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Fiduciary *focus*

Fiduciary Focus: How Does the Tax Reform Impact Employer-Sponsored Retirement Plans?

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Despite rumors of significant contribution alterations and encouraging after-tax Roth account contributions, the 401(k) and 403(b) industry emerged only slightly different after the final version of the tax law was passed by the House and Senate last month. The final bill increased contribution limits as accustomed, relaxed loan repayment rules, and added exceptions for individuals affected by 2016 disasters. Below is a summary of the changes in the law pertinent to the 401(k) and 403(b) industry:

- **Maximum annual contribution to plans – No significant change.**
  - Similarly to most prior calendar years, contribution maximums have slightly increased. In 2017, contribution maximums were $18,000. In 2018, the maximum increases to $18,500. If you are 50 years and older, the annual maximum is $24,000 in 2017 and $24,500 in 2018.
- **Loan repayments – Change.**
  - Under the new reform, it will be slightly easier to repay a loan if termination occurs. Under the old rules, a participant has 60 days after termination until the loan becomes payable in full or subject to a 10% penalty. The new tax rule allows repayment until tax filing deadlines. The change lessens the burden for those employees who have been terminated and may encounter financial hardships as a result.
- **2016 Disasters – Change.**
  - Individuals who suffered economic losses as a result of 2016 natural disasters can receive distributions before the age of 59½ without incurring the 10% early withdrawal tax. The distributions must occur between January 1, 2016 and January 1, 2018.

Re-Characterization of Roth and Traditional IRA Contributions

The new law did have significant language around IRA conversions, which do not affect Roth 401(k)'s. A Roth IRA account is a tax-advantaged savings vehicle funded with after-tax contributions that allows tax-free withdrawals during retirement. Many investors believe tax free withdrawals are essential in their investment strategy as taxes paid today could be lower than taxes paid in the future as brackets may change alongside increases in their salaries. A Traditional IRA account is a vehicle funded with pre-tax contributions with taxed withdrawals during retirement.

Currently, individuals have the ability to convert Traditional IRAs to a Roth IRAs. Individuals who convert are required to pay taxes on those amounts at the time of conversion. Under existing law, taxpayers normally have until October 15 of the year following the conversion to change their mind and undo the conversion transaction. Essentially they have time to decide if they want to be stuck with the tax liability. Under the reform, an individual will no longer be allowed to change their mind and re-characterize contributions to IRAs.

What is "Rothification"

The term "rothification," which was used with some regularity throughout the tax reform preliminary discussions, is defined as transitioning a traditional defined contribution plan to a Roth-like plan. Many policy makers were supporting contribution limits lowered from 2017's maximum of $18,000 to the $2-3,000 range. The contribution changes would essentially force participants to open Roth accounts to continue saving dollars for retirement (i.e., rothification). As a result of reducing maximums and "forcing" participants into after-tax Roth accounts, revenue to the government would increase as pre-tax contributions to employee sponsored plans would decline. The tax deferrals from defined contribution plans in 2016 was estimated by the Joint Committee on Taxation at over $583 billion.

Considerations for Plan Sponsors

Participants are likely considering how tax bracket and standard deduction changes will affect their personal finances and situations. Plan sponsors should discuss education initiatives regarding the tax reform with their education teams and recordkeepers/administrators to help keep participants informed.

Source: http://docs.house.gov/billsthisweek/20171218/CRPT-115HRPT-466.pdf