Bloomberg Tax

Daily Tax Report®

Reproduced with permission from Daily Tax Report, 48 DTR 15, 3/12/18. Copyright © 2018 by The Bureau of National Affairs, Inc. (800-372-1033) http://www.bna.com

*Retirement Plans*

# INSIGHT: 2017 Tax Reform Impacts IRAs Indirectly in Many Ways

Elizabeth Dold of the Groom Law Group discusses the effect of tax reform on IRAs. Among other things for taxpayers to consider is that any look-through or sole proprietorship income diverted to a simple IRA or simplified employee pension plan won't be eligible for the new 20 percent deduction.

By Elizabeth Thomas Dold, Esq.

Individual retirement plans under the tax code come in a variety of shapes and sizes, from traditional individual retirement accounts and annuities under Section 408(a) and Section 408(b) (traditional IRA), Roth individual retirement accounts and annuities under Section 408A (Roth IRAs), simplified employee pension plans under Section 408(k) (SEP IRAs), simple retirement accounts under Section 408(p) (Simple IRAs), and deemed individual retirement accounts and annuities under Section 408(q) (deemed IRAs). These IRA programs are popular with individual taxpayers and small employers, and the amount of tax-deferred savings under these programs has continued to grow over the years. Although the terms of these programs vary, this article summarizes the key impacts of the 2017 tax act (Pub. L. No. 115-97) for all these programs.

**New 20 percent Deduction for Look-through Entities** There is a new 20 percent tax deduction on qualified business income available for look-through entities (partnerships, LLCs treated as partnerships, and S corporations) and sole proprietorships that is designed to equalize the lower tax rate to corporations that now have a 21 percent top tax rate (Section 199A, as added by the 2017 tax act, Section 11011(a)). This very complex deduction, with its various conditions and limitations, is intended to help eliminate any disparate treatment in the tax rates due to the structure selected for the trade or business. Unfortunately, this 20 percent deduction does not apply to income used to make employer contributions to SEP and Simple IRAs (although they do retain their current tax-deductible treatment, subject to existing tax code limits). The SEP and Simple IRA remain important vehicles for retirement savings, but the individual tax rate (now up to 37 percent) will be imposed on any business income diverted to them.

*Elizabeth Dold is a principal at Groom Law Group, Chartered. Her practice focuses on the tax laws impacting a wide variety of retirement, health and welfare, and other compensation matters, including IRA compliance, employment taxes, and other reporting and withholding requirements.*

**Expansion of Indirect Rollover Contributions for Certain Plan Loan Offsets** The 2017 tax act extended the 60-day rollover period for plan loan offsets due to (1) a qualified plan termination, and (2) loan offsets due to failure to repay an outstanding loan due to severance from employment (e.g., if the qualified plan does not permit continued payment of the loan following termination) (Section 402(c)(3)(C), as added by the 2017 tax act, Section 13613). Now (effective Jan. 1, 2018), an individual has until his or her tax filing deadline (plus extensions) for the year of the offset to roll over proceeds up to the amount of such loan offset to another eligible employer plan or IRA.

**2016 Disaster Relief** The 2017 tax act also provides tax relief for payments of up to $100,000 from an IRA or qualified plan during 2016 and 2017 for disaster victims who are residents in any area that 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 (2017 tax act, Section 11028). The tax relief includes: (a) no 10 percent early withdrawal tax (Section 72(t)), (b) taxation spread over a three-year period, (c) a three-year period

to rollover the distribution to an IRA or another qualified plan (which replaces the standard 60-day period), and (d) treating repayment for disaster distributions from IRAs as a direct trustee-to-trustee transfer (which avoids the one-rollover-per-year limitation).

**Compensation Changes** The rules regarding what compensation is taken into account to determine IRA program contributions or deduction limits have not changed. However, an individual's calculation of such compensation may vary beginning Jan. 1, 2018, as there are a number of changes to the taxation of fringe benefits and the available employer deductions of these costs, and unreimbursed employee expenses are no longer deductible through 2025 (Sections 274, 132(f), 132(g), 217, 67(g), as amended by the 2017 tax act). For example, qualified moving expenses are no longer tax-free. Therefore, these changes may indirectly impact the definition of compensation, and any changes to fringe benefit programs should be reviewed for the impact on what is taken into account.

