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Tax Issues Are Percolating but None Are Yet Firmed Up

The SECURE Act is still pending action in the Senate; extenders (with estate tax and medical expense deduction involved) are just barely beginning to move. The cost of eliminating the expiration of tax reform rules approaches $1 trillion, and tax writers are on the hunt for offsets. The tax world is roiling, but a path forward is not yet clear.

Here's a rundown of the tax initiatives that are currently in play in Congress as lawmakers sprint to first the August recess, and then the September 30 end of the fiscal year. The September 30 date is key—a bill to fund the government and to increase (or suspend) the debt ceiling is mandatory, and Hill insiders believe it is this legislation that will carry pretty much any other bill that can be enacted into law this year.

- ***SECURE Act***: H.R.1994, the retirement savings bill, passed the House last month by a 417 to 3 vote. But it's still in limbo in the Senate. There, concerns held by three GOP Senators are preventing unanimous consent (UC) passage, and lack of floor time for debate is stopping a non-UC vote. Senate supporters remain optimistic that ultimately the measure will pass the Senate, but there is also growing pessimism as the hold-outs (Sens. Ted Cruz (R-TX), Mike Lee (R-UT) and Pat Toomey (R-PA)) show no signs of relenting in their objections to letting SECURE move by UC.

  The SECURE Act contains helpful open multiple employer plan (MEP) rules, a rule that would require employers to illustrate the projected lifetime income (payable monthly) that plan participants would get from their current retirement plan account balances, new safe harbor discrimination rules, expanded IRA rules, eased plan administration provisions, and—as an offset (that remains troubling, even though NAIFA supports the bill)—a stretch IRA provision that would require most non-spouse inherited 401(k) and IRA amounts to be distributed (and taxed) within 10 years of inheriting.

- ***Extenders***: The House Ways & Means Committee approved a tax extenders bill that contains two provisions of interest: the first is a revenue-raising provision that would accelerate the expiration of the Tax Cuts and Jobs Act (TCJA) estate tax rules from the end of 2025 to the end of 2022; the second would extend for two years current rules governing the above-the-line deduction for unreimbursed medical expenses. But there are currently no plans to take the approved measure to the House floor for a vote. Rather, House lawmakers

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are viewing it as their opening bargaining position with the Senate when (if) Congress gets serious about acting on the tax extenders issue.

The Senate Finance Committee has yet to act on a tax extenders package of its own, but is working on putting one together.

There remains considerable debate over whether (and if so how) to offset the cost of the extenders package. Ways & Means Committee Chairman Rep. Richard Neal (D-MA) has promised to find offsets (some $75 billion more is needed to fully fund the committee-approved package) before a House floor vote. Most Republicans (who control the Senate and Senate Finance Committee) think at least most of the extenders should not have to be offset, but are open to including revenue raisers if any can be found that are acceptable to a majority of the Senate.

Thus, things are still in limbo on this issue area, too. Resolution of the offset issue will be key. Most Hill folks think that ultimately this package, if it can be passed at all, will have to be attached to the fiscal-year-end government funding bill in September.

- ***Revenue Raisers:*** The hunt for new revenue is ongoing and intense. Not only are there revenue raisers needed for the tax extenders package, but also more revenue is required for other much-wanted (especially Democratic) tax priorities. For example, Ways & Means really wants to move a bill to eliminate the TCJA limit on the state and local tax (SALT) deduction—but only if such a bill is fully offset. Right now, committee staffers say they need almost half a trillion in new revenue to accomplish that. That’s a very heavy lift, even for a purely partisan “message bill” (the Republicans are already fierce in their defense of the TCJA SALT provision).

  As is always the case, the search for offsets is shrouded in secrecy, but here’s what we know so far: tax writers are looking at carried interest rules, at capital gains rules, and at estate tax rules (potentially including some change to step up in basis versus carryover basis rules). Also under consideration is “reusing” the stretch IRA offset that is included in the House-passed SECURE Act. Until/unless SECURE is enacted into law, that revenue is “fair game” for use in another tax bill. However, reusing the stretch IRA provisions puts enactment of SECURE at risk if another bill containing it is enacted prior to SECURE being enacted. So, such a move is somewhat controversial among the tax writers.

