the same, effective January 1, 2018. For example, qualified moving expenses are no longer tax-free. These changes may indirectly impact the definition of compensation, and therefore, any changes to fringe benefit programs should be reviewed for the impact on what is counted as plan compensation.
- *Loss of Deduction for Plan Overpayments of $3,000 or Less*. Correction of a plan overpayment typically involves the participant repaying the improper distribution back into the plan. If that repayment is made within the same year of the improper distribution, no tax reporting needs to be generated (and an offset approach applies). However, when the overpayment is not repaid within the same year, the participant has taxable income reported on Form 1099-R for the year of the distribution, and in the year of the repayment, the participant can take a deduction or credit to recover the taxes paid on his or her Form 1040. The bill eliminates this deduction through 2025 if the repayment does not exceed $3,000.

The bill also makes a change to recharacterizations of conversions to Roth IRAs, to prohibit a recharacterization to a traditional IRA following a Roth conversion beginning in 2018. This makes the IRA and qualified plan provisions for Roth deferrals more on an equal footing, so as to prohibit unwinding a Roth IRA conversion in the event of subsequent losses. (The bill also impacts the ability of a plan participant or IRA owner to take a deduction for losses due to having after-tax or Roth contributions that exceed the account balance.)

The bill also doubles the accrual amount from $3,000 to $6,000 for volunteer public safety Section 457(e)(11) programs, and indexes the limit as well. This provision is effective beginning in 2018.

Conclusion

Plan sponsors should make sure to discuss with their plan actuary the impact of the new tables, as these may impact plan distribution calculations, minimum funding projections, PBGC premiums, and benefit restrictions due to funding. Moreover, review your plans and update your administrative procedures for tax reform, and understand that the Service and Treasury will be preoccupied for some time with providing guidance on the new bill. ■