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Tax Notes

Tax Reform: Impact on Retirement and Health and Welfare Plans

By Louis F. LiBrandi, EA, CEBS, ChFC, TGPC, Principal

President Trump signed into law the "Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018," commonly referred to as the "Tax Cuts and Jobs Act" (TCJA).

We will give our readers some background surrounding proposed changes which did not materialize and highlights of the new law, as enacted, which affect retirement and health and welfare plans.

Earlier Proposals

Prior proposals would have had a major effect on qualified retirement plans by reducing the amount of contributions an employee could have contributed to a 401(k) plan [and 403(b) plan] from their pre-tax wages, or eliminating pre-tax contributions entirely and only permitting after-tax contributions referred to as "Rothification" to be made.

Non-qualified deferred compensation plans under Section 457 of the Internal Revenue Code (the "Code") would have been significantly impacted virtually eliminating these types of additional retirement plans.

New Law: Retirement Plans

As enacted, the new law affects the following with respect to retirement plans.

Plan Loans

Currently, a qualified plan [including a 403(b) plan] may offer a loan to be taken from the plan. Typically, a loan offset occurs in the event of an employee's termination, or upon separation from service by the employee since most plans do not allow an outstanding loan to be re-paid under these situations. The participant's accrued benefit is "offset" by the amount of the outstanding loan balance. Since this is considered an actual distribution, the amount equal to the plan loan offset may be rolled over to an eligible retirement plan (e.g., an IRA). This rollover is required to occur within 60 days.

Effective for tax years beginning after December 31, 2017, the rollover period is increased from 60 days to the due date, including extensions, of filing the federal tax return for the tax year the loan offset occurs, i.e., the tax year in which the amount is treated as distributed from a qualified plan.

Recharacterizations/Conversions of IRA

TCJA has eliminated the right to convert all or part of a traditional plan or IRA to a Roth IRA. Previously, this privilege was allowed up to the extended due date of the individual's tax return for the year of conversion.

Relief to Victims of 2016 Disasters

Generally, a defined contribution plan distribution to an individual under age 59-1/2 is subject to a 10 percent penalty tax, unless an exception applies. The tax applies to the amount of the distribution includable in income.

The new law not only provides relief by waiving the 10% early withdrawal penalty for qualified disaster relief distributions, it allows the income attributable to the distribution to be reported pro rata over three years beginning with the year in which the distribution is received; and, an individual who receives a qualified distribution may re-contribute up to the amount of the distributions to an eligible retirement plan within three years of receiving them.

The total dollar amount that is eligible for this treatment is $100,000 per individual.

The provision is effective on the date of enactment of the new law.

New Law: Health and Welfare Plans

As enacted, the new law affects the following with respect to health and welfare plans.

Individual Mandate

The Patient Protection and Affordable Care Act of 2010 requires all individuals to maintain minimum essential health coverage for themselves and their tax dependents or pay a tax penalty. The penalty is $695 for an adult or 25% of household income, whichever is greater. The new law eliminates the individual mandate penalty beginning after December 31, 2018.

Because of this change, many millions of people are expected not to retain health insurance, which can have the result of a higher cost risk pool and, consequently, increased health insurance rates.

Cadillac Tax

The Affordable Care Act imposes a 40% excise tax (known as the Cadillac Tax) on insurers and sponsors of self-funded group health plans if the cost exceeds a designated threshold amount.

The TCJA delayed the effective date of the Cadillac Tax to 2020. However, the Continuing Resolution legislation to fund the federal government until February 8, 2018 delays the effective date until January 1, 2022.

Medical Expenses

Under the new law, individuals who itemize their deductions when preparing their individual tax return can deduct qualified medical expense in excess of 7.5% of adjusted gross income (AGI) for tax years 2017 and 2018 for regular tax and alternative minimum tax purposes. Under current law, the deduction is limited to medical expenses in excess of 10% of AGI. After 2018, the 10% AGI threshold would again be applicable.

Other Changes

For tax years after December 31, 2017, the TCJA made substantial modifications to (1) executive compensation provisions affecting public and large private companies, and (2) tax-exempt employers. The applicable Tax Code sections that have been modified, or in the case of the tax-exempt employer, a newly-created Code section was required; namely, 162(m) and 4960, respectively. Thought Leadership newsletters discussing these changes are forthcoming.

Contact Us

More information about the new tax law and how it affects retirement plans and health and welfare plans will be published as rules and regulations are adopted by the regulatory agencies. In the meantime, please contact Tim Desmond at tdesmond@pkfod.com or Lou LiBrandi at llibrandi@pkfod.com or your PKF O’Connor Davies tax advisor.

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