  We also know that many House Democrats think a hike in the corporate tax rate (each percentage point increase scores about $100 billion in new revenue) is an appropriate way to go, but many other House Democrats are uncomfortable with (or outright oppose) such a move. And the GOP is unified in opposition to a hike in the corporate tax rate. So, for now at least, it appears unlikely that a corporate tax rate hike is on the table.

  The tax code is full of rules that govern life and health insurance, annuities, retirement savings and employer-provided benefits. Every tax code provision—including the many that govern our products—will be under the tax writers’ microscopes as they search for new revenue.

- ***TCJA Expiration:*** Also under discussion—but unlikely to get action this year—are the 2025 expiration dates for most tax reform (TCJA) individual provisions. On July 8, the Joint Committee on Tax (JCT) released a revenue estimate of the cost of making the TCJA's individual rules permanent. According to the JCT, making the TCJA's rules permanent would cost almost $920 billion over the 10 years ending in 2029. That's an enormous revenue issue.

  Some of the TCJA's tax rules have Democratic support, while some are on the Democrats' potential chopping block. So, addressing the TCJA's expiring provisions has the potential for changes that raise revenue (e.g., eliminating or skinnying down the 20 percent deduction for pass-through business income, or the estate tax rules) as well as for changes that "cost" revenue.

  This issue is likely to generate a lot of discussion, but appears at this point unlikely to win enough support to actually enact legislation. But it is an issue area that bears a close watch and ongoing interaction with Congressional tax writers.

- ***Small Business Tax Relief:*** The Ways & Means Committee is also looking at creating a new small business tax credit to offer as a way to ease small business pain from an increase in the Federal minimum wage. No decisions have been made—either as to whether to offer small business relief in conjunction with the minimum wage increase bill or, if so, what form the relief would take. But initial thoughts are to create a tax credit based on the difference in payroll before and after a minimum wage increase.

Prospects: Both the SECURE Act and a tax extenders bill have a real chance for enactment later this year, either on their own (less likely) or as part of the fiscal-year-ending government funding bill. But neither is a slam-dunk, and either or both could crater on the shoals of partisan politics as 2019 winds down.

Treasury Proposes Exceptions to MEP One Bad Apple Rule

On July 2, the Treasury Department and the Internal Revenue Service (IRS) issued a proposed regulation (REG-121508-18) that provides an exception to the "one bad apple" rule applicable to defined contribution multiple employer plans (MEPs). The proposed regulation calls the "one bad apple" rule the "unified plan rule."

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Generally, the proposed regulation allows for a MEP's participating employer that is in violation of qualified plan rules to be spun off from the MEP, thereby insulating the MEP from disqualification due to the noncompliance of a specific participating employer. The usual MEP rule, until/unless this proposed regulation is finalized, is that if any participating employer in the MEP is in violation of the MEP rules, the entire MEP is disqualified.

The exception to the one bad apple rule is available in two different circumstances, and is subject to compliance with specified conditions.

The two circumstances are:

- If a participating employer is responsible for a qualification failure that the employer is unable or unwilling to correct, or

- If the participating employer fails to comply with the plan administrator's statutorily-authorized (Section 413(c)) request for information about a qualification failure that the administrator reasonably believes might exist.

