HOW THE TAX CUTS & JOBS ACT OF 2017 COULD AFFECT YOUR IRA

The Tax Cuts and Jobs Act of 2017, signed into law on December 22, 2017, makes a number of changes that affect individual retirement arrangements (IRAs). The changes are varied and subtle in nature and, while it's highly unlikely all the changes will affect you, it is very possible that some of the changes could directly impact you as an IRA owner. These changes are generally effective for tax years beginning after 2017. This brochure is designed to provide you an overview of those changes so you can make informed decisions when managing your IRA.

Specifically, this brochure discusses the following provisions:

- The repeal of the rule allowing recharacterization of Roth IRA conversion contributions;
- An extended rollover period for plan loan offset amounts;
- The temporary reduction of the medical expense deduction floor;
- The suspension of miscellaneous itemized deductions;
- Use of retirement distributions for 2016 disasters;
- The inclusion of a new qualified hazardous duty area; and
- The repeal of the deduction for alimony payments and for the inclusion of alimony in adjusted gross income.

Repeal of the rule allowing recharacterization of conversions

Generally, recharacterization is the method by which an IRA owner can redesignate a contribution made to a traditional IRA as being made to a Roth IRA, or vice versa.

In tax years prior to 2018, you could "unwind" a conversion from a traditional IRA to a Roth IRA, as well as a qualified rollover from an employer-sponsored retirement plan to a Roth IRA, by recharacterizing the amount, in whole or in part, back to a traditional IRA.

For example, to avoid having to pay taxes on traditional IRA assets you converted to a Roth IRA you could have recharacterized part or all of the converted assets back to a traditional IRA. Similarly, a qualified rollover from an employer-sponsored retirement plan to a Roth IRA could have been recharacterized to a traditional IRA so you could avoid owing income taxes on the amount recharacterized.

Under the new law, you cannot use the recharacterization rules to unwind a conversion or a qualified rollover from an employer-sponsored retirement plan to a Roth IRA that occurred in 2018 or later. Thus, due to the significant income tax consequences of conversions and qualified rollovers to Roth IRAs, you may now want to pre-plan these transactions with your tax professional.

However, the new law does not change your ability to treat a regular contribution made to one type of IRA as being made to another type of IRA as long as the recharacterization of the contribution is completed on or before your federal tax-filing due date.

For example, if you make a regular contribution to a traditional IRA for a tax year that you determine is nondeductible you can still recharacterize that nondeductible contribution as a regular contribution to a Roth IRA, if eligible, on or before your federal tax-filing due date for such tax year.

Plan loan offset amounts

The new law provides for an extended rollover period for certain loans considered distributed from an employer-sponsored retirement plan. Under prior law, if an individual severed employment with a company while carrying an outstanding loan balance in his/her employer-sponsored retirement plan, the loan balance was basically considered a taxable distribution — sometimes referred to as a "loan offset" — and the individual had 60-days to roll over the amount considered distributed into an IRA.

Under the new law, in the same circumstances, the individual has until his/her tax-filing due date including extensions, for the tax year in which the amount is considered distributed, to roll over such amount to an IRA. For example, if a person severed their employment on August 1, they would at least have until April 15 of the following year to roll over the loan offset amount.

Temporary reduction of the medical expense deduction floor

Distributions taken from IRAs and employer-sponsored retirement plans by individuals younger than age 59½ are generally subject to a 10 percent early distribution penalty tax. One of the exceptions to the 10 percent penalty is for the payment of medical expenses.

Under prior law, the exception generally applied to distributions taken for medical expenses that exceeded 10 percent of an individual's adjusted gross income.

Under the new temporary law, the floor is reduced from 10 percent to 7½ percent. Thus, the 10 percent penalty would not apply to medical expenses that exceed 7½ percent of an individual's adjusted gross income. The new law only applies to distributions taken in taxable years 2017 and 2018. The 10 percent floor is set to return beginning with taxable year 2019.

