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Tax Reform Changes May Affect How Your Plan Determines Compensation

How is your plan's definition of compensation holding up in the wake of the Tax Cuts and Jobs Act (TCJA)? Changes to income brought about by this law could have a negative impact on your retirement plan's operations if you're not ready for them. The good news is that you have time to review what they are and make any necessary adjustments to your compensation definition before the plan year ends.

Your plan's definition of compensation, outlined in the plan's document, is what drives contribution amounts, contribution allocations, and nondiscrimination testing. It should specify certain elements of income that are either included or excluded when calculating contribution amounts, particularly with self-employment and partnership income. Wrongly including or excluding these elements can be time-consuming and expensive to correct under both the IRS' and Department of Labor's audit programs.

That's why conducting a self-audit of compensation—and making necessary adjustments—is crucial to avoiding operational errors and costly corrections. It's a good idea to regularly verify that a plan's definition of compensation matches the plan's administration to help ensure that, ultimately, the correct deferral and matching contributions are being made. This is even more important with the passage of the TCJA late in 2017. The following is a high-level explanation of two of the changes that may apply to your retirement plan.

Qualified Moving Expense Reimbursements Included as Income

One provision of the TCJA that could affect the determination of compensation for qualified plan purposes pertains to reimbursements for moving expenses. Effective after December 31, 2017, the TCJA eliminated the ability for employers to deduct reimbursements to employees for qualified moving expenses, as well as the ability for employees to exclude those reimbursements from income.

Before 2018, the Internal Revenue Code (IRC) allowed employees who incurred qualified moving expenses that

were reimbursed by their employer to exclude those reimbursement amounts from their adjusted gross income. In addition, employers were allowed to deduct those reimbursement amounts from their employment taxes. But for tax years 2018 through 2025, the deduction and exclusion for moving expenses is suspended under new IRC Sections 132(g) (2) and 217(k). During this time, employers must include any reimbursements for moving expenses on the employee's Form W-2, Wage and Tax Statement. Thus, reimbursements for moving expenses are reported as income to the employee. This may be counted as part of an employee's eligible compensation, depending on the plan's definition of compensation.

Plan sponsors should review their plan's definition of compensation, as they may need to change the payroll system to reflect whether the moving expense component of income is included or excluded for plan purposes.

Potential Deduction for Pass-Through Income Business Owners

Another provision of the TCJA that could affect compensation for qualified plan purposes relates to businesses that generate pass-through income for the business owner. Effective for tax years 2018 through 2025,

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some of these business owners are allowed to potentially deduct up to 20 percent of their qualified business income, subject to limitations and phase-out ranges. Prior to 2018, a deduction like this wasn't allowed.

Because pass-through business owners are taxed at their personal income tax rate rather than the corporate rate, this new deduction may have an impact on how their compensation is calculated and, consequently, the amount that they can contribute to the plan.

On August 8, 2018, the U.S. Treasury and the IRS issued lengthy proposed regulations implementing the 20 percent pass-through deduction for owners of sole proprietorships, partnerships, trusts, and S-corporations. At this time, it's not fully known how this deduction will be addressed on 2018 tax forms, or how it will affect the net income from self-employment calculation for owners of pass-through business entities.

Generally, if a business owner determines that he or she qualifies for the deduction, and the business owner's taxable income is $315,000 or less for the tax year (for married joint filers; $157,500 or less for single filers), the owner should be able to deduct the full 20 percent of qualified business income. Business owners should seek competent tax advice to determine if and how they can take advantage this new deduction.

As a plan sponsor for an employer that qualifies as a pass-through entity, you may need to make adjustments within your plan document to account for this potential deduction and its effect on your plan's definition of compensation.

Contact your plan's consultant with questions about the impact the TCJA may have on your plan's definition of compensation. ■

Defined Benefit Plan Document Restatement Update

Defined benefit plan restatement due date – April 30, 2020

The IRS has issued approval letters for new pre-approved defined benefit plan documents. Also, for the first time, pre-approved cash balance plan documents, with the ability to have an interest credit based on an actual rate of return of plan assets, will also be available. The IRS announced that April 30, 2020, is the deadline for sponsors of defined benefit and cash balance plans to restate their plans to the new pre-approved documents.

TPA Solutions anticipates having the supporting forms to begin restating defined benefit and cash balance plans in fall 2018.

If you sponsor a defined benefit or cash balance plan, watch for future communications regarding the restatement process. ■

Compliance Reminders 4Q2018

While the following list highlights important dates for retirement plan administrators, it isn't a listing of all compliance dates. Please contact your consultant with questions about compliance dates for your plan.

October 2018

1 Deadline to establish a first year, Safe Harbor 401(k) plan for the calendar plan year 2018.

15 Deadline to adopt a retroactive corrective amendment if the calendar year plan fails certain non-discrimination tests.

15 Minimum funding requirements for defined benefit, money purchase, and target benefit plan years ended January 31, 2018, must be met by October 15 in order to avoid excise taxes. An electronic transfer must be completed or a check mailed by this date.

15 Retirement plan employer contributions are due in order to be deducted on employer tax returns due to be filed October 15, 2018.

15 Form 5500 Series/8955-SSA – Forms that are on extension are due for the plan year ended December 31, 2017.

15 Pension Benefit Guaranty Corporation (PBGC) Comprehensive Premium filing due date for certain small pension plans with a 2017 calendar year end.

