INSIDE retirement

Second Quarter 2017

RETIREMENT PLAN NEWS

LEGISLATIVE UPDATE

Tax Reform Proposals

Despite several pressing issues under consideration on Capitol Hill, the tax reform debate is a priority for both the President and Republicans in Congress. Proposals are being discussed in key committees, including the House Ways and Means Committee and the Senate Finance Committee.

The tax code is a complex body of law, and there are many competing ideas on how the laws should be changed. Some members of Congress want to see tax cuts offset by revenue, generating provisions to avoid significantly increasing the federal deficit. Considering that $82 billion in potential tax revenue each year is deferred into retirement savings,[1] it's no surprise that reducing retirement savings tax benefits has been suggested as a potential revenue generator in some proposals. Others in Congress are less concerned about offsetting the tax cuts if it results in simplifying the tax code. Many of the proposed changes being discussed are found in the President's 2018 budget proposal and the House Republican's tax reform blueprint, as well as other legislative proposals.

The President's 2018 fiscal year budget proposal aims to simplify the tax code and provide tax relief to boost economic growth and investment. This includes reducing and replacing the current

individual income tax rates with three brackets – at 10%, 25% and 35%. The standard deduction would be increased and all itemized deductions would be eliminated, except for the mortgage interest and charitable contribution deductions. The Alternative Minimum Tax and the estate tax would also be eliminated. The corporate tax rate would be reduced to 15% as would the pass-through income rate. The budget proposal does retain the existing retirement plan tax benefits, however.

Previous tax reform proposals, including the Republican blueprint, had provisions similar to those included in the Administration's budget proposal—although the details vary slightly. As for changes that would directly affect retirement plans, however, there is less consensus.

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For example, the House blueprint would create a more “general retirement savings plan” by consolidating different types of deferral plans such as 401(k) plans, 403(b) plans, and governmental 457(b) plans. It would also create a new savings arrangement called the Universal Savings Account. These accounts would be funded by individuals with after-tax contributions up to $5,500 a year. Unlike regular savings accounts, the earnings would grow tax-deferred. All distributions would be tax-free and could be taken at any time. Other tax reform proposals would target retirement savings tax benefits by:

- Freezing contribution limits at the current levels for 10 years
- Requiring 401(k) deferrals above a certain amount to be treated as after-tax Roth contributions
- Eliminating the tax deduction for contributing to a traditional IRA

[1] Center for Retirement Research at Boston College, “Do Tax Incentives Increase 401(k) Retirement Savings? Evidence From the Adoption of Catch-Up Contributions,” July 2016

Proposed Legislation

Two bills affecting retirement plans were introduced in Congress this year:

The **Lifetime Income Disclosure Act** would require retirement plan sponsors to provide participants with an annual statement showing how much their plan account balance would pay each month in a lifetime income stream. The Department of Labor would be required to provide tables and assumptions that plan sponsors could use to calculate the annuity.

The **SEAL Act,** titled the Savings Enhancement by Alleviating Leakage in 401(k) Savings Act in the House and the Shrinking Emergency Account Losses Act in the Senate, addresses plan leakage issues. Together, these bills would:

- Extend the rollover period for unpaid participant loans
- Eliminate the six-month suspension of deferrals after a hardship distribution
- Ban 401(k) credit card loans (Senate bill)

Passed Legislation

Two other pieces of legislation have been passed and signed by the President to become law during second quarter. **H.J. Resolutions 66 and 67** block DOL regulations issued last year that described how states and large cities could design and operate mandatory state-based payroll deduction savings programs, without causing the plans or employers to become subject to ERISA. These types of plans are sometimes referred to as “auto IRA” plans.

Some members of Congress were concerned that the DOL safe harbor from ERISA reduced protection for participants and plan assets and created a confusing mix of federal and state rules for the retirement plan industry. This law change does not appear to have stopped some states from moving forward with their mandatory retirement plan initiatives.

