RECENT LEGISLATIVE AND REGULATORY CHANGES TO RETIREMENT PLANS

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Agenda

- Tax Cuts and Jobs Act of 2017
- Bipartisan Budget Act of 2018
- Other significant changes

Hardship Distributions

Section 401(k), allowing participant contributions either on a before-tax or Roth after-tax basis, imposes significant restrictions on when those Elective Deferrals can be distributed

Hardship Distributions

Specifically, Elective Deferrals, along with their attributable earnings, may not be distributed earlier than the earliest of:

1. the participant's severance from employment, death, or disability;
2. the termination of the plan without the establishment of another "alternative defined contribution plan";

Hardship Distributions (cont.)

3. the attainment of age 59 ½ in the case of a profit sharing or stock bonus plan, or
4. (iv) in the case of a profit sharing or stock bonus plan, on account of a hardship

Hardship Distributions

A Section 401(k) or 403(b) plan may also be drafted to allow distributions of Elective Deferrals to those called up to active duty in the reserves or National Guard for at least 179 days

Hardship Distributions

- Prior Law:
  - Distribution limited to Elective Deferrals and any pre-1989 earnings
  - For current participants, this effectively meant that a hardship distribution was limited to the participant's own contributions

Hardship Distributions

- While prior law effectively limited hardship distributions to a participant's own Elective Deferrals, Section 401(k) Plans often include other contributions including:
  - Employer Matching Contributions;
  - Special ER Match known as Qualified Matching Contributions, and/or
  - Special ER contributions known as Qualified Nonelective Contributions

Hardship Distributions

- QMACs (qualified matching contributions) are special ER matching contributions that can be counted in special nondiscrimination tests
- QNEC (qualified nonelective contributions) are special ER non-matching contributions that can also be counted in special nondiscrimination tests

Hardship Distributions

- Both QMACs and QNECs:
  - Subject to the same distribution restrictions that apply to Elective Deferrals;
  - Must be fully and 100% vested

Hardship Distributions

- Under the Tax Cuts and Jobs Act, a 401(k) Plan may be amended to expand the types of contributions eligible to be included in a hardship distribution to include any or all of the following:

Hardship Distributions

1. QMACs
2. QNECs
3. Earnings on all such contributions including pre-1989 earnings on Elective Deferrals

Hardship Distributions

- Impact of Change—Plans may be amended to allow hardship distributions to include any combination of the following for Plan Years beginning after 12/31/2018:
  1. Elective Deferrals
  2. QMACs
  3. QNECs
  4. Earnings on all such contributions

Hardship Distributions

- Note—Currently all plans are drafted to limit hardship distributions to Elective Deferrals
- This means that a plan may not include other contributions unless properly amended before the distribution

Hardship Distribution

- Unanswered Questions:
  - Would a plan be able to restrict distributions to now include employer contributions only (i.e., QMACs or QNECs) or specify the order of distribution?
  - Can a plan be drafted to allow participants to select from which subaccount a hardship distribution is to be made?

Hardship Distribution

- Unanswered Questions:
  - Not clear although any approach that would not first require the employee to take Elective Deferrals might be viewed as contrary to the basic approach of the statute

Hardship Distribution

- Action to be taken:
  - Any plan that wants to expand the category of contributions and/or earnings available for hardship withdrawal will need to be amended before allowing
  - The change will also require a change to the Plan's Summary Plan Description and administrative forms

Hardship Distributions—Safe Harbor Permissible Reasons

- Two basic requirements to satisfy hardship requirement:

1. Distribution must be made on account of an immediate and heavy financial need
2. Subject to gross up for taxes, the amount to be withdrawn must be no more than the amount necessary to satisfy the financial need.

Hardship Distributions-Safe Harbor Permissible Reasons

- Under the "deemed immediate and heavy financial need" safe harbor, a distribution is deemed to satisfy if:

1. for (or necessary to obtain) Section 213(d) medical care (determined without regard to whether the expenses exceed the threshold percentage of adjusted gross income to be deductible);
2. costs directly related to the purchase of a principal residence for the employee (excluding mortgage payments);

Hardship Distributions—Safe Harbor Permissible Reasons

3. tuition, related educational fees, and room and board expenses, for up to the next 12 months of post-secondary education;
4. payments necessary to prevent the eviction of the employee from the employee's principal residence or foreclosure on the mortgage on that residence;

Hardship Distributions—Safe Harbor Permissible Reasons

5. burial or funeral expenses for the employee's deceased parent, spouse, children or dependents; or
6. 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)

Hardship Distributions—Safe Harbor Permissible Reasons

- Note that the deemed safe harbor for uninsured medical expenses and payment for post-secondary schools include, not only the employee's own expenses but those of his/her dependents as well

Hardship Distributions—Safe Harbor Permissible Reasons

- The Tax Act amended the casualty deduction rules of Section 165 so that:
  - For tax years 2018-2025
  - Casualty deductions for damage to a home is only available with respect to losses attributable to a Federally-declared disaster

Hardship Distributions—Safe Harbor Permissible Reasons

Unanswered Questions:

Does the requirement for a Federally-declared disaster also apply to hardship withdrawals?

