Morgan Stanley

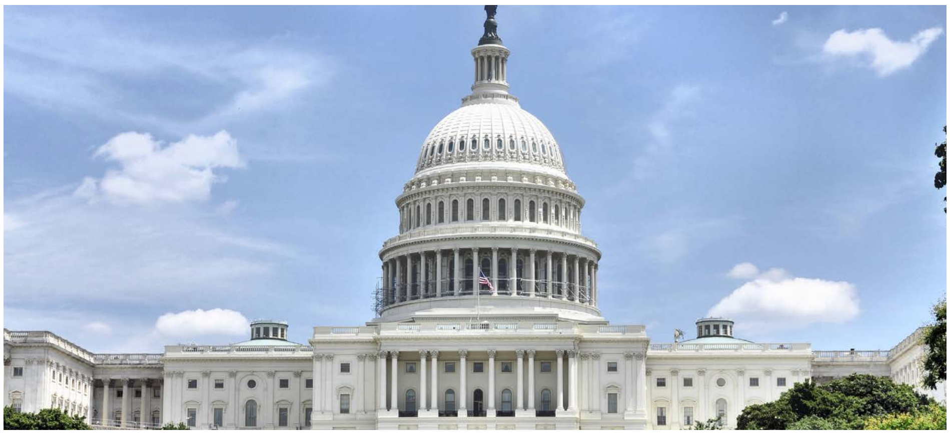
Plan Sponsor Insights

A Quarterly Newsletter for Retirement Plan Sponsors

Spring 2018

Overview of the Tax Cuts and Jobs Act

In December 2017, President Trump signed the Tax Cuts and Jobs Act into law. Highlights of the changes made to retirement plans are described below.



Rollover period relaxed for offset retirement plan loans

There are times when a participant may need to take a loan. If the participant terminates employment and takes a plan distribution while still having an outstanding loan, the plan treats the loan amount as a distribution, subject to taxation and possibly a 10 percent penalty tax. Based on the laws before the Act was effective, a participant would have only 60 days to roll over a distribution into another eligible plan (such as an IRA) in order to avoid this result.

The Act extends the 60-day period for rolling over the amount of the offset retirement plan loan. Participants now have until their tax filing deadline, including extensions, for the tax year in which the loan offset occurs. The extension applies to offsets as a result of both plan termination and severance from employment.

IMPACT: *This is effective for loan amounts treated as distributed in tax years beginning after 2017. This revision shouldn't affect how plan sponsors administer plans; however, understanding the change can help you explain it to participants as needed.*

Recharacterizing Roth IRA conversions eliminated

Before this change, participants could move non-Roth qualified retirement plan or IRA assets to a Roth IRA (e.g., a traditional IRA to Roth IRA conversion) and could later undo, or recharacterize, the conversion before their tax return due date (plus extensions). This allowed taxpayers to speculate, deciding on recharacterizing based on how much the Roth IRA gained—or lost. Or perhaps a taxpayer might have recharacterized simply because of the size of the looming tax obligation arising from the conversion.

"Taxpayers must be especially cautious when moving non-Roth assets to a Roth IRA."

The Act eliminates a taxpayer's opportunity to undo the conversion and avoid the tax implications. Significant assets can be involved in such transactions, so taxpayers must now be especially cautious when moving non-Roth assets to a Roth IRA.

Annual contributions to a Roth IRA can still be recharacterized as Traditional IRA contributions for the same tax year—and vice versa. In addition, recent guidance from the IRS confirms that conversion distributions made in 2017 may still be recharacterized in 2018. In its guidance, the IRS indicated that Roth IRA conversion distributions made in 2017 may be recharacterized as a contribution to a traditional IRA if the recharacterization is made by October 15, 2018.

