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February 12, 2018

Retirement Plan Provisions in Budget Act

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February 12, 2018 TO: ICI Members
Pension Committee
Pension Operations Advisory Committee SUBJECTS: Pension RE: Retirement Plan Provisions in Budget Act

The Bipartisan Budget Act of 2018 (the Act), reflecting a two-year budget agreement increasing federal spending and funding the government through March 23, includes changes impacting retirement plans. The Act was signed by President Trump on February 9, 2018 and is available here. Described below are provisions affecting defined contribution plans and IRAs, including certain changes to the rules for hardship distributions, a provision permitting re-contribution of improperly levied amounts, and temporary tax relief for victims of the California wildfires. The Act also provides for the creation of a new simplified tax return for individuals aged 65 and older.

Hardship Distributions

Sections 41113-41114 of the Act make the following changes to the rules associated with taking hardship distributions from 401(k) and 403(b) plans:

- The Act directs Treasury to modify safe harbor regulations for hardship distributions to eliminate the requirement that an employee be prohibited from making elective deferrals and employee contributions for six months after the receipt of a hardship distribution (this requirement is part of the regulatory safe harbor for deeming a distribution necessary to satisfy an immediate and heavy financial need). The modified regulations will apply to plan years beginning after December 31, 2018.
- Plans may permit hardship distributions of earnings and employer contributions (including safe harbor contributions), effective for plan years beginning after December 31, 2018.
- Plans may not require a participant to obtain an available plan loan before taking a hardship distribution, effective for plan years beginning after December 31, 2018.

These hardship distribution changes had been included in earlier versions of the tax reform package enacted at the end of 2017, but did not make it into the conference agreement for that legislation. The Institute has expressed support for these changes, which also have appeared in several other retirement bills over the past few years.

Re-contributions of Improperly Levied Amounts

For amounts returned to a taxpayer and attributable to improper federal tax levy on an IRA or employer-sponsored retirement plan, section 41104 of the Act permits individuals to contribute these amounts, with interest, back to a plan or IRA, and such amounts will not count toward the normally-applicable contribution limits. The re-contribution is treated as a rollover and must be completed by the tax return due date (not including extensions) for the taxable year in which the amount is returned. The provision is effective for amounts returned in taxable years beginning after December 31, 2017.

Disaster Relief

Section 20102 of the Act provides for temporary tax relief for victims of the California wildfires, including (1) tax-favored withdrawals from retirement plans, (2) re-contribution of withdrawals for cancelled home purchases; (3) liberalized plan loan rules; and (4) plan amendments to incorporate the relief. The relief mirrors prior disaster relief legislation, including that relating to Hurricanes Harvey, Irma, and Maria in 2017. The IRS previously issued guidance providing limited loan and hardship distribution relief and extended taxpayer deadlines for victims of the recent wildfires.

Tax-Favored Withdrawals from Retirement Plans

The Act provides that the 10 percent penalty tax applicable to certain early withdrawals under section 72(t) of the Internal Revenue Code shall not apply to any "qualified wildfire distribution." This term includes any distribution made:

- from an IRA, a qualified plan, a section 403(a) plan, a section 403(b) arrangement, or an eligible deferred compensation plan under section 457(b) of the Code;
- on or after October 8, 2017 and before January 1, 2019;
- to an individual whose principal place of abode during any portion of the period from October 8, 2017 to December 31, 2017, is located in the California wildfire disaster area; and who has sustained an economic loss by reason of the related wildfires.

An individual's penalty-free distributions under this provision generally are limited to $100,000. Unless the taxpayer elects otherwise, any such amounts required to be included in gross income for the taxable year will be spread over a three-taxable-year period. The amounts will not be considered eligible rollover distributions for purposes of the mandatory withholding rules of section 3405 of the Code, and such distributions will be treated as meeting the distribution restrictions of sections 401(k)(2)(B)(i), 403(b)(7)(A)(ii), 403(b)(11), and 457(d)(1)(A).

The relief also provides that an individual who receives a qualified wildfire distribution may contribute up to the full amount, within three years, to an eligible retirement plan to which a rollover contribution could be made. Such a contribution generally will be treated as a rollover, or, in the case of repayments of distributions from IRAs, as a direct trustee to trustee transfer.

Re-contributions of Withdrawals for Home Purchases

The Act addresses taxpayers who took hardship distributions from their 401(k) plans or 403(b) arrangements, or distributions from their IRAs, for the purpose of purchasing or constructing a principal residence in the California wildfire disaster area. This provision allows such taxpayers to contribute all or part of the amount to a retirement plan to which a rollover is permitted if the residence was not purchased or constructed on account of the related wildfires. To qualify for re-contribution, the distribution must have been received after March 31, 2017, and before January 15, 2018. The re-contribution must be made during the period beginning on October 8, 2017, and ending on June 30, 2018. Recontributed amounts generally will be treated as rollovers, and the recontributed portion of the distribution will not be included in income.

Loans from Qualified Plans

The Act amends the plan loan rules in Code section 72(p) with respect to an individual whose principal place of abode during any portion of the period from October 8, 2017 to December 31, 2017 is located in the California wildfire disaster area, who has sustained an economic loss by reason of the related wildfires, and who receives a plan loan during the period beginning on the date of enactment and ending on December 31, 2018. For such individuals, the dollar limit on plan loans under section 72(p)(2)(A) is increased from $50,000 to $100,000, and the entire present value of the nonforfeitable accrued benefit is available for the loan.

In addition, for plan loans outstanding on or after October 8, 2017, an individual can delay any repayment for one year if the payment due date occurs during the period beginning on October 8, 2017 and ending on December 31, 2018. Subsequent payments must be adjusted to reflect the delayed due date. The delay period must be disregarded for purposes of determining the five-year repayment period and the term of the loan under section 72(p)(2).

Plan Amendments

Plan amendments to reflect the Act’s provisions may be made on or before the last day of the first plan year beginning on or after January 1, 2019, or a later date as prescribed by the Secretary of the Treasury (with a later plan amendment deadline applying for governmental plans). Pending such amendments, the plan must be operated as if the amendments were in effect.

New Form 1040SR

In addition to the provisions affecting retirement plans described above, the Act requires the IRS to create a new simplified income tax return (Form 1040SR) for individuals aged 65 or older by the end of the taxable year. The form is intended to be similar to the Form 1040EZ, but may not be restricted as to use based on the amount of taxable income reported or the inclusion of certain types of income (social security benefits; distributions from qualified retirement plans, annuities, or other deferred payment arrangements; interest and dividends; or capital gains and losses taken into account in determining adjusted net capital gain). The new form shall be made available for taxable years beginning after the date of the enactment.

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