To qualify for an exception to the one bad apple rule, the MEP must satisfy eligibility requirements, including:

- The MEP must have established practices and procedures to promote compliance, and a requirement to adopt relevant plan language
- The MEP plan administrator must provide notice and an opportunity for an unresponsive participating employer to take remedial action to correct the participating employer's plan failure
- The plan administrator must implement a spin-off of the unresponsive participating employer (including assets and account balances attributable to participants who are employees of the unresponsive participating employer) if and when the potential noncompliance evolves into actual noncompliance
- The spun-off participating employer's plan must be terminated; distributions as a result of termination will "not fail to be eligible for favorable tax treatment accorded to distributions from qualified plans (including that the distributions will be treated as eligible rollover distributions…)"
- The plan administrator must comply with any inquiry the IRS or spun-off plan representative makes in connection with an IRS examination of the spun-off plan, including for years prior to the spin-off

The proposed regulation also makes clear that a MEP will not be eligible for the exception to the one bad apple rule if it is under examination (by the IRS). It also provides considerable detail about what constitutes acceptable established practices and procedures to promote compliance, what must be in the required notices, and specifics about the plan language that the MEP must adopt.

Generally, a participating employer that is subject to these notice and potential spin-off requirements will have 90 days to respond to each required notice, and will have the option of correcting the problem(s) prior to spin-off/termination. The proposed regulation allows 180 days to complete a spin-off, if one is required.

Detailed rules about how to accomplish the spin-off and the subsequent termination of the spun-off plan are provided in the proposed regulation. Generally, the proposed regulation allows for what it calls “favorable tax treatment” of distributions from a spun-off, terminated plan, but also authorizes the IRS to “pursue appropriate remedies” against any party (including the participating employer’s owner) responsible for the failure that resulted in the spin-off/termination.

The proposed rules will take effect when they are finalized. The proposed regulation specifically states that employers may not rely on the proposed rules until after finalization. The proposed regulations are subject to a comment period that will be open for 90 days after the proposed regulation is published in the *Federal Register*.

***Prospects*:** The Department of Labor (DOL) is close to finalizing its own MEP regulation, which is also expected to at least loosen if not eliminate the one bad apple rule. The DOL regulation is currently under review at the White House’s Office of Information and Regulatory Affairs (OIRA) and could be returned to DOL for finalization at any time.

Both Hill and industry people believe that while the regulations could be helpful in expanding the use of MEPs by small employers, the pending legislation (the SECURE Act, H.R.1994; and/or RESA, S.972) is far more helpful. This is because the agencies are constrained by their statutory authority, while the legislation expands that statutory authority.

President Orders Regulations to Expand HSA and FSA Rules

On June 24, President Trump issued an Executive Order (EO) directing the Treasury Department to promulgate regulations to ease the rules surrounding health savings accounts (HSAs) and flexible spending arrangements (FSAs). The EO also directs Treasury to broaden the definition of medical expenses that can be paid from HSAs and FSAs.

On HSAs, the EO directs Treasury to address a coverage gap arising from the current “no other plan rule.” Generally, the problem is that a person may not have an HSA without a high deductible health plan (HDHP) and may have no other plan than the HDHP. But, an HDHP may not pay for treatment of chronic illnesses until the deductible is fully satisfied—and many HDHPs have deductibles that are higher than HSA contribution limits. This creates a coverage problem for people with chronic health conditions.

The EO zeroes in on this "no other plan rule" issue. It states that Treasury must promulgate a regulation—within 120 days of the EO (that would make it by mid-September)—that would "expand the ability of patients to select high-deductible health plans that can be used alongside a health savings account, and that cover low-cost preventive care, before the deductible, for medical care that helps maintain health status for individuals with chronic conditions."

On FSAs, the EO directs the Treasury to, within 180 days of the EO (or, by mid-December), to propose a regulation that would increase the FSA $500 rollover amount.

On eligible medical expenses, the EO requires Treasury—within 180 days—to promulgate regulations that would broaden the definition of medical expenses (in section 213(d) of the Internal Revenue Code) so that more expenses can be paid from HSAs and FSAs. The broader definition should cover direct primary care arrangements and health care sharing ministries, the EO states.

Prospects: New regulations reflecting these presidential orders will be issued, likely within the prescribed time frame. NAIFA will watch for the proposed regulations, which by and large are expected to provide helpful new rules for users of HSAs and FSAs.

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