Chimento & Webb, P.C.

MEMORANDUM

To: Clients and colleagues

From: George Chimento, Rob Webb and Jessica Stanford

Date: February 14, 2018

Re: Retirement Plan Changes in the Budget Deal

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1. GOOD IDEAS SHOW UP IN THE BUDGET DEAL

When Congress passed the Tax Cuts and Jobs Act last December, we were disappointed that some non-controversial retirement plan reforms did not make the final cut. We speculated they would show up shortly in another bill after a bit more polish, and here they are in the **Bipartisan Budget Act of 2018** (the "BBA"), enacted on February 9, 2018.

Retirement reforms are just a tiny piece of the BBA. In case you want to see how the government will spend all your unprinted billions, the full text of the BBA is at this link.

2. HARDSHIP DISTRIBUTION RULES EASED (in 2019)

A. Six month delay no longer required after hardship distributions

Hardship distributions from 401(k) and 403(b) plans may only be made if there is "financial need." Rather than relying on employee affidavits that alternate funds are not available from other sources, including asset liquidation and plan loans, most plans use a six (6) month suspension rule in IRS regulations to establish "financial need."

The problem with requiring employees to suspend deferrals for six months after a hardship distribution is that they often lose half a year's worth of matching contributions. That's unfair for people who already are having financial difficulties.

The BBA gives IRS a twelve month deadline to remove the six month rule from its regulations.

Effective for plan years starting in 2019 and later. Old rules apply to 2018 plan years.[1]

B. Sources for hardship distributions are expanded

It will now be possible to take hardship distributions from previously prohibited sources: investment earnings on 401(k) and 403(b) deferrals, QMACs, QNECs, and safe harbor contributions. Taking hardships from sources already allowed, such as employer profit sharing contributions, continues to be OK.

Effective for plan years starting in 2019 and later. Old rules apply to 2018 plan years.

C. No requirement to borrow before a hardship distribution

To establish "financial need" for a hardship distribution, it will no longer be necessary that the employee first borrow all available amounts from available employer plans.

Effective for plan years starting in 2019 and later. Old rules apply to 2018 plan years.

D. Other hardship rules are unchanged

(a) To establish "financial need" there is another IRS requirement that remains in effect unless IRS uses its discretion in the new regulation to eliminate it, and that's doubtful.

[1] BBA Sec. 41113 p. 98 et seq.

Before withdrawing for hardship, an employee will still have to take all available taxable and non-taxable distributions (other than loans) from other "employer plans." The term "employer plans" includes equity and option plans, and withdrawable after-tax and rollover contributions from qualified plans.

(b) The rule that hardship withdrawals may only be made for "immediate and heavy financial needs" is also unchanged. For this purpose, plans may continue to rely on a list of "heavy need" reasons allowed by IRS, or can make discretionary judgments if their plan permits that. (Most plans we see only allow hardship withdrawals for reasons on the IRS list, such as purchase of a primary residence and eligible tuition.)

E. Amendments will be required

An amendment will be required at some point. We recommend waiting for IRS guidance before amending plans because the new rules will not apply until the 2019 plan year. Note that a plan can still provide more restrictive rules. For example, some employers may want to limit hardship withdrawals to employee money, so that employer contributions stay invested for retirement. Will a plan be allowed to keep a six 6 month suspension rule? We don't think so, but the new regulations will answer that. In addition, before adopting any new rules, be sure your record keeper is geared up to handle them.

3. MORE RETIREMENT PLAN RELIEF FOR NATURAL DISASTERS

BBA adds to the plethora of 2017 disaster relief coming from Congress and the IRS. For Hurricane Harvey, we first had IRS Announcement 2017-11. Hurricanes Harvey, Irma, and Maria were then covered by the *Disaster Tax Relief and Airport and Airway Extension Act of 2017.* The 2017 Tax Reform then included more limited relief for victims of any other 2016 or 2017 presidential-declared natural disaster. BBA focuses on the tragic California wildfires, with relief similar to what was provided for the three 2017 Hurricanes.[2]

If you have employees affected by any disaster, don't rely just on this Memo. You will want us to check the area affected, the specific relief allowed, and applicable dates which vary based on when the disaster occurred.

A. Rules for the three hurricanes and California wildfires

(a) employees can withdraw for their natural disaster needs without a 10% early distribution penalty, or a financial hardship showing, and tax withholding will be optional;

(b) Distributions up to $100,000 in the aggregate qualify;

[2] BBA Sec. 20102, p.47 et seq.

Note: The $100,000 is an individual limit. An employer will only need to keep track of withdrawals from its plans. If an employee overwithdraws from plans of more than one employer, there will need to be IRS guidance on what an employer should do. This may be similar to the rules for excess 401(k) deferrals.

(c) The taxable income will be reported over three years, but the employee may elect to include it in the year of distribution.

