Recent Tax Acts Impacting Retirement Plans

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2/15/2018

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Over the past couple of months, there have been two tax acts signed into law that contain provisions related to retirement plans.

The ***Tax Cuts and Jobs Act***, signed on December 22, 2017, included the following changes to retirement plan administration:

1. Beginning with distributions occurring on or after January 1, 2018, employees will have until the due date of their tax return (including extensions) to roll over a loan that has been offset. What does this mean? Under old law, when a participant terminated with a loan outstanding and took a distribution without first repaying the loan, the plan would reduce (or offset) the value of the participant's account by the outstanding loan and only distribute the net difference. The entire distribution, including the value of the loan offset, was taxable. If the participant wanted to roll over the account to avoid paying taxes, he could roll over the net cash payment and he then had 60 days to come up with additional funds equal to the outstanding loan amount and make an equivalent contribution to the rollover custodian of the loan value. Under the new law, the 60-day deadline for contributing the loan offset amount has been extended to the filing due date (including extensions) for the participant's tax return for the year in which the loan offset arises.

   Note that this change only applies to loans that are being distributed. If a loan goes into default because no loan payment has been made within the default cure period (usually the end of the quarter that begins after the quarter in which the default arises), then the loan will be treated as a taxable distribution to the participant. The Tax Act provision described above does not change this treatment.

2. For tax years beginning after December 31, 2017, taxpayers are no longer allowed to reclassify a Roth conversion. Under old law, individuals were allowed to convert a pre-tax account to a Roth account and pay taxes at the time of the conversion. If the individual later changed his mind, he had until October 15th of the year following the conversion to "undo" the conversion. Under the new law, the individual may no longer change his mind about this decision. If he transfers money from a traditional IRA to a Roth IRA or from a pre-tax contribution source in a 401(k), 403(b) or 457 retirement plan to a Roth IRA, he will not be allowed to "undo" that transaction.

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3. Special relief has been provided for participants in designated disaster areas in 2016. Any individual whose principal residence was located in an area that was declared a federal disaster area and who sustained an economic loss related to the disaster may make a retirement plan or IRA withdrawal which is exempt from the 10% early withdrawal penalty and the 20% mandatory federal tax withholding. In addition, such persons may repay the plan over a 3-year period or may choose to pay the associated taxes ratably over a 3-year period. Distributions may not exceed $100,000 and must have been taken prior to January 1, 2018.

4. Under current law, there are six safe harbor reasons for which an employee may request a hardship withdrawal. One of those is expenses for the repair of damage to the employee's principal residence *that would qualify for the casualty deduction under §165 of the Internal Revenue Code* – generally damage to the residence on account of storms or fire. Under the new Tax Act, §165 of the Internal Revenue Code has been modified so that it only pertains to personal casualty losses if the loss is attributable to a federal disaster under the Disaster Relief and Emergency Assistance Act. By changing the definition of a personal casualty loss in the tax code, the plan definition of hardship withdrawals for storm damage (which typically references the tax code) is now limited to storms in areas that are declared federal disaster areas.

The ***Bipartisan Budget Act of 2018*** contains changes to the ways in which hardship withdrawals from qualified retirement plans are administered. All of the below changes are effective for plan years beginning after December 31, 2018. Specifically:

1. Employees who take a hardship withdrawal from the plan will no longer be subject to the 6-month prohibition on contributions. What about employees who take a hardship withdrawal at the end of 2018? Will they only be suspended through December 31, 2018, and then have the suspension dropped as of January 1, 2019? The language in the Act is not clear, but presumably they would still be subject to the full suspension, as they took the withdrawal during 2018, with the understanding that they would be subject to a suspension. It appears to me that only hardships that are initiated after 12/31/18 (for a calendar year plan) can avoid the suspension. But hopefully, we will be given clarification on this point before the end of 2018.

2. The Internal Revenue Code is amended to allow that not only can employees take a hardship from their employee deferrals to a 401(k) or 403(b) plan, but they can also withdraw the earnings from those accounts. Under current rules, employees are only allowed to withdraw their accumulated contributions, not the earnings on the account.

3. Qualified Matching Contributions (QMACs) and Qualified Nonelective Contributions (QNECs), as well as earnings on those accounts, may be distributed on account of hardship.

4. The requirement that the employee must first obtain all nontaxable loans available under the plan (and any other plans maintained by the employer) before requesting a hardship withdrawal has been removed.

In addition, the Budget Act permits special considerations for individuals whose principal residence was in the California wildfire disaster area and who sustained an economic loss due to the wildfires. For the period October 8, 2017 until December 31, 2018, such individuals can take a distribution of up to $100,000 that is not subject to the 10% early withdrawal penalty. The distribution can be recontributed within a 3-year period or included in income ratably over a 3-year period. If a person in the wildfire disaster area took a distribution to purchase a home, that distribution may be repaid to the plan if the home purchase was cancelled because of the fires. Finally, such individuals may be allowed a plan loan of up to $100,000 with an extended repayment period.

If you have questions on any of the above provisions, please contact your RMS Account Executive to discuss. Some of these changes will require plan amendments to take advantage of them, although in some cases the plan may be administered immediately in accordance with the new laws, and then amended retroactively at a later date to reflect the change. We expect our plan document will be amended later this year to incorporate these tax law changes.