THE NORTH PIER*spective*

Fiduciary Commentary

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Tax Reform - Here we go Again

In April 2017, President Trump revealed his administration's proposal for comprehensive tax reform. Trump's plan represents the largest tax change since the Tax Reform Act of 1986 (TRA 1986). If history serves as any guide, the preferential tax treatment that retirement plan incentives have long enjoyed may be at risk to pay for the tax cuts.

This is Yuuuuge! Trump's tax plan would affect nearly every taxpayer as well as sector of economy. Trump's proposal would:

- Reduce the current seven individual tax brackets into three; 10, 20 and 25 percent
- Reduce the corporate tax rate to 15 percent
- Double the standard deduction
- Repeal the federal estate and gift taxes and the alternative minimum tax
- Eliminate the 3.8 percent net investment income tax on high-income earners

The Committee for a Responsible Federal Budget estimates the cost of tax reform to be $5.5 trillion in the first decade alone. The math is simple…. If the intent is to lower personal and corporate income tax rates with a neutral effect on tax receipts, additional tax revenue must be secured to offset the costs of the tax cuts.

To help cover the cost of tax reform, Trump's plan calls for the elimination of many personal tax breaks. Americans have historically enjoyed an abundance of personal deductions including mortgage interest, charitable contributions and retirement plan and IRA contributions. Defined contribution plans represent one of the largest tax expenditures of the federal government. The Joint Committee on Taxation estimates that over the next five years defined-contribution plans will cost $584 billion in lost federal tax revenue. These figures may prove too costly for those in Washington when pressured to find a revenue neutral solution to tax reform.

A previous 2014 proposal to ease the cost of tax reform offers a glimpse into how Trump's legislation may play out and affect retirement plan contributions. The proposal sought to freeze retirement plan contribution limits for a decade and permit only half of elective deferrals to be made on a pre-tax basis (the remainder to be Roth contributions). The changes were estimated to raise over $200 billion in revenue over 10 years, mostly by transitioning saver's pre-tax savings to after-tax contributions. Furthermore, last generation's tax act, the Tax Reform Act of 1986, had a significant impact on retirement plans reducing deferral limits by 75%.

This time around, tax preference items will certainly be scrutinized again and a focus of any reform negotiations. The favored status of the of retirement plans will be high on that list of items. Retirement details that could be reduced or eliminated include:

- Reducing contribution limits
- Emphasizing after-tax or Roth deferral contributions over pretax deferrals
- New discrimination testing requirements limiting highly compensated employees benefits
- Limiting the deduction amount for pretax deferrals despite of marginal income tax rate

What is apparently not factored into Washington's budget calculations is that retirement plan tax preferences are temporary. Pre-tax deferrals and employer contributions (and their earnings) will be subject to taxes in the future when the contributions are withdrawn. However, Washington bean-counters view tax revenues and expenditures within a 10-year window. Taxable retirement plan distributions that will typically occur after that time period is considered lost tax revenue, despite the future tax consequences. This makes them an especially ripe target for cuts.

Trump's chief economic advisor and director of the National Economic Council, Gary Cohn that "retirement savings will be protected." Given the potential sweeping nature of the proposed reform and the immediate impact of cutting employer-sponsored contributions, it's easy to see why many are concerned that it will be especially difficult for retirement plans will remain unscathed during the tax-reform negotiations.

There will be considerable pressure for lawmakers to restrict or even eliminate current income exclusions to alleviate the fiscal pressure from Trump's tax reform initiatives. In the wake of the country's swelling federal budget deficit, retirement plans, having long benefitted from a favorable position in the Internal Revenue Code, again appear to be a valuable revenue target for law makers. The legislation proposed could serve to limit individual savings opportunities at the expense of future generation's tax receipts.

Extension of DOL Fiduciary Rule

On Feb. 3, 2017, President Trump issued a memorandum that would delay the DOL new fiduciary rule by up to 180 days. The memorandum directed the DOL to review the rule and its possible impact on the economy and savers. In doing so, if it were found inconsistent with administrative policy, Trump ordered the DOL to rescind and revise the rule.

Consequently, the Labor Departmentpushed the official effective date of the final regulation from April 10th to June 9th 2017, and extended the applicability dates of the amendment's previously granted fiduciaty advice exemptions

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