(d) An amount up to the withdrawal can be recontributed to an IRA or qualified plan within three years of the withdrawal, and negate the taxation;

(e) loans up to $100,000 can be made without regard to the 50% / $50,000 limits usually applicable to loans;

(f) Outstanding loans can qualify for a one year extension of term;

(g) Hardship withdrawals to purchase or construct a primary residence can be recontributed if the disaster prevented the transaction. The period to make this tax saving re-contribution is very limited. For the Hurricanes, the deadline is February 28, 2018; for California wildfires, the deadline is June 30, 2018.

B. Rules for other 2016-2017 disasters

For declared 2016-2017 disaster areas other than the three major hurricanes and California wildfires, only the relief in clauses (a) through (d), above, is available.

C. Relief is immediately effective, and amendments can be made later

These are optional rules which can be applied now. Plans are not required to include them. Plans must be amended by the end of the first plan year beginning in 2019, i.e. December 31, 2019 for calendar year plans. (Unless extended by IRS, the deadline for 2016 disaster relief is one year earlier, but we expect IRS to be reasonable so that all disaster amendments have the same amendment deadline.) Check with your record keeper, because many of these options require its cooperation and updated systems.

4. RELIEF AFTER IRS RETIREMENT PLAN LEVIES

If the IRS levies on a person's retirement funds (whether in a plan, IRA, 403(b) or governmental 457(b)) and then returns the money, the taxpayer can avoid taxation on the levied distribution by rolling over all or part of the refund, with any interest the IRS paid, to an eligible rollover vehicle, like an IRA or a qualified plan that will accept the rollovers. Rollovers under this provision must be made by the due date (with extensions) of the taxpayer's return for the year of the refund.[3]

[3] BBA Sec. 41104, p. 92 et seq.

This ability to "roll over" refunded amounts applies to levies on inherited IRAs, even though distributions from such accounts are normally not eligible for rollover.

Effective for calendar quarters beginning on and after April 1, 2018.

5. JOINT SELECT COMMITTEE ON SOLVENCY OF MULTIEMPLOYER PENSION PLANS

A. The mission

Not later than November 30, 2018, a new Congressional Committee is to come back with a report and a legislative proposal to improve the solvency of multiemployer defined benefit pension plans and the Pension Benefit Guaranty Corporation ("PBGC").

B. A bipartisan approach

In a display of bipartisanship, there will be eight members from the Senate and eight from the House. The Majority and Minority leaders of each chamber have four appointments. There are two co-chairs, representing each party. The final report and recommendation must have the majority support of members of each party. Selecting November 30 (after the midterm elections) was no accident, because this report is too important for electioneering.

C. Background information about the PBGC and multiemployer plans

The PBGC is a government entity, but its obligations are not full faith and credit obligations of the federal government. Its mission is to insure benefits, up to limits, in ERISA defined benefit plans. Its only funding is from compulsory premiums paid by ERISA defined benefit plans, meaning that the employers who sponsor those plans are indirectly covering the costs of the PBGC.

Most defined benefit plans are sponsored by a single employer for its workforce. Multiemployer plans are different. They cover employees in collective bargaining units of unrelated employers. Multiemployer plan trustees are appointed by contributing employers and unions. Because of the significantly higher liabilities of multiemployer plans, the PBGC is required to keep separate accounting for liabilities and assistance it provides to them.

D. The problem, and projected insolvency of PBGC assistance program

Union employment has decreased over the years, often because unionized industries are declining. In addition, when major employers have sufficient clout, they negotiate to sponsor their own plans rather than getting caught in a multiemployer plan where they bear responsibility for everyone's employees. Due to shrinkage in their numbers, remaining union employers simply cannot cover all the costs for retirees of insolvent employers. Many just go out of business themselves, further increasing the liabilities of those who remain.

When plans become insolvent, the PBGC steps in. It loans money to the trustees for benefit payments but first insists on a dramatic cut in vested pensions. There are many variables, but PBGC considers it more likely than not that its funds for multiemployer plan assistance will run out by 2025. Its 2016 report and projections are at this link.
https://www.pbgc.gov/documents/Five-Year-Report-2016.pdf

By 2025, the projected liabilities are likely to exceed eighty billion dollars.

E. The pensioners are not fat cats

PBGC reports that over 1.2 million people are now dependent on critical and declining multiemployer plans which are likely to become insolvent. When PBGC steps in, pensions are cut to the barebones. If the retiree had 30 or more years of service, the benefit is cut to a maximum pension of $12,870 per year. Contrast that with the PBGC guarantee to participants in plans which are not multiemployer: $65,045 per year, with no service requirement. For multiemployer plan retirees, the PBGC cutback is devastating at an age where there are not many options, and PBGC won't be able to afford even those reduced pensions by 2025.

F. Where will the money come from?

There is no easy answer.

(a) Contributing employers are already contributing at unsustainable levels for many underfunded multiemployer plans.

(b) Multiemployer plan pensioners are not in a position to take further cut-backs, and are too old to go back to work.

(c) Taxpayers may resist assuming an unfunded mandate, especially when many of them have no defined benefit pension at all.

(d) People who like or hate unions can be expected to chime in.

If ever there was an issue that cried out for bipartisanship, this is it. Creation of this select congressional committee, which gives no preference to either party, is a good start.

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