

# PENTEGRA

## Your AdvantEDGE

First Quarter 2018



### Retirement Plan Implications of the New Tax Bill

The new tax bill does more to impact taxes than it does to retirement plans. The good news: when it comes to elective deferrals, there are no changes to the pre-tax amounts people are allowed to put into 401(k)s, IRAs and Roth IRAs. This alone is the cause for many sighs of relief, as during negotiations Congress was reportedly giving serious consideration to “Roth-izing” the 401(k), meaning that contributions to 401(k) plans would have been required to be made largely, or even entirely, on an after-tax basis, as is the case with a Roth IRA.

A Plan Sponsor Council of America (PSCA) survey published earlier this year found that three-quarters of its respondents “strongly agreed” that eliminating or reducing the pre-tax benefits of 401(k) or 403(b) retirement savings plans would discourage employee savings in workplace retirement plans. Thankfully, this did not come to pass.

In addition, changes to how distributions are made in hardship situations – not addressed by the Senate’s version of the bill, but included in the House’s -- failed to become reality. The House version of the bill would have eliminated the requirement that individuals take all available plan loans prior to hardship distribution, as well as the rule that prohibits participants from making contributions for six months following a hardship distribution.

It also would have allowed earnings, qualified non-elective employer contributions (QNECs) and qualified matching contributions (QMACs) to be taken in hardship distribution.

The House bill also would have repealed the credit for the elderly and permanently disabled. Instead, the bill as it stands retains that proviso.

Also eliminated was a House proviso that would have permitted in-service distributions under a pension plan or a governmental section 457(b) plan at age 59 ½, which would have made the rules for those plans consistent with the rules for 401(k) and 403(b) plans.

Another House proviso, which would have provided non-discrimination testing relief to closed defined benefit plans that met specified conditions, was also not included.

Many of the other changes included in the new law revolve around taxes, which of course will have an impact on participants' retirement strategies as well. These include:

- Individual tax cuts, where a seven-rate structure was maintained, although with lower rates and revised bracket amounts. The top rate was cut from its current level of 39.6 percent to 37 percent, as opposed to the 38.5 percent rate that appeared in the Senate bill.
- The standard deduction was increased to \$12,000 for single filers and \$24,000 for joint filers – practically double the old rate – while personal exemptions were completely eliminated.
- The child tax credit was doubled from \$1,000 to \$2,000 per qualified child, with \$1,400 being refundable.
- The deduction for mortgage interest will be limited to interest paid on up to \$750,000 of acquisition debt, down from its current limit of \$1 million.
- The top corporate tax rate will decrease from 35 percent to 21 percent.
- The individual alternative minimum tax (AMT) remains, but will now exclude any taxpayer with income under \$500,000 or family below \$1 million. The corporate AMT was repealed.

Also worth consideration is the new law's "pass-through" provision, which Republicans say is aimed at helping small businesses. ("Pass-through" refers to how individual owners of a business pay taxes on income derived from that business on their personal income tax returns.) Currently, owners of pass-through companies -- LLCs, partnerships, sole proprietorships, and S corporations -- are taxed on a personal income basis. The new law gives pass-through businesses a 20 percent deduction, in addition to cutting the top individual tax rate.

Will the 20 percent pass-through tax deduction hurt qualified plans? The short answer is: it depends. Under the old law, "pass-through" taxpayers like partners and S-corporation owners have all of their income from the business flow through to their personal income tax returns, where they paid ordinary income tax rates.

Under the new law, owners of sole proprietorships, S corporations and partnerships can take a deduction of 20 percent against their income from the business. However – as one might assume – that 20 percent deduction requires meeting a number of provisos regarding limitations, thresholds, phase-ins, and – outs, and more. As usual, we recommend you consult with a tax professional before simply assuming that 20 percent deduction.

This can affect a business owner's decision to sponsor or fund a qualified plan as follows:

- **Lower deduction.** While the lower rate overall is good news for a business owner, it actually lowers the effective deduction for qualified plan contributions.
- **Distributions still taxed at ordinary rates.** An owner in a high tax bracket in retirement will still pay ordinary income tax rates of up to 37 percent on distributions — even though he or she only got a 20 percent deduction up front (instead of 37 percent).
- **Practical impact.** The math will change, and retirement savings advisors will need to study the math so as to tweak their plan design advice -- but relatively few business owners are going to outright stop contributing to or

sponsoring plans. The new rules are less beneficial to business owners than the old, and contributions will likely drop somewhat in the aggregate, but the overall rules will remain beneficial.

Your Relationship Management team is available to help clarify these provisions. Please contact them with any questions or concerns.



## Pentegra's 2018 Millennial Benefit Trends Survey

Pentegra recently released its 2018 Millennial Benefit Trends Survey.