Will IRS treat the Federally-declared disaster requirement the same way as the adjusted gross income threshold for uninsured medical and thus ignore other restrictions that might prohibit a deduction?

Hardship Distributions—Safe Harbor Permissible Reasons

Action to be taken:

Plans should prohibit hardship withdrawals due to casualty loss unless and until IRS clarifies

Plans may also need to revise administrative forms and summary plan descriptions

Hardship Distributions—Safe Harbor Permissible Reasons

- Again remember the two basic requirements to satisfy hardship:

1. Distribution must be made on account of an immediate and heavy financial need
2. Subject to gross up for taxes, the amount to be withdrawn must be no more than the amount necessary to satisfy the financial need.

Hardship Distributions—Necessary to Satisfy the Need

- Under the second requirement, a distribution is not considered necessary to satisfy an immediate and heavy need if the employee has available adequate other resources including assets of the employee's spouse and in some instance, minor children

Hardship Distributions—Necessary to Satisfy the Need

- This requirement can be met either by:
  - Employee written representation, or
  - Satisfaction of the Safe harbor

Hardship Distributions—Necessary to Satisfy the Need

- The Safe Harbor is satisfied under Prior law if:

1. the employee has obtained all other currently available distributions and loans under the plan and under all other plans maintained by the employer, other than hardship distributions; and

Hardship Distributions—Necessary to Satisfy the Need

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—Necessary to Satisfy the Need

- The Budget Act directs the IRS to amend its regulations to remove the 6-month restriction on resuming Elective Deferrals following a hardship distribution

Hardship Distributions—Necessary to Satisfy the Need

- IRS is directed to revise its regulations to apply to Plan Years beginning after December 31, 2018

Hardship Distributions—Necessary to Satisfy the Need

- Plans will need to wait to see how the IRS responds to this directive
- IRS could simply remove any restriction or interpret the directive to simply reduce the 6-month period to some lesser period

Hardship Distributions—Necessary to Satisfy the Need

- Unanswered Questions:
- What should a Plan do where a participant takes a hardship distribution at a time the 6-month restriction applies but the restriction period bleeds into a new plan year that is subject to the new rule?

Hardship Distributions—Necessary to Satisfy the Need

- Action to be taken

  When the regulations are revised, Plans relying upon the safe harbor will need to be amended to reflect the change

  The change must also be reflected in the Plan's Summary Plan Description

Hardship Distributions—Necessary to Satisfy the Need

- Remember that the first requirement of this Safe Harbor is satisfied under Prior law if:

1. the employee has obtained all other currently available distributions and loans under the plan and under all other plans maintained by the employer, other than hardship distributions

Hardship Distributions—Necessary to Satisfy the Need

- The Budget Act removes the requirement that a participant first take all nontaxable loans
- Employees must still first take all other available distributions
- This change applies for Plan Years beginning after December 31, 2018

Hardship Distributions—Summary of Changes

- Plans may be amended to allow earnings, QMACs and QNECs to be distributed along with Elective Deferrals
- Hardship withdrawals for home casualty loss may be limited to only where there is a Federally-declared disaster
- Six month restriction on Elective Deferrals following a hardship is to be removed
- Participants won't need to take loans before applying for a hardship

Participant Loans

- When a participant terminates employment with an outstanding loan, most Plan terms generally provide that the outstanding loan is accelerated
- If the participant cannot then repay the entire balance, the participant's loan is offset against his/her account

Participant Loans

- A terminating participant whose loan was otherwise in good standing may then still avoid taxation by using other funds to replace the offset and rolling over
- Under prior law, the rollover would have to have been done within 60 days

Participant Loans

- The Tax Act extends the rollover period from 60 days to the due date, including extensions, for filing the participant's tax return for the taxable year in which the loan offset occurs

Participant Loans

- This extended rollover period applies to plan offset amounts which are treated as distributed in taxable years beginning after December 31, 2017

