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Tax Reform — What Changes May the New Year Bring for Qualified Plans?

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The new year brings changes to the Internal Revenue Code (the Code), the likes of which have not been seen since the Code was revamped in 1986. These changes include reducing business and individual tax rates, eliminating many deductions and other tax incentives, overhauling the international tax rules, and for the employee benefits community, some changes to tax-qualified retirement plans.

We first look at the qualified plan provisions in the House and Senate bills, and then review the changes picked up with the Conference report and in the final bill (H.R. 1, signed into law as Pub. L. No. 115-97 on December 22, 2017). Congress worked quickly to work out the differences between the House and Senate versions of the tax reform, but unfortunately, many of the relief provisions for qualified plans did not make the final cut. It is worth noting that none of these bills included any ''Rothification'' requirements as a ''pay for'' provision (which would generate a sizable amount of funds with its immediate taxation). This mandatory Roth deferral notion was a concern for many, as it would replace the historic §401(k) benefit of pre-tax deferrals.

HOUSE AND SENATE BILLS

The changes for tax-qualified plans (§401(a) and §403(b) plans) are all rather favorable, but there may be other changes that indirectly impact qualified plans, such as elimination of the recharacterization provisions for IRAs (which would track more closely the irrevocable nature of Roth funds within qualified plans and, for example, lose the flexibility to change one's mind and unwind a Roth IRA conversion due to subsequent market decline), the new tax rates for pass-through entities (and the impact on the incentive to continue to maintain tax-qualified plans), and changes in the unrelated business income tax that may not be as well received within the employee benefits community.

Relief for Defined Benefit Plans (House Bill Only)

Relief From Minimum Participant Violations for Closed DB Plans (§401(a)(26))[1]

For years, the employee benefits community has been seeking relief from §401(a)(26) minimum participant requirements for closed (i.e., no new participants) defined benefit (DB) plans. The concern is that these plans will eventually run afoul of these rules, which require participation of at least the lesser of (1) 50 employees, or (2) the greater of (i) 40% of all employees of the employer, or (ii) two employees. The Internal Revenue Service has informally indicated that such relief requires legislative action, which the House bill delivered (§1506), effective as of the date of enactment, with an election to apply to plan years beginning after 2013. Unfortunately, the Senate bill did not contain a conforming provision.

Relief From Benefits, Rights, and Features Nondiscrimination Testing for Closed DB Plans (§401(a)(4))

As with §401(a)(26) relief, the employee benefits community has been seeking broad relief from benefits, rights, and features (BRFs) testing for closed defined benefit plans. For example, grandfathered par-

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[1] All section references are to the Internal Revenue Code of 1986, as amended (Code), and the regulations thereunder, unless otherwise specified.

ticipants are entitled to certain BRFs, such as an early retirement subsidy, for the traditional formula that is not otherwise available outside the closed group. And as time passes, this group tends to become more highly compensated, which raises BRF testing concerns. The House bill (§1506) provided welcome relief in this area, effective as of the date of enactment, with an election to apply to plan years beginning after 2013. This guidance is similar to the relief the IRS issued in its 2016 proposed regulations that have not yet been finalized.

Nondiscrimination Testing Relief for Make-Whole Defined Contributions in Connection with Closed DB Plans (§401(a)(4))

When a plan sponsor freezes or reduces future benefit accruals for closed DB plan participants, the plan sponsor often provides for an additional ''make-whole'' contribution to its defined contribution plan to offset the negative impact to participants. These contributions raise nondiscrimination concerns. The House bill (§1506) provided welcome relief in this area, effective as of the date of enactment, with an election to apply to plan years beginning after 2013. This guidance is similar to the relief the IRS issued in its 2016 proposed regulations and the temporary guidance (e.g., Notice 2017-45 and its predecessors), but without the ''gateway'' restrictions.

Optional In-Service Distributions at Age 59½ (§401(a)(36))

Historically, defined benefit plans did not permit in-service distributions to participants, as the funds are to be used for retirement. With the Pension Protection Act of 2006, Congress added an optional in-service distribution right at age 62 to facilitate phased retirement. Specifically, §401(a)(36), as added by §905(b) of PPA '06, provides that, for plan years beginning after December 31, 2006, a pension plan does not fail to qualify under §401(a) solely because the plan provides that a distribution may be made to an employee who has attained age 62 and who has not separated from employment at the time of the distribution. The House bill (§1502) lowered this age to 59½, effective for plan years beginning after 2017. This lowered age is more in line with §401(k) distributions that are also permitted at age 59½.

Relief for Defined Contribution Plans

Relaxed Rules for Hardship Distributions (§401(k))

In-service distributions from §401(k) and §403(b) plans before a participant reaches age 59½ are rather limited. However, there is an exception for certain hardship distributions.

