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PENSION ANALYST

Important information – Plan Administration and Operation

Prudential
Bring Your Challenges

Tax reform impacts retirement benefits

Who's affected

This information applies to sponsors of and participants in defined contribution plans (including qualified plans, ERISA and non-ERISA 403(b) plans, and governmental section 457 plans), qualified defined benefit pension plans, and non-qualified deferred compensation plans.

Background and summary

On December 22, 2017, House Resolution 1 (H.R. 1), titled "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018," was signed into law by President Trump. This new law amends the Internal Revenue Code (IRC) to reduce tax rates and modify policies, credits, and deductions for individuals and businesses.

Certain provisions included in H.R. 1 (the Act) impact retirement plans. While earlier versions included numerous provisions impacting retirement plans, many were excluded from the final version signed into law.

Retirement-related provisions included in the Act apply to taxable years beginning after December 31, 2017, unless otherwise noted.

Actions and next steps

Plan sponsors should review the information contained in this publication and the Act to understand the new provisions and potential impacts to their plans.

In this issue

Impact of new provisions on retirement benefits

The Act includes provisions that have an impact on retirement plans and participants. Below is a summary of these provisions.

Repeal of special rule permitting recharacterization of Roth conversions

Effective for taxable years beginning after December 31, 2017, recharacterization of a qualified rollover contribution from a non-Roth account to a Roth IRA is no longer permitted. This includes the rollover of non-Roth contributions made to an IRA, qualified defined contribution plan, ERISA or non-ERISA 403(b) plan, or governmental section 457 plan.

Contributions made to a Roth IRA may still be recharacterized as contributions to a traditional IRA. Additionally, contributions made to a traditional IRA may be recharacterized as contributions to a Roth IRA. However, recharacterizing traditional IRA contributions to Roth IRA contributions is only available to individuals who are eligible to contribute to a Roth IRA in that year.

Conversions from a traditional IRA to a Roth IRA are still permitted, but they may no longer be recharacterized at a later date following the conversion.

Extended rollover period for plan loan offset amounts

Retirement plan loans may be offset against a participant's account for a variety of reasons, including when a participant terminates employment or the plan terminates. When the loan is offset, the participant is taxed on the amount of the outstanding loan balance, unless the participant rolls over the offset amount to an IRA or another qualified plan within 60 days. Under the Act, when the loan offset is caused by termination of employment or plan termination, the period to roll over a qualified plan loan offset amount is being extended from 60 days to the individual's tax return filing due date (including extensions) for the taxable year in which the offset amount is treated as a distribution from a qualified plan.

This new provision applies to loan offset amounts that are treated as distributed in taxable years beginning after December 31, 2017.

Relief for 2016 disaster areas

Following Hurricanes Katrina, Wilma, and Rita in 2005, and Hurricanes Harvey, Irma, and Maria in 2017, Congress provided special relief with respect to loans and distributions from retirement plans for participants directly affected by these disasters. The Act provides similar relief for qualified distributions from an eligible retirement plan with respect to designated disaster areas in 2016. Relief includes tax-favored withdrawals, which are exempt from the 10% early distribution tax and 20% mandatory federal income tax withholding, may be repaid to an eligible retirement plan within a three-year period beginning on the day after the distribution was received, and may be included in gross income ratably over a three-year period. Unlike prior relief, the Act does not include increased loan limits or a delay in loan repayment rules. Additionally, the Act does not permit the repayment of distributions taken to purchase or build a home that was in a hurricane disaster area.

Qualified distributions may not exceed $100,000 and must be made on or after January 1, 2016 and before January 1, 2018. An individual whose principal residence was located in a presidentially declared disaster area and sustained an economic loss related to the disaster is eligible for this special relief.

Modification of individual income tax rates

The reduction in income tax rates for individuals may impact withholding on future benefit payments. The Internal Revenue Service (IRS) recently released updated income tax withholding tables based on the new rates for 2018. According to the IRS website, the new tables should be implemented as soon as possible, but no later than February 15, 2018. The IRS indicates that the existing 2017 withholding tables and systems should continue to be used until the 2018 tables are implemented.

In addition, the reduction in the highest individual income tax rate from 39.6% to 37% impacts the supplemental wage withholding rate applicable to certain non-qualified deferred compensation plan distributions.

Other provisions

The following provisions, also included in the Act, may also be of interest to plan sponsors.

- *Modification of rules applicable to length of service award plans.* Increases the annual maximum deferral amount from $3000 to $6000 with a cost of living adjustment beginning after December 31, 2017; provides clarification related to calculations for length of service awards for defined benefit plans.
- *Modification of IRC 162(m) $1 million deduction limitation on public company remuneration.* Expands the categories of public companies subject to the deduction limitation; removes the exemption for performance-based compensation and commissions; modifies the definition of covered employee and provides that once an executive is a covered employee, the executive will continue to be considered a covered employee, even after that individual is no longer a member of the covered group. Limited grandfathering is provided for compensation paid under written contracts in effect as of November 2, 2017 that are not materially modified. These modifications may result in limiting the deductibility of certain non-qualified plan distributions.
- *Excise tax on tax-exempt organization executive compensation in excess of $1 million.* Imposes an excise tax of 21% on the tax-exempt organization for remuneration in excess of $1 million and also applies to any excess parachute payment paid to any covered employee (top five highest paid executives). Once an executive is a covered employee, the executive will continue to be considered a covered employee, even if that individual is no longer a member of the covered group. Application of tax is based on W-2 wages, including amounts that vest under a IRC 457(f) non-qualified plan even if not yet payable; certain limited exceptions apply (e.g., compensation paid to a licensed medical professional for performance of medical or veterinary services and designated Roth contributions).
- *Changes regarding reporting of unrelated business taxable income (UBTI).* Requires tax-exempt entities that are subject to tax on their UBTI to segregate taxable income and loss for each unrelated trade or business activity for purposes for purposes of determining their UBTI.

Plan sponsor next steps

Plan sponsors should review these new provisions and consult with the plan's legal counsel to understand the impacts on their plans. Prudential Retirement will continue to monitor guidance by federal agencies clarifying the provisions of this law. We will keep you informed as additional guidance is issued.

Pension Analyst by Prudential Retirement
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