Special bulletin: Legislative and regulatory update

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How the House tax reform bill would impact retirement plans

On November 2, the House Ways and Means Committee released a draft of a comprehensive tax reform bill titled the Tax Cuts and Jobs Act. If enacted as proposed, the legislation would make sweeping changes throughout the tax code, including a few changes that would affect retirement plans.

Mandatory "Rothification" appears to be off the table—at least for now. Before the proposal was made public, it was widely speculated that Congress would cap employee pre-tax contributions to 401(k)s and other defined contribution (DC) plans at $2,400. Under that scenario, any employee plan contributions above that cap would be made with after-tax dollars into a Roth account—a change that would have raised significant tax revenue to help offset the bill's tax cuts. While so-called Rothification is not happening now, some observers speculate it could resurface before the tax reform bill becomes law.

Here is a summary of the proposed bill's retirement plan provisions vs. current law:

Elimination of IRA "re-characterization"

Today: An individual can contribute to an IRA (traditional or a Roth) for a year and then re-characterize that contribution as a contribution to the other type of IRA by transferring it to the other type of IRA by his or her tax return due date.

Proposed: This re-characterization would no longer be permitted, effective for tax years beginning after 2017.

Reduction of minimum age for in-service withdrawals in defined benefit (DB) and 457 plans

Today: Under current law, all DB plans as well as state and local government 457 plans are prohibited from allowing employees to take in-service withdrawals before age 62.

Proposed: The bill would permit these plans to provide in-service withdrawals to employees who have reached age 59-1/2, effective for plan years beginning after 2017.

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Modification of hardship withdrawal rules

Today: Under current IRS rules, an employee is required to take any available plan loan prior to receiving a hardship distribution from a DC plan. An employee who takes a hardship distribution cannot make contributions for six months following the distribution. In addition, the hardship withdrawal cannot include earnings on investments or employer contributions.

Proposed: The bill would eliminate the requirement to take a loan prior to receiving a hardship distribution. In addition, the IRS would be required to change its rules to permit employees to continue making contributions to the plan after a hardship withdrawal. The bill would also permit employers to allow hardship withdrawals to include employer contributions and earnings. These changes would be effective for plan years beginning after 2017.

Extension of time to roll over plan loan offsets

Today: Under current law, if an employee has an outstanding plan loan when he/she leaves an employer, the employee can avoid taxation on that amount by contributing the loan balance to an IRA within 60 days of leaving.

Proposed: The bill would extend that rollover deadline to the due date of the employee's tax return, effective for tax years beginning after 2017.

Increased flexibility in testing for nondiscrimination

Today: The code provides various ways to test whether a plan discriminates in favor of highly compensated employees.

Proposed: The bill provides additional flexibility for employers that maintain both defined benefit and defined contribution plans by permitting expanded use of "cross testing" to establish that the plans do not discriminate in favor of highly compensated employees. Generally, this would be effective on the date of enactment.

NEXT STEPS

Congressional Republicans hope to have a bill on the President's desk by year-end. It's likely that many members of Congress will propose changes as the bill works its way through the legislative process. Whether any of the provisions described above will survive as written—or whether new retirement items will be tacked on—remains to be seen.

We will monitor this and other proposed legislation and keep you apprised of any significant developments.

For more information, please refer to U.S. House of Representatives' website at the following link: https://waysandmeansforms.house.gov/uploadedfiles/tax_cuts_and_jobs_act_section_by_section_hr1.pdf

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