Our report provides a look at how millennial job seekers prioritize employee benefits, along with best practices recommended by human resource (HR) professionals. The report combines surveys and interviews with millennials and HR professionals about health insurance coverage, retirement plans, vacation policies, work-life balance and flexible work arrangements, among other issues of importance to millennials when seeking employment.

Report highlights include:

- Millennials rated five general benefits categories in order of importance: 401(k) retirement savings outpaced the others, with 38.98 percent rating it extremely important. Tying for runner-up were health insurance and pension plans.
- Over half – 53.85 percent – of HR respondents said they had noticed an increase in millennial job-seekers asking specifically about benefits.
- HR pros report that telecommuting and flex-time are an important benefit for this generation and state that companies are becoming more accommodating on that front.
- While HR respondents said that health insurance was a top benefit that millennial job seekers ask about, they also said that millennials are not particularly savvy when it comes to signing up for coverage.

There are plenty of other intriguing insights in our survey, which are detailed in the full version: [2018 Millennial Benefit Trends Report](#)



## Safe Harbor Summarized

The advantage of a safe harbor 401(k) plan is that it is not subject to the nondiscrimination tests required by traditional 401(k) plans. However, employees must receive a pre-determined level of employer contribution either in the form of safe harbor matching or safe harbor non-elective contributions.

In addition, the IRS requires the plan sponsor to provide an annual safe harbor notice to participants either by mail or electronically. This notice must inform participants of their rights and obligations under the retirement plan as well as the pre-determined level of employer contribution for the following plan year.

### The Safe Harbor Notice Deadline

For calendar year plans, there is a December 1st deadline. The safe harbor notice must also be provided to each newly eligible participant throughout the year. The following information should be included:

- The identification of plan(s) intended to satisfy the safe harbor provisions.
- Details about the formula used to compute the safe harbor match or non-elective contribution as well as information about other possible contributions.
- Information about the compensation on which the contributions are based.
- Information about the method for participants to make deferral elections.
- Details about withdrawal and vesting provisions.
- Also, if the plan sponsor reserves the right to decrease or suspend the safe harbor contribution, this must be noted.

For any questions about this safe harbor notice requirement or any other compliance deadline, please contact your Relationship Management team.



## When M&A Occurs, Don't Forget Retirement Plan Review

In recent years, many companies have grown their businesses through mergers and acquisitions (M&A). In fact year to date in the US, there have been 12,109 M&A transactions representing a total value of \$1,931 billion.\* This robust M&A trend only looks to continue.

If your company is contemplating acquiring another organization, the following considerations may prove helpful when evaluating another firm's retirement plan. Understanding the nature of the M&A transaction and comparing the respective retirement plans are important first steps.

### **Start By Analyzing The Structure Of The M&A Transaction**

Understanding whether the M&A transaction is a stock sale or an asset sale can help in determining next steps and identifying any issues involved that need to be front of mind as you progress through the transaction.

### **What You Need To Know About Stock Sales**

If the transaction is a stock sale, the acquiring employer purchases another company in its entirety. The acquiring employer becomes the employer and, therefore, the sponsor of the seller's qualified retirement plan. Key considerations of a stock sale include:

If both the acquiring and selling employers have a 401(k) plan at the time of the transaction, the successor plan rules prevent the acquirer from terminating the 401(k) plan of the purchased company once the sale is complete.

An acquiring employer may decide during the planning stages that the two 401(k) plans will be merged. Once the stock sale transaction is complete, the new owner can then merge the two plans together.

If the acquiring employer does not want to keep the selling employer's 401(k) plan, the purchase agreement needs to be crafted to include a requirement that the seller terminate the plan before the business transaction occurs. If the resolution to terminate the seller's plan is passed by the board and takes effect prior to the transaction, the seller is responsible for distributing all plan assets.

When a stock sale takes place, the acquired employees typically continue working for the acquiring company. Therefore they do not incur a severance from employment and there is no distributable event. The years of service the employees have with the seller will count toward eligibility and vesting credit under the acquiring employer's plan.

### **What You Need To Know About Asset Sales**

If the transaction is an asset sale, the acquiring company purchases only the assets or, for example, divisions of the selling company. The following outcomes will occur:

- The seller continues to exist and maintains its own qualified plan while employees of the purchased divisions or company move to the acquirer.
- Participants are generally treated as having severed service with the seller and can take a distribution from the seller's retirement plan.
- The entities may agree to transfer the retirement assets of the relocated participants from the seller's plan to the acquiring employer's plan. This would not be considered a distributable event since the acquiring employer would be seen as maintaining the seller's plan.

**Evaluating And Comparing Retirement Plans Is Key**

Once you understand the nature of the transaction and the issues involved, the next step is to review both the acquiring company's and the selling company's retirement plans. Creating a detailed comparison will enable you to identify differences that may need to be addressed as you move forward. It is also a perfect time to do a competitive analysis of the plans compared with industry best practices.