**Repayment of IRA Overpayments of $3,000 or Less** Correction of an IRA overpayment typically involves the individual repaying the improper distribution back into the IRA. If that repayment is made within the same year of the improper distribution, no tax reporting needs to be generated following an offset approach. However, when the overpayment is not repaid within the same year, the individual has taxable income reported on Form 1099-R for the year of the distribution, and in the year of the repayment, the individual can take a deduction (or credit under Section 1341) to recover the taxes paid on his or her Form 1040. The new law eliminates this deduction through 2025 if the repayment does not exceed $3,000 (amounts over $3,000 are still eligible for a deduction or credit under Section 1341, which has not changed) (Sections 67(b); 67(g), as added by the 2017 tax act, Section 11045).

**Recharacterizations** The Code permits an IRA owner to recharacterize an IRA into a different type of IRA. For example, an owner may change from a Roth IRA to a traditional IRA, from a traditional IRA to a Roth IRA, or change a rollover from a qualified plan that was made to a Roth IRA to a traditional IRA. However, effective Jan. 1, 2018, the 2017 tax act prohibits a recharacterization of a Roth IRA conversion (Section 408A(d)(6)(B), as amended by the 2017 tax act, Section 13611). Therefore, once a participant or IRA owner makes a decision to trigger taxation and move funds into a Roth IRA, there is no unwind. This irrevocable election now tracks the rule for in-plan Roth conversions within a qualified plan, which have always been irrevocable. Notably, one of the first pieces of informal guidance, via the Internal Revenue Service website, was to clarify that IRA owners are still permitted to recharacterize their 2017 Roth conversions through Oct. 15, 2018. In addition, IRA owners continue to be permitted to recharacterize regular contributions between a traditional and Roth IRAs. Notably, without the recharacterization option, it is more important than ever that taxpayers carefully review their conversion elections to ensure there are no mistakes.

**Cost-of-Living Increases** The IRS annually updates the limits on various plan and IRA limits that use a CPI-U index (Sections 219, 408A(c)). The 2017 tax act replaced this index, effective beginning in 2018, for only traditional and Roth IRA limits (e.g., contribution and deduction limits, eligibility for Roth contributions) to the ''chained'' CPI-U index (expected to increase more slowly). All other plan and IRA limits remain unchanged. Recently, the IRS published a News Release that this change does not impact the 2018 limits published in Notice 2017-64.

**IRA Losses** An IRA owner can take a miscellaneous itemized deduction for IRA losses, where after-tax or Roth contributions exceed IRA account balances. However, the 2017 tax act suspends all miscellaneous itemized deductions beginning Jan. 1, 2018, through 2025 (Section 67(g), as added by the 2017 tax act, Section 11045).

**IRA Fees** Following Revenue Ruling 84-146, administrative-type IRA fees (but not brokerage fees) paid by an IRA owner outside the IRA are not deemed contributions to an IRA. Rather, they are generally treated as trustee-related expenses that are deductible under Section 212, as a miscellaneous itemized deduction. However, the 2017 tax act, as noted above, suspends all miscellaneous itemized deductions, so these fees are no longer deductible (but presumably still not treated as deemed contributions). If these administrative-type fees are paid through the IRA (and the IRA is not reimbursed), then they are apparently still not treated as deemed distributions from the IRA (even though the deduction is no longer permitted).

**Calculation of Unrelated Business Income Tax (UBIT)** IRAs are subject to UBIT under Sections 511-514. Many IRAs hold oil and gas master limited partnerships or other pass-through investments that generate UBIT (and call for filing Form 990-T and paying any resulting tax). Starting this year, IRAs that own two or more unrelated trade or businesses will no longer be able to ''net'' the income and losses of the businesses when determining the UBIT. Instead, the UBIT for the year is the sum of the UBIT (but not less than $0) for each trade or business (Section 512(a)(6), as added by the 2017 tax act, Section 13702(a)). The new law also limits the application of the carryover of net operating losses for tax years beginning after Dec. 31, 2017, to the UBIT of the same trade or business in future years. (Net operating losses from tax years beginning prior to 2018 can be applied to any trade or business to reduce UBIT.) Of course, a key question is what is a ''trade or business'' for this purpose.

## Conclusion

Various stakeholders should review the potpourri of these primarily indirect changes affecting IRAs.

IRA providers should review these changes and update their procedures and documents accordingly.

Plan sponsors of SEPs, Simple IRAs, and deemed IRAs should update their IRA materials and procedures, and consider whether any amendments are needed to reflect these changes.

Participants and IRA owners should consider taking advantage of these new relief provisions, and review how they pay their IRA fees. Notably, the IRA owners that made a Roth conversion last year should check with their tax advisor and monitor their finances, their tax rates, and the markets through Oct. 15, 2018, to see

 COPYRIGHT © 2018 BY THE BUREAU OF NATIONAL AFFAIRS, INC.  ISSN 0092-6884

if a recharacterization to a traditional IRA is desirable to avoid the 2017 tax on the conversion.