Voya Alert!

January 10, 2018

Author: Davis & Harman LLP; January 1, 2018

Only Modest Changes to Retirement Savings and Executive Compensation Included In Final Tax Legislation

For retirement savings plans, the biggest headline from the passage of H.R. 1 (also known as the Tax Cuts and Jobs Act, or the "Act"), is that there is no headline. The Act contains almost no significant changes to the treatment of retirement savings plans.

In the months leading up to passage of the Act, there was much speculation that Congress might significantly modify the current tax treatment of defined contribution retirement plans in order to offset revenue losses from any reductions made to the corporate and individual tax rates. There were substantial rumors that Congress would require at least some participant contributions to be made as after-tax Roth contributions instead of traditional pre-tax contributions (so-called Rothification). On October 23, 2017, after a number of press stories reported on these rumors, President Trump tweeted: "There will be NO change to your 401(k). This has always been a great and popular middle class tax break that works, and it stays!"

There were also concerns that Congress might restrict higher-income taxpayers from making catch-up contributions, place severe restrictions on nonqualified deferred compensation plans, or modify the special contribution rules for 457(b) and 403(b) plans. But while a number of these ideas were seriously considered, none were included in the final legislation. In fact, both the Senate and House bills contained changes to the rules for hardship distributions, and even those were removed in the conference report.

In the end, the Act's only significant provisions directly affecting retirement and executive compensation are the following:

- ***Loan offsets*.** The Act extends the period for rolling over a loan offset amount until the individual's tax filing due date, including extensions, for the year in which the offset occurred.
- ***Roth recharacterizations*.** Recharacterization is no longer allowed in the case of a qualified rollover contribution, including a conversion, from a non-Roth account or annuity to a Roth IRA. This limitation applies to qualified rollover contributions made from pre-tax accounts under an IRA, qualified retirement plan, 403(b) plan, or 457(b) plan. The ability to convert traditional IRAs to Roth IRAs is not affected; however, individuals no longer have the ability to later recharacterize, or "undo," that conversion. Recharacterization continues to be allowed in case of non-rollover contributions to a traditional or Roth IRA.
- ***Additional disaster relief*.** The Act provides tax relief for certain retirement plan and IRA distributions taken on or after January 1, 2016, and before January 1, 2018, by individuals: (1) whose principal place of abode was located in a presidentially declared disaster area at any time during 2016, and (2) who sustained an economic loss by reason of the events giving rise to the disaster declaration. For distributions treated as a "qualified 2016 disaster distribution," the Act: (1) provides an exception to the 10% early distribution penalty; (2) exempts the distribution from mandatory 20% withholding; (3) permits ratable income inclusion over the three-year period beginning with the year the distribution would otherwise be taxable; and (4) permits contribution of the distribution to a plan or IRA within three years, in which case the contribution is generally treated as a direct trustee-to-trustee transfer within 60 days of the distribution. This special tax treatment is limited to aggregate distributions not in excess of $100,000.
- ***Volunteer length of service awards***. A length of service award given to a volunteer who provides firefighting and prevention, emergency medical, or ambulance services is not considered to be deferred compensation. Under the Act, the annual limit on the accrual of length of service awards is doubled to $6,000, with a cost-of-living adjustment in $500 increments provided for future years.

- ***Deduction limit on compensation above $1 million***. The Act makes significant changes to the limit on the deduction of compensation above $1 million that applies to certain public company executives. To conform with SEC reporting, the Act modifies the group of covered individuals to be any employee who was the CEO or CFO at any time during the taxable year, in addition to the three highest-compensated officers for the taxable year (other than the CEO or CFO). In addition, a company is subject to the deduction limit if the company is required to file reports under § 15(d) of the Securities Exchange Act, even if the company is not required to register its securities under § 12 of the Securities Exchange Act. The exceptions for commissions and performance-based compensation are removed. Finally, an employee is considered to be a covered employee if he or she was a covered employee for the company or any predecessor in any taxable year after 2016. The Act contains a limited transition rule that effectively grandfathers future remuneration paid to employees if (1) the remuneration is paid under a written binding contract in effect on November 2, 2017 and (2) the terms of such contract are not modified in any material respect on or after November 2, 2017.
- ***Excise tax on tax-exempt entity executive compensation.*** An excise tax of 21% is imposed on remuneration in excess of $1 million paid by tax-exempt organizations to the five highest compensated employees. Certain parachute payments are also subject to the excise tax. Further, deferred compensation subject to Code § 457(f) is taken into account when there is no longer a substantial risk of forfeiture, requiring much more careful planning for 457(f) plan vesting rules. The tax is imposed on the employer, not the individual.
- ***Qualified equity grants of non-public companies***. The Act creates a new rule allowing employees who are granted stock options or restricted stock units as compensation for the performance of services to elect to defer recognition of income for up to five years, if the corporation's stock is not publicly traded and certain other requirements are satisfied.

It remains possible that Congress could pass separate retirement legislation in 2018, including the provisions passed by the Senate Finance Committee in 2016 in the Retirement Enhancement and Savings Act of 2016. Kevin Brady (R-TX), chairman of the House Ways and Means Committee, said shortly after H.R. 1 was passed that he was going to recommend future reconciliation bills focusing on other areas that could not be accommodated, including retirement savings and education.