A number of rules apply to hardship distributions, including the following:

- To meet the safe harbor requirement that the distribution is deemed necessary to satisfy an immediate and heavy financial need, (1) the employee must have obtained all other currently available distributions (including distribution of ESOP dividends, but not hardship distributions) and non-taxable (at the time of the loan) loans, under the plan and all other plans maintained by the employer, and (2) the employee is prohibited, under the terms of the plan or an otherwise legally enforceable agreement, from making elective contributions and employee contributions to the plan and all other plans maintained by the employer for at least 6 months after receipt of the hardship distribution.
- Hardship distributions are not available from the following sources: (A) qualified nonelective contributions (QNECs), (B) qualified matching contributions (QMACs), (C) safe harbor plan contributions, and (D) post-December 31, 1988 earnings.

Effective for plan years beginning after 2017, both the House (§1504) and Senate (§11033) bills eliminated the requirement noted above regarding the need to take available plan loans before a hardship distribution is requested. This was welcome relief for participants, plan sponsors, and recordkeepers, where it was not unforeseen that any loan taken would likely be shortly defaulted in any event as the participant is in financial difficulties and hence the reason for the hardship distribution in the first place. Both bills also expanded the available sources for hardship distributions to include QNECs, QMACs, safe harbor plan contributions, and any earnings on such amounts (including all earnings on elective deferrals). This expansion of the hardship provisions, particularly for safe harbor plans, were viewed as welcome relief for participants in need of access to their retirement funds.

Lastly, the House bill (§1503) also directed the IRS to eliminate the six-month suspension requirement noted above, effective for plan years beginning after 2017. This was also welcome relief as it simplified the hardship provisions and allowed continued participation in retirement savings.

Extended Rollover Period for Loan Offsets

A loan offset amount (unlike a deemed distribution) is eligible for rollover treatment. Therefore, in the

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event that a participant terminates employment and their account balance is offset for an outstanding loan, this amount is eligible for an indirect rollover to another qualified plan or IRA within 60 days to avoid taxation.

Effective for taxable years beginning after 2017, both the House (§1505) and the Senate (§13613) bills extended this 60-day period for certain loans. Generally, for participants with outstanding loan balances at time of their severance from employment or in the event of plan termination, the indirect rollover period was extended until the due date for filing their tax return (plus extensions) for the taxable year in which the loan is treated as distributed.

New 2016 Disaster Relief

Section 7508A (and IRS Announcements thereto) provides the IRS authority to issue certain relief for natural disasters, and Congress also, on occasion, provides additional disaster relief for qualified plans. For example, Congress recently provided relief to victims of hurricanes Harvey, Irma, and Maria, including relief from 10% early withdrawal tax under §72(t), permissible in-service distributions up to $100,000 with special tax relief to spread the taxation over three years, and increase of the loan dollar limit to $100,000 and 100% of the participant's account balance.

The Senate bill (§11029) provided similar relief (but no loan relief) for disaster victims resident in any area with respect to which a major disaster has been declared by the President under §401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act during calendar year 2016. Specifically, effective with the date of enactment, the bill provided the following:

- Section 72(t) relief for withdrawals of a ''qualified 2016 disaster distribution'';
- Relief from mandatory 20% withholding and §402(f) notice as the qualified 2016 disaster distribution is not treated as an eligible rollover distribution;
- Permissible in-service distribution for a qualified 2016 disaster distribution;
- Qualified 2016 disaster distribution taxed over a three-year period; and
- Recontribution of a ''qualified 2016 disaster distribution'' to an eligible retirement plan within three years.

For this purpose, a ''qualified 2016 disaster distribution'' is a distribution of up to $100,000 from a §401(a), §403(b), IRA, or governmental §457(b) on or after January 1, 2016 through December 31, 2017, to an individual whose principal place of abode at any time during 2016 was in a disaster area and sustained an economic loss by reason of events giving rise to a Presidential disaster declaration.

2017 TAX ACT (H.R. 1)

Unfortunately, in H.R. 1, which was signed December 22, 2017, and adopted, for the most part, the conference committee report, all the relief for defined benefits plans noted above did not make the final cut. For defined contribution plans, the only surviving provisions were those relating to (1) extending the rollover period for loan offsets in the event of plan termination or for participants who fail to meet the loan repayment terms because of the participant's severance from employment through the end of the participant's tax filing deadline (plus extensions) for the year of the offset, and (2) disaster relief for storms and flooding across the country in 2016, as described above.

Notably, there is relief for special volunteer public safety programs under §457(e), which doubles the accrual permitted under such plans, and indexes the new $6,000 limit going forward. And conversions to Roth IRAs can no longer be unwound after 2017, which was rather common in the event of losses incurred after conversion.

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