Participant Loans

- This extended rollover period applies only in the cases of a loan outstanding when:

1. a participant terminates employment or
2. the plan terminates

Participant Loans

- Note that this will not impact situations where a participant who remains employed defaults on a loan or in any other situation other than participant termination of employment or plan termination

Participant Loans

- This change may or may not require an amendment to the plan
- But will require a modification to the Plan's Section 402(f) Notice, i.e., Rollover Notice
- It may also require a change to the Plan's administrative loan documents

IRA Recharacterization Rules

- Taxpayers with adjusted gross incomes above the indexed amounts are precluded from making contributions directly to a Roth IRA
- However, such taxpayers can make contributions to a traditional IRA and convert the traditional IRA to a Roth IRA
- The conversion is accomplished via a trustee-to-trustee transfer or by use of the 60-day rollover option with, in either case, the taxable amount converted includible in the taxpayer's income.

IRA Recharacterization Rules

- Similar rules allow other pre-tax amounts from certain tax-favored employer sponsored plans to also be converted to a Roth IRA
- Again, this requires that the taxable amount converted be included in the taxpayer's income

IRA Recharacterization Rules

- Under Prior law, if a taxpayer makes a contribution to an IRA (traditional or Roth) for a taxable year, the individual is permitted to recharacterize the contribution as a contribution to the other type of IRA before the due date for the individual's income tax return for that year including extensions

IRA Recharacterization Rules

- The Tax Act removes the ability to unwind a Roth conversion
- Under the Tax Act, the rules allowing a contribution to one type of IRA to be recharacterized as a contribution to the other type of IRA will no longer apply to a conversion contribution to a Roth IRA

IRA Recharacterization Rules

- Recharacterization is still permitted with respect to other contributions
- For example, an individual may make a contribution for a year to a Roth IRA and, before the due date for the individual's income tax return for that year, recharacterize it as a contribution to a traditional IRA
- An individual may also still make a contribution to a traditional IRA and convert the traditional IRA to a Roth IRA

IRA Recharacterization Rules

- However, this provision would then preclude the individual from later unwinding the conversion through a recharacterization.

[See Joint Committee on Taxation Explanation of Tax Cuts and Jobs Act of 2017, Section E]

IRA Recharacterization Rules

- This change is effective for taxable years beginning after December 31, 2017
- This means, however, that Roth IRA conversions made in 2017 may still be recharacterized if done by October 15, 2018
- A Roth IRA conversion made in 2018, however, cannot be recharacterized

IRA Recharacterization Rules

- This change applies with respect to conversions from a traditional IRA, SEP or SIMPLE to a Roth IRA as well as from Section 401(k)s and 403(b)s

[IRS IRA FAQs—Recharacterization of Roth Rollovers and Conversions]

IRS Levies

- Subject to certain specified exceptions, both ERISA and the Code prohibit the alienation or assignment of assets of covered plans
- One of the exceptions is for a Federal tax levy made pursuant to Section 6331 as well as for the collection by the United States on a judgment resulting from an unpaid tax assessment

IRS Levies

- Courts have generally broadened this exception to cover other payments due to the Federal and State government such as criminal fines and penalties as well as in some instances, for restitution

[See, e.g., Private letter Ruling 200426027 (June 25, 2004); United States v. Tyson, 265 F. Supp. 2d 788 (ED Mich. 2003)]

IRS Levies

- If a participant's retirement assets become subject to an incorrectly imposed levy, it may be beyond the 60-day rollover period when the IRS releases the funds
- The Budget Act attempts to provide relief in such situations

IRS Levies

- Specifically, the Budget Act provides that a taxpayer in such case will have until the due date (not including extensions) for filing the return for the taxable year in which the property or money is returned to contribute such amounts (plus any interest paid) into an eligible retirement plan

Regulatory Changes

- In addition to the changes made legislatively by the Tax Cuts and Jobs Act and the Bipartisan Budget Act, the IRS has also made some changes by regulation and through other guidance of significance

Rollovers Between IRAs

- If Indirect rollover, only 1 can be made in a 12 month period
- This limitation applies to Traditional, Roth to Roth, SIMPLEs and SEPs

Rollovers Between IRAs

- If Indirect rollover, individual must make a rollover contribution to the new account by the 60th day after the day the individual received the distribution

Rollovers Between IRAs

- Historically, the IRS applied the 1 rollover per year rule on an IRA by IRA basis
- The Tax Court ruled this interpretation incorrect [Bobrow v. Commissioner, T.C. Memo 2014-21]

Rollovers Between IRAs

- IRS Historical Interpretation

EX: Lee has traditional IRAs 1 and 2. Lee rolls (60 day rollover) from IRA 1 into new IRA 3. Lee cannot, within 1 year of the IRA 1 distribution, make another tax-free rollover from either 1 or 3.

