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US tax reform
Considerations for accelerating deductions for qualified retirement plans

Overview

Background

December 22, 2017 saw the passage of the 2017 Tax Act ("the Act"), following successful reconciliation of the House and Senate versions of the bill. Tax reform has created opportunities to accelerate deductions related to certain employee benefit programs into a corporation's 2017 tax year. By accelerating these deductions, the company benefits from higher marginal tax rates in effect prior to the Act and has an opportunity to make additional strategic choices about its programs.

What's changing

As a result of the Act, the top marginal tax rate for corporations has been reduced from 35% to a flat 21%. Corporations that file on a fiscal year basis will also see a reduction in their top marginal tax rates, though the rate applicable to such corporations in the taxable year beginning in 2017 will be a blend of the rates for 2017 and 2018.

As a result of this change, deductions are generally more valuable if taken for 2017, rather than 2018.

Taxpayers who maintain defined benefit plans (e.g., traditional pension plans, cash balance plans) or who maintain defined contribution plans (e.g., profit-sharing plans) may be able to take a 2017 deduction for contributions made during 2018.

Deducting Retirement Plan Contributions

Contributions to qualified retirement plans are deductible in the year contributed. However, contributions made after the end of the year may be treated as if made during the prior year if (a) the contribution is "on account of" the prior year, and (b) the contribution is made no later than the extended due date for the tax return (during a "grace period") for the year for which the deduction would be taken. For example, a calendar year corporation who has filed for extension of their 2017 calendar year tax return has until October 15, 2018, to make a contribution that would be deductible in 2017. However, as a consequence of minimum funding requirements applicable to defined benefit pension plans, it may be necessary, or advisable, to make the contribution earlier (no later than September 15, 2018 in the case of a calendar year plan) in order to comply with minimum funding obligations.

New Law, Old Rate, Strong Incentives

The Act lowers marginal tax rates effective beginning in 2018. At the same time, the Act left rules related to timing of deductions for retirement plan contributions unchanged. Therefore, the ability to accelerate deductions for plan contributions into earlier years remains, and the benefits of accelerating these deductions can be significant.

If the return for the year ending in 2017 has not yet been filed, 2018 grace period contributions to a plan may be deducted on the 2017 return at the pre-Act 35% rate.

In the case of a defined contribution plan, the plan's allocation language should be considered, as it will be necessary for the plan to contain language to accommodate the additional contribution.

In addition to the value of the accelerated deduction, there are strategic reasons to consider contributing additional amounts to defined benefit plans at this time, including:

- SERP Shift—Corporate taxpayers with SERPs may choose to increase benefits under the qualified retirement thereby potentially reducing their overall SERP liability. Paying benefits from a qualified retirement plan instead of a SERP may result in savings on FICA taxes, greater benefit security for SERP participants, and tax-free rollovers of related funds.
- Derisking—Additional funding in a defined benefit plan may allow a plan sponsor to purchase annuities or paying out lump sums to directly provide for the benefits of terminated vested participants, effectively limiting such sponsor's ongoing capital market risk.
- Plan termination—To terminate, a plan must be able to pay out its liabilities; additional funding can help facilitate a move away from an existing plan.
- Retiree Medical Benefits—A sponsor's plan has an existing retiree medical account (Section 401(h) account) in its defined benefit plan, the sponsor may have an opportunity for an additional 2017 tax year deduction by making additional contributions to the 401(h) account, up to applicable limits.

Deloitte's view

The change in tax rates presents an opportunity to preserve the value of deductions associated with certain common retirement programs. Important steps for employers to consider include:

- Obtain and review plan documents to determine whether the plans create the conditions for accelerating contributions.
- Obtain actuarial reports to determine whether a defined benefit plan's funding will permit any additional contributions to be made and deducted in the prior tax year.
- Discuss use of increased funding with advisers

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