Tax Reform Act of 2014

In February 2014, Congressman Dave Camp (R-MI), Chairman of the House Ways and Means Committee, released his long-awaited tax reform draft, the Tax Reform Act of 2014. This is a summary of the provisions that appear to be of interest to CIEBA plan sponsors.

Rules Related to Roth Contributions to 401(k) Plans

Under current law, 401(k) plans may offer either traditional accounts or both traditional and Roth accounts. Contributions to traditional 401(k) accounts are excluded from an employee's income and earnings are tax deferred, but distributions are taxable. Contributions to a Roth 401(k) account are made from an employee's after-tax income, earnings are not taxable, and distributions generally are not taxable.

Under the Camp proposal, plans would generally be required to offer Roth 401(k) accounts. Employees would be able to contribute up to half the maximum annual amount into a traditional 401(k) account. Any contributions in excess of half of the limits would be to a Roth account. Employees could contribute their entire deferral into a Roth account, but employer contributions would continue to be made to a traditional 401(k) account.

According to Joint Committee on Taxation (JCT), this provision would raise $143.7 billion over the 10-year period, 2014-2023. However, the JCT's estimate does not consider the lost revenue from the non-taxable Roth distributions that would occur after 2023.

Inflation Adjustments

For 2014, the maximum benefit under a tax-qualified defined benefit plan is an annual payment equal to the lesser of an employee's average compensation for the three highest compensation years or $210,000. For 401(k) plans, the maximum annual elective deferral by employees is $17,500 and the maximum catch-up amount is $5,500 for employees at least 50 years old, for a total of $23,000. Total employer and employee contributions may not exceed $52,000. These limits are adjusted annually for inflation.

Under this provision, the inflation adjustments for the maximum benefit under a defined benefit plan, the maximum elective deferrals (including catch-up contributions) to a defined contribution plan, and the maximum combined contribution by an employer and employee to a defined contribution plan would be suspended until 2024. While the explanation for the provision states that this change would have little or no effect on annual contribution limits, according to JCT the provision would raise $63.4 billion over 10 years.

Modifications of Required Distribution Rules

Under current law, both defined contribution and defined benefit plans are subject to required minimum distribution rules which generally require an employee to take minimum distributions beginning at age 70½ or pay a 50% excise tax on the amount of the distribution. Special rules apply when the employee dies before the entire benefit has been distributed. Generally, any remaining amounts paid to a beneficiary are spread over the life expectancy of the deceased employee or the beneficiary, if longer.

Under this provision, any distributions to a beneficiary would be spread over five years following an employee's death. An exception would apply if the beneficiary is a spouse, is disabled, chronically ill, not more than 10 years younger than the deceased, or is a child. Under the exception, distributions would be spread over the life expectancy of the beneficiary. However, if the beneficiary dies or a child turns 21, the general five-year-distribution rule would apply. This provision would be effective for distributions with respect to employees who die after 2014, but would not apply to certain qualified annuities in effect on the date of enactment. JCT estimates that this provision would raise $3.5 billion over 10 years.

Reduction in Minimum Age for In-Service Distributions

Under current law, defined contribution plans generally may permit in-service distributions (distributions while an employee is still working for the employer) if the employee is at least 59½ years old. For defined benefit plans, plans may permit in-service distributions only for employees at least 62 years old.

Under this provision, all defined benefit plans would be permitted to make in-service distributions for employees at least 59½ years old. JCT estimates that this provision would raise $0.9 billion over 10 years.

Modification of Rules Governing Hardship Distributions

Under current law, generally plans may offer a hardship distribution to a participant if the distribution is necessary for an immediate and heavy financial need. Treasury regulations require that plans not allow employees taking hardship distributions to make contributions to the plan for six months after the distribution.

Under this provision, employees taking hardship distributions would be allowed to continue to make contributions to the plan. JCT estimates that this provision would have negligible revenue effect over 10 years.

Extended Rollover Period for Plan Loans

Under current law, if an employee terminates employment while a plan loan is outstanding, the employee has 60 days to contribute the loan balance to an IRA or the loan is treated as a taxable distribution and may also be subject to the 10% penalty for early withdrawals.

Under this provision, an employee who separated from employment with an outstanding plan loan would have until the due date for filing the federal tax return for that year to contribute the loan balance to an IRA. JCT estimates that this provision would have negligible revenue effect over 10 years.

No Proposed Retirement Savings Account Cap

The Administration's FY 2014 budget proposal included a cap on tax-deferred retirement savings that would limit the total amount in retirement accounts to the amount needed to provide the maximum annual benefit permitted for a defined benefit plan. Last year, the maximum annuity was $205,000 payable as a joint and 100% survivor benefit beginning at age 62. According to EBRI, using interest rates available in April 2013, the $205,000 limit would have translated to a maximum permitted accumulation of about $3.4 million. This provision was not included in the Camp bill.

There seems to be general agreement that tax reform legislation is not likely to see action soon. However, any of these provisions could be offered separately to raise revenue for other purposes.