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Milliman

# CLIENT ACTION Bulletin

Employee Benefits

## Tax Reform Offers Incentive for Companies to Accelerate Pension Contributions


**SUMMARY**

**The enactment of the "Tax Cuts and Jobs Act" (TCJA) at the end of 2017 reduced the corporate tax rate from 35% to 21%, generating attention due to the significant savings that will result for corporations. But this change alone produces a unique opportunity for companies that contribute additional cash to corporate single-employer and multiple-employer defined benefit (DB) retirement plans, but only for the 2017 plan year. For a calendar-year plan, contributions for the 2017 plan year are deductible at the 35% corporate tax rate if made by Sept. 14, 2018 (if filing with extension). Going forward, a company's tax deduction will be at the lower, 21%, rate.**


**DISCUSSION**

The TCJA, enacted on Dec. 22, 2017, made significant changes to the tax code. Although the law contained no provisions directly affecting DB plan funding or maximum deductibility, its corporate-rate reduction produces an incentive for pension plan sponsors to accelerate their contributions, thereby maximizing the tax effectiveness of the deductions for the 2017 plan year. By doing so, companies also stand to gain other immediate and longer-term benefits. The analysis below should not be considered corporate tax planning advice.

### TCJA's Corporate Tax Rate Reduction

While contributions made for the 2018 plan year will generally be deducted at the new, lower corporate tax rate of 21%, contributions for the 2017 plan year remain deductible at the higher, 35%, rate. For many corporations with underfunded or fully funded DB plans, contributing additional dollars beyond the minimum required – or accelerating already scheduled contributions for the 2018 plan year and recharacterizing the amounts as plan year 2017 contributions – will generate a net tax savings. This is particularly true for underfunded plans, as they eventually are expected to require additional contributions.

### Lowering Amounts Paid for PBGC Variable-Rate Premiums

By increasing the plan year 2017 amounts contributed to a DB plan that is not deemed fully funded by the definition used by the Pension Benefit Guaranty Corporation (PBGC), a corporate sponsor may get the plan to the fully funded threshold and avoid paying the PBGC variable-rate premiums. In 2018, the PBGC's flat-rate premium applicable to all plans is $74 per participant, while the variable-rate premium is $38 per $1,000 of unfunded vested benefits, capped at $523 times the number of plan participants. (Small plans may have a lower cap.) Thus, any contribution in 2018 to the DB plan for the 2017 plan year immediately reduces the PBGC variable-rate premium by 3.8% in 2018 (and more in future years). And the PBGC currently projects the variable-rate premium to increase in 2019 to $42 per $1,000 of underfunded liabilities, followed by increases based on inflation starting in 2020. In addition, corporate DB plan sponsors should bear in mind that updated mortality assumptions also might produce volatility in the PBGC variable-rate premium amounts.

### Downstream Effects

A company making the additional, discretionary contributions to the DB plan also could derive additional benefits. That money, for example, would then be invested and anticipated to grow at the plan's expected rate of return (e.g., 6.5%), leading to an effective return on capital of 10.5% in 2018 and 11.0% in 2019, and potentially higher returns in future years. With improved earnings, a sponsor of a corporate DB plan may not have to make funding contributions in some years.

### Illustrative Example

To illustrate how a corporate DB plan sponsor could benefit, assume it makes an additional contribution of $10 million into an underfunded pension plan in 2018 for the 2017 plan year. This additional contribution would:

- reduce the variable-rate premiums paid to the PBGC by $380,000 in 2018 (and $420,000 in 2019, and growing in following years);
- be anticipated to grow by a company's expected return on plan assets in 2018 (an estimated range of 5% to 7%, which translates to $500,000 to $700,000);
- reduce the Financial Accounting Standards Board (FASB) accounting expense in 2018 and beyond (by an amount similar to investments in the trust, depending on timing) – to the extent these contributions were anticipated at the beginning of the fiscal year; and
- likely be tax deductible at the 2017 corporate tax rates, because any contribution before Sept. 14, 2018, can count as a 2017 plan-year contribution for calendar-year plans.

While plans that are *fully funded on a PBGC basis* will not see additional PBGC savings (since there is no variable-rate premium), these plans will see the additional tax deductibility and FASB accounting expense savings outlined above. In addition, because of the structure of the PBGC variable-rate premium, additional contributions to plans *at the PBGC variable-premium cap* (due to per-participant head count) may not result in the corporate plan sponsor sharing in the PBGC advantages, but it will see the additional tax deductibility and accounting expense savings outlined above.

### Other Issues to Consider

Accelerated funding of plans improves overall plan funding. Well-funded plans have more flexibility and options when considering risk transfer opportunities such as liability driven investments and de-risking through either annuity purchases or lump-sum offerings. A final advantage of accelerated funding is a reduction in required contributions, which will allow a plan sponsor to be more strategic about contributions in the future.

## ACTION

With tax reform now in place, many corporations are poised to take advantage of opportunities to improve the financial status of their DB retirement plans. Companies should discuss the new law's effects and make decisions on their corporate DB plans with their accounting, tax, and actuarial advisers in the upcoming months and take action by the deadline (for calendar-year plans) of Sept. 14, 2018. Doing so will enable them to stabilize, move their plans more firmly into the black, and provide future contribution flexibility.

For additional information about the TCJA's provisions regarding its DB plan funding opportunity, please contact your Milliman consultant.


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