For example, assume an individual has income of $100,000. Under the prior law, if the individual took distributions while under age 59½ from an IRA to pay for medical expenses and those distributions exceeded $10,000 for the tax year, they would not have to pay the 10 percent penalty tax on the amount that exceeded $10,000. Under the current law, medical expense distributions in excess of $7,500 will avoid the 10 percent penalty tax. Again, the 7½ percent floor only applies to distributions taken in taxable years 2017 and 2018.

Suspension of miscellaneous itemized deductions

The new law suspends the deduction for miscellaneous expenses. This change impacts some IRA owners.

Under the old law, some IRA owners that paid IRA fees directly, rather than having fees taken form the IRA balance, may have been able to deduct the fees as miscellaneous itemized deductions. For example, if you had traditional or SIMPLE IRA fees that were paid separately by you, you may have been able to claim those fees as miscellaneous itemized deductions on your federal income tax return.

Under the new law, beginning in taxable year 2018, no deduction would be allowed for those same fees. This provision will sunset after the 2025 tax year.

Thus, for the 2026 tax year, the fees could once again be deductible.

Use of retirement distributions for 2016 disasters

Existing law provides special tax treatment for retirement plan distributions taken by taxpayers affected by Hurricanes Harvey, Irma, and Maria. The special tax treatment includes the ability to spread the income tax on the distribution over a three-year period, avoid the 10 percent early distribution penalty, and roll the distribution back into a retirement plan within three years after having taken the distribution.

Under prior law, there was no special tax treatment for retirement plan distributions taken by individuals to help those individuals recover from 2016 disasters.

Under the new law, the existing special tax treatment rules for hurricane Harvey, Irma, and Maria distributions have been extended to 2016 presidentially declared disaster-related distributions taken before January 1, 2018.

For example, if at the time of the disaster, you lived in a 2016 presidentially declared disaster area, suffered economic loss, and took a distribution during 2017 from your IRA to help pay for the recovery, you may be entitled to the special disaster relief described above. Consult your tax professional to better understand all the options you may have available.

New qualified hazardous duty area

Under existing law, members of the U.S. Armed Forces serving in certain combat zones or hazardous duty areas are allowed an extended time period to make IRA contributions for a prior tax year. That period is the time the participant was in the designated zone or area plus at least 180 days.

Under prior law, members serving in the Sinai Peninsula of Egypt were not entitled to the extended contribution period.

Under the new law, the Sinai Peninsula of Egypt has been added as an additional hazardous duty area for members serving in that region after June 9, 2015 as well as any subsequent taxable years prior to January 1, 2026.

For example, if you are a servicemember deployed to the Sinai Peninsula of Egypt during the relevant time period, and your deployment ended on April 30, you would have at least until October 13 of the following year to make an IRA contribution for the tax year in which your deployment ended. Consult your tax advisor to discuss your specific circumstances and understand all the options you may have available.

Exclusion of alimony from gross income

The new law removes the deduction for alimony payments and also removes provisions for the inclusion of alimony in gross income. The new law applies to a divorce or separation instrument executed after December 31, 2018, as well as certain instruments modified after that date.

Under law prior to 2019, alimony received through a divorce or separation instrument is considered compensation for purposes of making an IRA regular contribution.

Under the new law, alimony received through a divorce or separation instrument executed after December 31, 2018, will not be taxable to the recipient, and therefore will not be considered compensation for purposes of making an IRA regular contribution. The new law, and this same rule, also applies to any divorce or separation instrument executed on or before December 31, 2018, but is subsequently modified and the modification expressly provides that the new law applies to the modification.

For example, if you receive alimony as the result of a divorce decree executed January 31, 2019, and had no other source of income in 2019, you would probably not be eligible to make a contribution to your IRA for the 2019 tax year.

This brochure is intended to provide general information regarding the impact to IRAs resulting from the Tax Cuts and Jobs Act of 2017. It is not intended to provide recommendations, legal advice, or to be a detailed explanation of the rules or how those rules may apply to your individual circumstances. For specific information, you are encouraged to consult your tax or legal professional. IRS Publication 590-A, Contributions to Individual Retirement Arrangements (IRAs), *IRS Publication 590-B,* Distributions from Individual Retirement Arrangements (IRAs), *and the IRS web site, www.irs.gov, may also provide helpful information.*

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