Lee could, however, make a tax-free rollover from IRA 2

Rollovers Between IRAs

- Post-Bobrow, an indirect rollover from any IRA precludes any other 60-day rollover during the 1 year period beginning on the date the individual receives the IRA distribution
- That is, the 1 rollover per year rule is now applied on an aggregate individual basis

Rollovers Between IRAs

This means that, subject to a transition rule, on or after January 1, 2015, no portion can be rolled in an indirect rollover into an IRA if a distribution was received from any IRA in the preceding one-year period that was rolled over in an indirect rollover into an IRA

Tax-Deferred Rollover Option

- Rollovers can be direct–directly from transferor to transferee plan, or

- Indirect–participant receives and then has 60 days to rollover (60 day option)

Tax-Deferred Rollover Option

- Indirect Rollovers—IRS may waive 60-day requirement for:
  1. Casualty
  2. Disaster
  3. Other events beyond taxpayer's reasonable control

Failed 60-Day Requirement

- IRS now allows a written Self-Certification of waiver by a taxpayer to the receiving plan of the 60-day requirement [see sample in Rev. Proc. 2016-47]
- Self-Certification allows the receiving plan to accept even though beyond the 60-day period

Failed 60-Day Requirement

- Self-Certification requires:

1. No prior IRS denial of waiver request
2. Reason for failure must be one listed as acceptable, and
3. Rollover must be completed as soon as practicable following end of event (safe harbor if made within 30 days after)

Failed 60-Day Requirement

- Acceptable Reasons are:

1. Error by financial institution;
2. Check was misplaced and not cashed;
3. Mistakenly deposited into an account that turned out not to be an eligible retirement plan;

Failed 60-Day Requirement

- Acceptable Reasons are:

4. Principal residence severely damaged;
5. Family member died;
6. Taxpayer or family member seriously ill;
7. Taxpayer was incarcerated;
8. Restrictions imposed by foreign country;

Failed 60-Day Requirement

- Acceptable Reasons are:

9. Postal error;
10. Distribution due to tax levy and the proceeds are then returned; or
11. Distributing party failed to timely provide necessary information to receiving plan despite taxpayer's reasonable efforts

Failed 60-Day Requirement

- Taxpayer must keep documents on file in case of audit
- If IRS disagrees on audit, the IRS can impose penalties and include additional amounts in income

DOL Regulatory Change of Note

- Historically, the Department of Labor has taken the position that in order for multiple unrelated employers to sponsor a plan that can be treated as a single plan for purposes of ERISA, the unrelated employers must share some sort of common bond or nexus other than just the desire to co-sponsor a retirement or health plan

DOL Regulatory Change of Note

- Historically, the Department of Labor, however, has found few instances where the necessary bond exist

DOL Regulatory Change of Note

- On October 12, 2017, President Trump issued Executive Order 13813, “Promoting Healthcare Choice and Competition Across the United States” directing the Secretary of Labor to consider issuing regulations or revising guidance that would permit more employers to form association health plans (AHPs)

DOL Regulatory Change of Note

- The Executive Order specifically directed the Secretary to consider expanding the conditions that satisfy the commonality of interest requirements and also to consider ways to promote AHP formation on the basis of common geography or industry

DOL Regulatory Change of Note

- In response, the DOL has issued final regulations that provide an alternative means by which multiple unrelated employers can satisfy the commonality of interest requirements in order to be able to maintain a health plan that can be treated as a single employer plan although maintained by multiple unrelated employers

DOL Regulatory Change of Note

- In theory, this would allow small employers to form association plans that have the healthcare purchasing power of larger employers

DOL Regulatory Change of Note

- Not, however, the new regulations do not replace or amend existing law regarding the ability of states to regulate health plans maintained by multiple unrelated employers

DOL Regulatory Change of Note

- Specifically, fully insured association health plans can be fully regulated by states
- Self-funded association plans may be regulated by a state on a more restricted basis so long as the law is not inconsistent with ERISA

DOL Regulatory Change of Note

- Some states already have laws that substantially restrict the maintenance of MEWAs (multiple employer welfare plans) in the state
- Note that laws may also apply to related but not controlled group entities maintaining a single plan