IMPACT: *This is effective for tax years beginning after December 31, 2017. Participants can still roll over non-Roth qualified retirement plan or IRA plan assets into a Roth IRA, so this change doesn't affect plan administration.*

Casualty loss provision could affect plan hardship distributions

The Act no longer allows a deduction for casualty losses unless the casualty loss is attributable to a presidentially declared disaster. This change could severely restrict the deduction for those not covered by such a declaration. For example, if a falling tree damages a taxpayer's roof or their basement floods within an official disaster area as a result of a presidentially declared disaster, the taxpayer can deduct unreimbursed losses once a certain threshold is reached. However, if any damages occur to the taxpayer's house outside this zone or not as a result of a presidentially declared disaster, those losses would not be eligible for the casualty loss deduction.

Deductible casualty losses are among the "safe harbor" conditions for hardship distributions from workplace retirement plans under existing Treasury regulations. Those who don't qualify for this deduction because of the law change also may not qualify for a hardship distribution from their plan.

IMPACT: *This is effective for losses incurred in taxable years beginning after December 31, 2017, and before January 1, 2026. This change may require plan sponsors to verify whether any casualty loss happened within a presidentially declared disaster area before approving a hardship distribution.* ■

What To Think About When Considering Automatic Enrollment

If your plan hasn't implemented auto enrollment or auto escalation features, it may be time to consider whether these features are right for your plan.

How it works

In general, automatic enrollment puts new hires (or existing employees, through periodic sweeps) into the plan automatically, without a specific election to join. Instead, the employee decision becomes an "opt-out" election. Essentially, if the employee does nothing, the enrollment, the deferral amount, and the investment options are automatic. Auto escalation is an additional feature that increases the deferral percentage by a specified amount each year, up to a maximum. The idea is to put participants' inertia to work for them, in order to improve their retirement readiness.

It works!

Auto enrollment seems to deliver on its promise. One large retirement plan provider notes that its plans with auto enrollment boast a 79% participation rate, versus 70% for those without the feature.[1] Other providers show similar outcomes. As a result, auto enrollment plans have become popular, with around 68% of large retirement plans currently offering the feature in 2017, up from 58% in 2015.[2]

Three flavors of auto enrollment

The IRS recognizes three types of auto enrollment arrangements. They differ in many respects, but the essential elements are these:

1. Automatic contribution arrangement (ACA): This is the most basic type. New hires and/or current employees are automatically enrolled at a specified deferral rate unless they opt out. Allowing annual automatic escalation of a participant's deferral rate is optional.

2. Eligible ACA (EACA): This arrangement offers two additional features to those available in an ACA. It allows participants a limited time to opt out of deferring after elective deferrals have begun, and to withdraw their contributions. In addition, if both new hires and current employees are automatically enrolled, the IRS gives the plan more time to complete required year-end testing.

3. Qualified ACA (QACA): This arrangement exempts a plan from certain testing requirements, mandates sponsor contributions, and requires both new hires and current employees to be automatically enrolled and their deferral rate automatically escalated annually. Like EACA, during a limited time after contributions have begun, participants may opt out and withdraw their contributions.

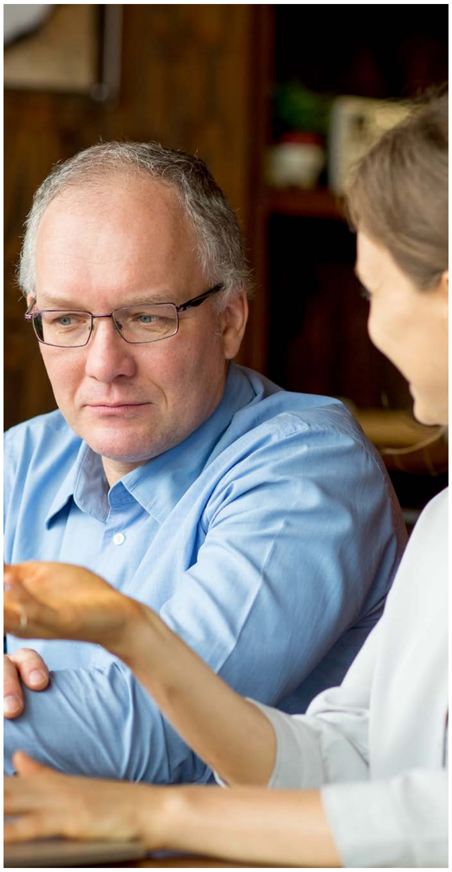
[1]Ascensus, as of December 31, 2017.
[2]Alight Solutions' *Trends & Experience in Defined Contribution Plans*, 2017, http://bit.ly/alight-survey

Are there drawbacks?