**Key considerations include:**

- Does the surviving plan(s) meet your company's benefit objectives and comply with all regulatory requirements?
- Are plan investment options and performance consistent with your investment policy statement?
- Is plan pricing in line with industry standards and your company's expectations?
- Do you have the information needed to identify liabilities and estimate future contribution and expense requirements?
- Does the acquired plan contain any protected benefits, such as, early retirement provisions and distribution options?

**With M&A Comes An Opportunity To Improve Your Plan**

A merger or acquisition can also present an opportunity to update and refine your retirement plan. Your Relationship Management team is always available to help evaluate plans in terms of investment options, pricing, participant engagement and more.

\*Factset, as of 8/31/17.



**Understanding Partial Plan Terminations – More Art Than Science**

Partial plan terminations occur when, by virtue of employer action, a plan realizes a significant decrease in the number of covered participants. Staff layoffs, factory closures and the sale of businesses are all common causes of a reduction in plan participation. Failing to identify a partial plan

termination can result in the disqualification of a plan sponsor's qualified retirement plan by the IRS as well as other adverse consequences for both the plan sponsor and plan participant. In this article, we take a quick look at what you need to consider with partial plan terminations.

**The IRS Perspective**

According to the IRS, partial terminations occur because of employer-initiated turnover. Under IRS Rev. Rul. 2007-43, this includes any severance from employment other than that which results from death, disability, or normal retirement.

To complicate matters, the IRS does not explicitly define the term "partial termination." As a result, the determination of whether a reduction in a plan sponsor's workforce results in a partial termination of the sponsor's tax-qualified retirement plan can be problematic. Instead, it requires the IRS to consider all facts and circumstances surrounding a plan and the employer sponsoring the plan to determine whether a plan has incurred a partial termination. Often IRS rulings and case law is referenced to provide context to this determination.

### **Why It Matters**

The IRS specifies that upon the partial termination of the plan, the rights of all affected employees to benefits accrued as of the date of such partial termination are non-forfeitable. If a partial termination occurs and a plan sponsor does not vest affected employees in their accrued benefits, the plan will cease to be qualified.

Losing qualified status can result in a number of serious consequences for both for the plan sponsor and the plan participants:

#### **Plan Sponsor Impacts:**

- The employer loses its tax deduction for non-vested contributions made to the plan.
- The plan's trust must also recognize income on its earnings.
- The plan sponsor and/or the plan fiduciaries responsible for failing to maintain the plan's tax-qualified status face the risk of lawsuits by participants who are forced to prematurely recognize income on their tax returns.
- In addition, in the event of an unfavorable IRS audit, the plan sponsor may need to pay fines and reinstate any forfeited benefits or balances to participants.

#### **Plan Participant Impacts:**

The plan participants must declare income on their tax return with respect to their vested accrued benefits.

Distributions from the disqualified plan are not eligible for rollover into another tax-qualified vehicle.

#### **The 20% Turnover Test**

Historically, the IRS has used 20% or greater turnover on an annual basis as a threshold for requiring an employer to demonstrate why a partial termination has not occurred. The onus is on the employer and the following factors are generally considered:

Is the turnover rate for an applicable period "routine" for the employer?

Do any new employees hired subsequently perform the same function or have the same title or comparable compensation?

Because of the lack of clarity surrounding the application of the partial termination rule and the adverse consequences that could result, an employer whose workforce has seen significant reductions should carefully evaluate whether or not their retirement plan has incurred a "partial termination."



### Did you Know?

Effective January 1, 2018 state of CT passed a law mandating pension tax withholding minimum of 6.99% on pensions.

Retirees can opt out of paying taxes by completing the state of CT's W4-P form and returning it to Pentegra. The form has codes allowing retirees to opt out of paying any taxes up front. These exclusions include having a total income that is less than a dollar amount specified on the form. If retirees do not elect to opt out or return a completed form with withholding that does not meet the 6.99% required minimum, then Pentegra will have to change the withholding to 6.99% by default.



### Pentegra Employees Volunteer for Project Linus

On November 20, John Pinto, President and CEO of Pentegra, along with over 40 employees from Pentegra's Shelton, CT and White Plains, NY offices, volunteered to make no-sew cozy fleece blankets for [Project Linus](#).

The Project Linus non-profit organization provides a sense of security, warmth and comfort to children who are seriously ill, traumatized, or otherwise in need through the gift of a new, handmade blanket created by volunteer "blanketeers."

According to Pinto, "It was a special day for us – particularly during Thanksgiving week -- to devote the day to creating these handmade blankets that will make a difference for a child. Project Linus is an extraordinary charity and we are proud to support them. We also want to thank [Volunteer New York](#), who made this partnership possible."

### Look For Us At These Upcoming Events

Feb 19-22  
ABA National Conference for Community Bankers  
Hilton Hawaiian Village Beach Resort  
Honolulu, HI

February 25-28  
ABA Wealth Management and Trust Conference  
Omni Orlando Resort at Champions Gate



Orlando, FL



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