Re: 2017 Tax Cuts Act: Retirement Plans and IRAs

Dear Client:

The Tax Cuts and Jobs Act modifies several provisions related to retirement plans and IRAs. These include

- the repeal of the special rule permitting recharacterization of Roth IRA conversions,
- an increase in the period during which a qualified plan loan offset amount may be rolled over,
- relief for qualified 2016 disaster distributions, and
- an increase in allowable amount of length-of-service awards.

Recharacterization of Roth IRA Contributions

An individual who has made contributions to a Roth or traditional IRA may subsequently decide that a contribution to an IRA of the other type is more advantageous. If certain requirements are met, a contribution can be characterized and treated as having been originally made to a different type of IRA. Recharacterizing an IRA contribution requires transferring amounts previously contributed to a traditional or Roth IRA (plus any resulting net income or minus any resulting net loss) to another IRA of the opposite type and electing to have the amounts treated as having been transferred to the second IRA at the time they actually were contributed to the first IRA.

A recharacterization election effectively reverses the contribution from one type of IRA to another (e.g., Roth to traditional, or traditional to Roth). The contribution being recharacterized is treated as having been originally contributed to the second IRA on the same date and for the same tax year as that in which the contribution was made to the first IRA. Because the owner never has use of the IRA assets, the recharacterization does not count towards the once-per-year limit on IRA-to-IRA rollovers.

The Tax Cuts and Jobs Act repeals the special rule permitting recharacterization of Roth conversions for tax years beginning after December 31, 2017. Therefore, for example, a conversion contribution establishing a Roth IRA during a tax year can no longer be recharacterized as a contribution to a traditional IRA (thereby unwinding the conversion).

The Tax Cuts and Jobs Act does not preclude an individual from making a contribution to a traditional IRA and converting the traditional IRA to a Roth IRA. Rather, the provision would preclude the individual from later unwinding the conversion through a recharacterization.

Rollover of Plan Loan Offset Amounts

Plan loan offset amounts occur when, under the terms governing a plan loan, the accrued benefit of the participant or beneficiary is reduced to repay the loan, including the enforcement of the plan's security interest in the accrued benefit. These amounts are treated as actual distributions, not deemed distributions, so that a plan may be prohibited from making the offset. As an actual distribution, a plan loan offset is eligible for rollover if it otherwise qualifies.

The Tax Cuts and Jobs Act increases the period during which a qualified plan loan offset amount may be contributed to an eligible retirement plan as a rollover contribution from 60 days after the date of the offset to the due date (including extensions) for filing the Federal income tax return for the tax year in which the plan loan offset occurs, that is, the tax year in which the amount is treated as distributed from the plan. This extended time is effective for plan loan offset amounts treated as distributed in tax years beginning after December 31, 2017.

Under the Tax Cuts and Jobs Act, a qualified plan loan offset amount is a plan loan offset amount that is treated as distributed from a qualified retirement plan, a section 403(b) plan or a governmental section 457(b) plan, solely by reason of the termination of the plan or the failure to meet the repayment terms of the loan because of the employee's severance from employment.

Relief for 2016 Disaster Areas

Under the Tax Cuts and Jobs Act, an exception to the 10-percent early withdrawal tax applies in the case of a "qualified 2016 disaster distribution" from a qualified retirement plan, a section 403(b) plan or an IRA. A "qualified 2016 disaster distribution" is a distribution from an eligible retirement plan made on or after January 1, 2016, and before January 1, 2018, to an individual whose principal place of abode at any time during calendar year 2016 was located in a 2016 disaster area and who has sustained an economic loss by reason of the events giving rise to the Presidential disaster declaration. The total amount of the 2016 disaster distribution cannot exceed $100,000.

Income attributable to a qualified 2016 disaster distribution may be included in income ratably over three years, unless the individual elects not to have ratable inclusion apply. Any portion of a qualified 2016 disaster distribution may, at any time during the three-year period beginning the day after the date on which the distribution was received, be recontributed. Any amount recontributed within the three-year period is treated as a rollover and therefore is not includible in income.

A qualified 2016 disaster distribution is subject to income tax withholding unless the recipient elects otherwise. The mandatory 20-percent withholding does not apply. If the amount of the qualified disaster distribution is recontributed to an eligible retirement plan, the individual may file an amended return to claim a refund of the tax attributable to the amount previously included in income. In addition, if a portion of the distribution has not yet been included in income at the time of the contribution, the remaining amount is not includible in income.

Length of Service Awards

For tax years beginning after December 31, 2017, the Tax Cuts and Jobs Act increases the aggregate amount of length of service awards that may accrue for a bona fide volunteer with respect to any year of service from $3,000 to $6,000 and adjusts that amount in $500 increments to reflect changes in cost of living after 2018. Qualified services for this purpose are firefighting and prevention services, emergency medical services and ambulance services.

If the plan is a defined benefit plan, the limit applies to the actuarial present value of the aggregate amount of length of service awards using reasonable actuarial assumptions and methods.

The Tax Cuts and Jobs Act is a comprehensive package of reform that affects a large number of taxpayers. If you have any questions related to the tax changes for retirement plans and IRAs, or related to the Tax Cuts and Jobs Act in general, please call our office. We are here to assist you.

Sincerely,