31 Form 5500 Series/8955-SSA – Forms are due for the plan year ended March 31, 2018, that aren't on extension.

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November 2018

15 Minimum funding requirements for defined benefit, money purchase, and target benefit pension plan years ended February 28, 2018, must be met by November 15 to avoid excise taxes. An electronic transfer must be completed or a check mailed by this date.

15 Retirement plan employer contributions are due to be deducted on employer tax returns due to be filed November 15, 2018.

15 Form 5500 Series/8955-SSA – Forms that are on extension are due for the plan year ending January 31, 2018.

30 Form 5500 Series/8955-SSA – Forms are due for the plan year ending April 30, 2018, that aren't on extension.

December 2018

15 Minimum funding requirements for defined benefit, money purchase, and target benefit pension plan years ended March 31, 2018, must be met by December 15 to avoid excise taxes. An electronic transfer must be completed or a check mailed by this date.

15 Deadline for qualified retirement plans' Summary Annual Report (SAR) for the calendar plan year 2017.

17 Retirement plan employer contributions are due to be deducted on employer tax returns due to be filed December 17, 2018.

17 Form 5500 Series/8955-SSA – Forms that are on extension are due for the plan year ending February 28, 2018.

31 Deadline for March 31, 2018, plan year end defined benefit pension plans to prepare the funding adequacy related Adjusted Funding Target Attainment Percentage (AFTAP) calculation to avoid a presumed 10% funding adjustment.

31 Deadline for employers to execute a first year, qualified retirement plan document effective for the 2018 calendar plan year.

31 Deadline to execute certain discretionary amendments to a qualified retirement plan effective for the 2018 calendar plan year.

31 Deadline for AFTAP related "Range" Funding Certification for certain calendar year pension plans.

31 Deadline for certain Required Minimum Distributions (RMDs) for certain qualified retirement plan participants who have attained age 70 1/2 or over. ■

Cash Balance Plans as a Savings Strategy

Combining a cash balance plan with a 401(k) plan – with proper design – can provide for a retirement plan with maximum deductibility and significantly higher contributions at a lower cost than a conventional 401(k) or defined benefit (DB) plan alone.

How It Works

Defined contribution (DC) plans, such as 401(k) plans, allow employees to make contributions based on their compensation. DB plans, such as cash balance plans, provide a specific benefit at retirement that is funded by the employer. So employees receive retirement savings in addition to what they save on their own.

In a 401(k) plan, the participant's retirement benefit amount depends on employee (and possibly employer) contributions, gains, and losses. Employer contributions in the 401(k) plan can be very limited. Participant accounts in cash balance plans grow through annual employer contributions and interest credits. The plan actuary generates annual participant statements expressing the participant's benefit as a hypothetical account balance. In other words, a cash balance plan defines the accrued benefit in terms of a stated account balance. Older participants have the capability to receive a higher benefit accrual because they have fewer years to save toward a very significant (up to $2.6 million at age 62) lump sum allowed in the plan.

When a cash balance plan is partnered with a 401(k) plan, the plan design of the profit sharing portion often uses a new comparability allocation formula with individual allocation groups. This allocation formula gives the actuary ultimate flexibility in funding contributions to minimize an employer's funding obligation and satisfy annual coverage and general nondiscrimination compliance testing.

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How Cash Balance and 401(k) Plans Compare

	Cash Balance Plan	401(k) Plan
Employee Participation	Does not depend on employees contributing	May depend on employees choosing to contribute
Contribution Funding Obligation	Mandatory	Discretionary
IRS Sec. 415 Annual Benefit/Additional Limit	2018 annual benefit limited to lesser of 100% of average compensation or $220,000	2018 contributions limited to lesser of 100% of Section 415 compensation or $55,000
Minimum Participation Test IRC Sec. 401(a)(26)	Yes	No
IRC Section 410(b) Coverage and IRC Sec. 401(a)(4) General Nondiscrimination Testing	Yes	Yes
Annuities	Must offer as a lifetime annuity	May offer as a lifetime annuity
Investment Risk	Employer bears risk	Employee bears risk
Creditor Protection	Yes	Yes
Federal Guarantee	May be insured by PBGC	Not insured by PBGC

A Growing Strategy

The use of cash balance plans as a retirement planning strategy is growing. Kravitz, Inc., an Ascensus company, released in August 2018 the 2018 National Cash Balance Research Report, showing a 15% net increase in the number of new cash balance plans compared with a 1% increase in new 401(k) plans. Cash balance plans now make up 37% of all defined benefit plans, up from just 2.9% in 2001.

Ideal candidates for cash balance plans include:

- Principals seeking a tax deduction of more than $50,000 or making more than $250,000 per year
- Consistently highly profitable companies of all types and sizes
- Consistently successful family businesses and closely held businesses
- CPA and law firms, medical groups, and professional service employers
- Older business owners who may have postponed saving for retirement

Partnering with a 401(k) Plan

If you're considering combining a cash balance plan with an existing 401(k) plan, it may require an amendment to the existing plan. If you're adopting a new cash balance plan, you have until the end of the intended plan year to do so. In either case, to get the most from a cash balance plan, you should work with your financial professional, outside council, actuary, and TPA to be sure that you completely understand future obligations and how certain situations may affect your plan. Under the right circumstances, cash balance plans—alone or partnered with a 401(k) plan—may be the right solution to help your business meet your retirement savings goals.

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