IRS UPDATE

New Interpretation on Plan Loan Amounts

The IRS recently issued an Internal Memorandum to IRS employees who conduct retirement plan examinations. The Memorandum provides an alternate method for calculating the maximum

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loan amount available to a plan participant who has taken multiple plan loans in the past year. Generally, the maximum loan available to a participant is one-half the value of the participant's account or $50,000, whichever amount is smaller. If the initial loan was less than $50,000, and the plan permits multiple loans, the participant may take another loan if the total amount borrowed is not more than $50,000 in one year (or half of their balance). To calculate the amount available for the new loan, the $50,000 limit must be reduced by the difference between:

- The highest outstanding balance of the participant's loans during the 12-month period ending the day before the new loan is taken and
- The outstanding balance of the participant's loans on the date of the new loan.

The IRS memorandum states that a plan may interpret this limit in one of two ways. For example:

Assume that Jane, a 401(k) plan participant, borrows $30,000 in February 2017 and fully repays the loan by April 2017. Jane then takes another loan in May 2017 for $20,000. Jane repays that loan in July 2017. Jane applies for a third loan in December 2017.

The plan administrator has two methods for determining the amount available for a new loan.

1. $0.00 would be available since the highest outstanding loan balance in the past 12 months = $50,000 ($30,000 + $20,000)
2. $20,000 would be available since the highest outstanding loan balance in the past 12 months = $30,000

Mid-Year Testing Projections

To meet the tax qualification requirements in the Internal Revenue Code, a 401(k) plan must be tested each year to ensure that it is not disproportionately benefitting or discriminating in favor of highly compensated employees (HCEs). Two tests are used in 401(k) plans to compare the benefits received by HCEs and non-HCEs: the Actual Deferral Percentage (ADP) test and the Actual Contribution Percentage (ACP) test.

These tests are conducted after the end of each plan year. If these tests are failed, plan sponsors will need to correct the failure, generally by making additional contributions on behalf of lower paid employees or by requiring highly paid employees to take a distribution of a portion of that year's salary deferrals.

A proactive check-up mid-year can prevent the unexpected costs of failed testing at year end. Most third party administrators (TPAs) or recordkeepers provide mid-year testing projections to help plan sponsors assess if their plan is on track to pass testing at the end of the year.

If the plan passes the mid-year testing projections, the plan is likely on track to pass the tests at year-end. Plan sponsors may want to evaluate whether any anticipated changes in plan demographics for the coming year may impact future testing results and spot-check the data provided to the plan's TPA and recordkeeper to ensure that the test results are accurate.

If the plan receives poor mid-year testing projections, plan sponsors may want to work with their service providers to take steps that may improve testing results by the end of the year,

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such as limiting HCE deferrals. Future years' testing results may be improved through actions such as

- Enhancing participant education to increase participation and savings rates
- Amending plan features to include automatic enrollment or the 401(k) safe harbor design

TPAs and other plan design specialists can illustrate how these features may impact a plan's future testing results and can project the potential costs in terms of plan contributions or administrative expenses.

Upcoming Compliance Deadline for Calendar-Year Plans – Filing Form 5500

In the coming weeks, service providers will be preparing to complete the annual information return, Form 5500, *Annual Return/Report of Employee Benefit Plan,* and related schedules, for retirement plans subject to ERISA. Most plans are required to file Form 5500 with the DOL by the last day of the seventh month following the end of the plan year. For example, a plan that operates on a calendar-year basis must file Form 5500 by July 31, unless an extension has been obtained.

Plans must also file Form 8955-SSA, *Annual Registration Statement Identifying Separated Participants With Deferred Vested Benefits*, if there are terminated participants with a vested deferred benefit from the plan. If a plan has 100 or more participants, an independent qualified plan audit (IQPA) must also be obtained and filed with Form 5500.

If more time is needed to prepare the Form 5500 and related schedules and forms, a 2½ month extension is available—which falls on October 15 for calendar-year plans. An extension can be obtained by filing Form 5558, *Application of Extension of Time to File Certain Employee Plan Returns,* by the original due date for filing Form 5500 or Form 8955-SSA. Alternatively, if an extension is obtained for the business's federal income tax return, an extension for the Form 5500 is automatic, without filing Form 5558. To be eligible for this extension, the plan year and the business tax year must be the same, and the business must have an extension of time to file its federal income tax return to a date later than the normal due date for filing Form 5500.

This information is provided as a reference tool for your convenience and may not represent a complete list of all events that apply to your plan.

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