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BENEFITS BRIEF

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Tax Reform Series II: Retirement Plan and IRA Provisions

This summary of the tax bill focuses on the rather limited changes made to pension benefits and IRAs. Unfortunately, a number of the participant-friendly provisions in the House and Senate bills did not survive to the final tax bill, but stay tuned as Congress has pension reform on the front burner, which could give rise to a number of more sweeping changes later this year. A summary of the changes, and next steps for plan sponsors and IRA providers, are summarized below.

The Changes

1. **Extended Rollover Period for Loan Offsets**. A loan offset due to plan termination or default due to termination of employment can be indirectly rolled over to another eligible retirement plan or IRA by the individual's tax filing deadline (including extensions) for the year of the offset.
   - Prior Law – A loan offset amount is generally eligible for rollover treatment, but the rollover must be completed under the standard rollover rules. As such, this amount is eligible for an indirect rollover to another qualified plan or IRA within 60 days to avoid taxation of the outstanding loan balance.
   - What Changed – A loan default due to (1) plan termination, or (2) severance from employment that results in a loan offset, may be indirectly rolled over by the individual's tax filing deadline (plus extensions) for the year of the loan offset.
   - When – Taxable years beginning after 2017.
   - Impacted Plans – Tax-qualified retirement plans, including 401(k), 401(a), 403(b), governmental 457(b) plans that offer loans.

Next Steps:

- Review your loan policy and plan loan provisions to determine if either should be updated to reflect this rule, or consider whether to modify the loan policy to take advantage of this rule (e.g., if your plan allows the continuation of loan repayments following termination of employment, consider eliminating this option, or reconsider if a loan note should be rolled over to a successor plan on plan termination or if this extended rollover period is sufficient to address the outstanding loan). It is unlikely that a plan amendment would be needed to reflect the extended period, and in any event for individually designed plans, no amendment is needed until it is listed on the IRS' Required Amendment List.
- This change is unlikely to impact the timing of loan offsets and reporting and withholding of loan offsets, but gives participants additional time to come up with the additional funds to avoid the adverse tax consequence (i.e., taxation of the outstanding loan balance).

Next Steps (Continued):

- Revise your distribution paperwork and rollover notice (402(f) notice) to reflect this special rollover extension.
- As this is currently effective, discuss with your third party plan administrator the impact of this change. (IRA providers should also update their rollover procedures to accept these loan offsets.)

2. 2016 Disaster Relief. The bill provides for various tax relief for 2016 and 2017 distributions from eligible employer plans and IRAs due to 2016 storms and flooding, similar to (but not as extensive as) the recent Congressional relief for Hurricanes Harvey, Irma, and Maria.

- Prior Law – No special relief was available for 2016 storms.
- What Changed – Distributions made in 2016 and 2017 that constitute a "qualified 2016 disaster distribution" are eligible for the following tax and plan treatment:
  - No 10% early distribution tax under Code section 72(t).
  - Not eligible for rollover treatment, and therefore, plan sponsors should not impose the 20% mandatory withholding or provide the 402(f) notice. (As this provision is retroactive, we anticipate that any withholding imposed will not be changed).
  - Permissible in-service distribution (as this is retroactive relief it is unlikely to have been used).
  - Taxed pro rata over a three-year period.
  - Ability to recontribute the amount to an eligible retirement plan within three years.
  - A plan amendment is required by the end of the 2018 plan year (longer for governmental plans), unless the Secretary indicates a later date, for plan sponsors that make qualified 2016 disaster distributions.

  For this purpose, a "qualified 2016 disaster distribution" is a distribution for disaster victims resident 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 of up to $100,000 from a 401(a), 403(b), IRA or governmental 457(b) plans 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 who sustained an economic loss by reason of events giving rise to a Presidential disaster declaration.
- When – As of the date of enactment (December 22, 2017).
- Impacted Plans – Tax-qualified retirement plans, including 401(k), 401(a), 403(b), governmental 457(b) plans and IRAs.

Next Steps:

- We anticipate the IRS will provide guidance to plan sponsors and participants regarding these special distributions.
- Plan sponsors are not required to offer these distributions, and as the distribution period has expired, it is likely that most plan sponsors will not need a plan amendment, but will still need to develop procedures to implement the recontribution option.