Participants who are automatically enrolled can sometimes adopt a "set-it-and-forget-it" mindset. Sponsors should keep participants engaged by continuing to share plan information and financial education, even if the messaging might change from "why enroll" to an emphasis on monitoring progress, contributing as much as possible, and considering the likely cost of retirement.

Learn what tools are available

If you're considering automatic enrollment for your plan, work with your Financial Advisor to explore the tools available to help you achieve your goals. Financial wellness programs, calculators, and gap analyses can all help participants understand the short- and long-term implications of the retirement plan choices they're making – or, in the case of automatic enrollment, not making. ■



Make Sure Employees Know About the Saver's Credit

If they're eligible, employees can get even more benefit out of participating in their retirement plan.

You can help employees stay on track for retirement by showing them the value of participating in their retirement plan. One way they can benefit is through the Saver's Credit, which provides qualifying taxpayers a tax credit of up to $1,000 for single filers, or $2,000 for those married and filing jointly.

The Saver's Credit gives eligible taxpayers an income tax credit for contributions to certain qualified retirement plans. A tax credit directly reduces the amount of taxes owed, unlike a deduction, which only decreases taxable income. This means the Saver's Credit reduces a taxpayer's income tax dollar-for-dollar. Note that the credit won't reduce the tax below zero. However, if employees have had tax withheld from their paycheck in excess of their tax liability, the credit could increase their refund check.

Eligibility

To qualify for the Saver's Credit, taxpayers must have met the following requirements during the taxable year:

- Made voluntary employee contributions to SIMPLE IRAs, 401(k) plans, and other employer-sponsored retirement plans, and/or annual contributions to IRAs
- Reached age 18 before the end of the taxable year
- Weren't claimed as a dependent on someone else's return
- Weren't a full-time student
- Had adjusted gross income (AGI) within certain limits

"The Saver's Credit reduces a taxpayer's income tax dollar-for-dollar."

Income limits and qualifying contributions

The credit decreases as the AGI increases.

Eligibility for 2017 tops out at $62,000 for married employees filing jointly, $46,500 for heads of households, and $31,000 for all others. Lower earners receive a larger credit. Rollover contributions and employer matches don't count toward qualifications for the Saver's Credit. Finally, eligible contributions may be reduced by any recent distributions.

The IRS has all the details, including the required form (bit.ly/savers-credit), and a tax advisor can help employees determine their eligibility and potential credit amount. ■

Every Day Is Retirement Planning Day

Employers often communicate the value of retirement planning only once a year – at enrollment time. But employees may be more receptive to that message at a variety of points throughout their lives. Milestones like these can happen any time, and can push long-term financial thinking to the front burner:

- Marriage
- Becoming a parent or grandparent
- Onset of a disability or chronic illness
- Spousal unemployment, retirement, or re-entry to the workforce
- Divorce
- Looming college tuition bills
- Death of a spouse
- Significant promotions

Obviously, you can't schedule benefits meetings around individuals' financial lives. But you can ensure that employees are getting year-round education about your retirement plan. It's never "out of season" to promote your plan on your company intranet, encourage managers to remind employees about it during team meetings, or send a reminder email to emphasize how and why employees should join the plan or check on their progress.

Enrollment meetings will always be a great time to educate employees about your retirement plan. But depending on what's going on in their lives, *every day* may be a great time to talk to employees about it.

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