2 tax law changes that may affect your business's 401(k) plan

When you think about recent tax law changes and your business, you're probably thinking about the new 20% pass-through deduction for qualified business income or the enhancements to depreciation-related breaks. Or you may be contemplating the reduction or elimination of certain business expense deductions. But there are also a couple of recent tax law changes that you need to be aware of if your business sponsors a 401(k) plan.

1. Plan loan repayment extension

The Tax Cuts and Jobs Act (TCJA) gives a break to 401(k) plan participants with outstanding loan balances when they leave their employers. While plan sponsors aren't required to allow loans, many do.

Before 2018, if an employee with an outstanding plan loan left the company sponsoring the plan, he or she would have to repay the loan (or contribute the outstanding balance to an IRA or his or her new employer's plan) within 60 days to avoid having the loan balance deemed a taxable distribution (and be subject to a 10% early distribution penalty if the employee was under age 59½).

Under the TCJA, beginning in 2018, former employees in this situation have until their tax return filing due date — including extensions — to repay the loan (or contribute the outstanding balance to an IRA or qualified retirement plan) and avoid taxes and penalties.

2. Hardship withdrawal limit increase

Beginning in 2019, the Bipartisan Budget Act (BBA) eases restrictions on employee 401(k) hardship withdrawals. Most 401(k) plans permit hardship withdrawals, though plan sponsors aren't required to allow them. Hardship withdrawals are subject to income tax and the 10% early distribution tax penalty.

Currently, hardship withdrawals are limited to the funds *employees* contributed to the accounts. (Such withdrawals are allowed only if the employee has first taken a loan from the same account.)

Under the BBA, the withdrawal limit will also include accumulated employer matching contributions plus earnings on contributions. If an employee has been participating in your 401(k) for several years, this modification could add substantially to the amount of funds available for withdrawal.

Nest egg harm

These changes might sound beneficial to employees, but in the long run they could actually hurt those who take advantage of them. Most Americans aren't saving enough for retirement, and taking longer to pay back a plan loan (and thus missing out on potential tax-deferred growth during that time) or taking larger hardship withdrawals can result in a smaller, perhaps much smaller, nest egg at retirement.

So consider educating your employees on the importance of letting their 401(k) accounts grow undisturbed and the potential negative tax consequences of loans and early withdrawals. Please contact us if you have questions.