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3. **Restriction on Casualty Loss Deduction**. The bill narrows the casualty loss deduction under Code section 165 to losses attributable to a disaster declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act. This in effect narrows the safe harbor hardship withdrawals on account of damage to an employee's principal residence that would qualify for a casualty deduction.

- Prior Law – The 401(k) regulations list certain expenses as being deemed to be on account of an immediate and heavy financial need, which includes a distribution for expenses for the repair of damage to the employee's principal residence that would qualify for the casualty deduction under section 165 (determined without regard to whether the loss exceeds 10% of adjusted gross income).
- What Changed – The bill requires the casualty loss to be attributable to a disaster declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act.
- When – Taxable years beginning after 2017 through 2025.
- Impacted Plans – Defined contribution plans with safe harbor hardship provisions.

Next Steps:

- Revise your hardship procedures to gather information regarding the president declared disaster for casualty losses for the principal residence (or otherwise discuss with your third party administrator to ensure implementation of this change).

4. **Volunteer Public Safety 457(e) Plan**. The bill doubles the benefit accrual permitted for special volunteer public safety programs under Code section 457(e)(11) from $3,000 to $6,000, and indexed the $6,000 for inflation going forward.

- Prior Law – Volunteer Public Safety plans under Code section 457(e)(11) historically capped annual accruals to $3,000.
- What Changed – The bill replaces the $3,000 cap with a $6,000 cap, which is indexed thereafter.
- When – Taxable years beginning after 2017.
- Impacted Plans – Length of service award plans under Code section 457(e)(11).

Next Steps:

- If you offer these programs, consider increasing the plan's benefits in light of the increased cap of benefits. A plan amendment will be required, which we typically recommend adopting by the end of the plan year in which the change is made.
- If you don't offer such a program for your volunteer public safety workers, reconsider offering such a program to provide a valuable retirement benefit for your workers.

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5. **<u>Recharacterization of Roth Conversions</u>**. The bill eliminates the ability to recharacterize a Roth conversion after 2017.

   - <u>Prior Law</u> – Contributions and conversions to an IRA can be recharacterized to another type of IRA within the individual's tax deadline (plus extensions) for the year of the contribution/reconversion.
   - <u>What Changed</u> – The bill prohibits Roth conversions from being recharacterized after 2017. However, contributions to a traditional IRA can still be recharacterized to a Roth IRA (and vice versa).
   - <u>When</u> – Taxable years beginning after 2017.
   - <u>Impacted Plans</u> – IRAs (including rollover from a qualified plan to an IRA).

<u>Next Steps</u>:

- IRA providers should modify their recharacterization processes to reflect the new limitation on Roth conversions.
- Plan sponsors may consider adding a note to their distribution packages or rollover notice to make clear that a rollover to a Roth IRA cannot be unwound.

6. **<u>New Cost of Living Adjustment Index for IRA Limits</u>**. The bill changes the index used to determine the annual cost of living adjustment on IRA (including Roth IRA) contribution and deduction limits.

   - <u>Prior Law</u> – IRA limits were set by the CPI-U index.
   - <u>What Changed</u> – IRA limits are set by the chained CPI-U index, which is typically viewed as a slower inflation index.
   - <u>When</u> – Taxable years beginning after 2017.
   - <u>Impacted Plans</u> – Traditional and Roth IRAs.

<u>Next Steps</u>:

- IRA providers should update their disclosure statements to reflect the new limits (pending release from IRS).

7. **<u>Fringe Benefit Changes</u>**. The bill makes a number of changes to fringe benefits, regarding either the taxation of such amounts, or the company deduction of these amounts. The details of these changes are set forth in the Tax-Reform Series I: Fringe Benefit and Health & Welfare Provisions write-up.

   - <u>Prior Law</u> – The Code has historically provided favorable tax treatment to certain fringe benefits.
   - <u>What Changed</u> – The bill changed either the employer deductibility of certain fringe benefits or the tax treatment to the employees that will likely result in a fresh look at these programs. For example, moving expenses are now taxable.

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- When – Generally, taxable years beginning after 2017.
- Impacted Plans – All plans.

Next Steps:

- Plan sponsors should review their various definitions of compensation under the plans to ensure the proper pay codes are being counted in compensation.

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