



WRMarketplace

An AALU Washington Report

Thursday, February 19 2015

WRM# 15-06

The *WRMarketplace* is created exclusively for AALU Members by the AALU staff and Greenberg Traurig, one of the nation's leading tax and wealth management law firms. The *WRMarketplace* provides deep insight into trends and events impacting the use of life insurance products, including key take-aways, for AALU members, clients and advisors.

TOPIC: Administration's FY 2016 Budget - Part II: Notable Provisions Relating to Retirement Plans and Savings

MARKET TREND: The Administration's FY 2016 Budget ("2016 Budget") proposals continue to target wealthier individuals while including some provisions which focus on retirement coverage for the broader population. Some proposals seek to cap retirement savings by high net worth individuals and limit the ability to transfer wealth to future generations using certain retirement vehicles. Other proposals facilitate the operations of qualified retirement plans and provide some incentives and/or mandates for increasing the availability of these plans to individuals on a wider-scale.

SYNOPSIS: The Administration's 2016 Budget renews many prior proposals relating to retirement plans and adds a few new provisions, including: (1) limiting the total accrual of certain retirement benefits; (2) eliminating "stretch" payments; (3) allowing 60-day rollovers by non-spouse beneficiaries; (4) simplifying the required minimum distribution rules; (5) implementing mandates and financial incentives for employers to provide retirement plans; (6) facilitating annuity portability; (7) requiring employers to cover long-term part-time workers; and (8) limiting Roth conversions to pre-tax contributions.

TAKE AWAYS: While it is unclear whether any of the Administration's proposals will actually become law, particularly with a Republican-led Congress, these proposals are important because they may indicate potential changes to the laws affecting retirement plans and related financial planning. Because these provisions could affect AALU members who consult on retirement plan administration and/or financial planning relating to retirement plans, AALU will remain vigilant in monitoring of legislative activity and interacting with those who will craft pertinent legislation.

PRIOR WRM REPORTS: 15-05; 15-03; 14-11; 14-10; 13-16.

MAJOR REFERENCES: [*Budget of the U.S. Government Fiscal Year 2016; General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals \(Feb. 2015\).*](#)

The retirement plan-related provisions of the 2016 Budget are almost identical to those contained in the President's budget and revenue proposals for FY2015, with a few revisions, although several new provisions have been added. The following is a description of the most significant renewed or newly-introduced retirement plan-related proposals.

RENEWED PROVISIONS

Limitation on the Total Accrual of Certain Retirement Benefits. The 2016 Budget would limit the maximum amount an individual could accrue in the aggregate under all IRAs and qualified retirement arrangements in which he or she participated. This limit applies to IRAs and to qualified plans, 403(b) annuities, and funded 457(b) arrangements, regardless of the identity of the employer maintaining the arrangement. The 2016 Budget would limit the maximum accrual in any year to the actuarial value of a joint-and-100% survivor annuity beginning at age 62 in an amount equal to the maximum annual benefit that could be provided that year under a qualified defined benefit plan under Internal Revenue Code (“**Code**”) § 415(b). This annual amount is \$210,000 for 2015, and the 2016 Budget estimates the current maximum accrual to be approximately \$3.4 million.

The limit, once reached, applies to any additional contributions and accruals, not to future investment earnings on plan and IRA account balances. Thus, earnings may allow total accounts to exceed this limit. In addition, if the participant’s accounts suffer investment losses or generate earnings less than the amount by which the limit is increased to account for inflation, such that the total aggregate value of all IRAs and plans subject to this rule drop below the maximum permissible amount, additional contributions or accruals can be made to bring the aggregate accrual to the limit.

- **Comment:** This limitation would affect high earners and individuals who have participated in qualified retirement plans and IRAs for many years and who derived substantial investment earnings on the amounts deferred under those arrangements. For these individuals, this limitation could shift their attention to other products, such as life insurance.

This cap would be very complicated to administer and would significantly increase burdens on plan participants, who would face new obligations (such as obtaining an actuarial valuation of their aggregate retirement savings). Individual participants would bear the onus for complying with this limitation and would be required to remove amounts contributed to these retirement arrangements if the cap is exceeded. Employers also would need to cooperate with those plan participants who need to remove amounts from employer-sponsored plans.

Elimination of “Stretch” Payments. Currently, the required minimum distribution (“**RMD**”) rules applicable to qualified plans and IRAs allow plan/account distributions made after the death of the plan participant or IRA holder to be made over the life expectancy of the designated beneficiary, thereby “stretching” out the period of distribution and, therefore, the deferral of taxation on distributions. Under the 2016 Budget, distributions to non-spouse beneficiaries of qualified plan accounts or IRAs would be required to take distribution of the entire inherited account balance within five years. Exceptions to this rule apply in limited circumstances to any beneficiary who, as of the date of the participant’s death, is: (1) disabled, (2) a chronically ill individual, (3) an individual not more than ten years younger than the participant or IRA holder, or (4) a minor child (but the exception applies only until the child reaches majority).

- **Comment:** This provision also has appeared in recent proposed legislation. Its enactment would eliminate stretch IRA planning and the appeal of Roth conversions (because why incur income tax now when the deferral benefits will be limited to only five years?), but it may increase the attractiveness of life insurance (*i.e.*, if the IRA funds will ultimately be taxed anyway, it may make sense to place the money into annuities, life insurance, or an irrevocable life insurance trust).

Allow All Inherited Plan and IRA Balances to Be Rolled Over within 60 Days. Currently, transfers of amounts inherited by surviving non-spouse beneficiaries under an employer retirement plan or IRA are transferrable to a non-spousal inherited IRA only by a direct rollover or trustee-to-trustee transfer. The 2016 Budget would expand the roll-over options for these beneficiaries by allowing 60-day rollovers of such assets. The liberalized rollover treatment would be available only if the beneficiary informs the new IRA provider that the IRA is being established as an inherited IRA, so that the IRA provider can title the IRA accordingly.

Simplification of RMD Rules. RMDs must be taken from qualified plans and IRAs (but not Roth IRAs) shortly after the plan participant has both terminated employment with the plan sponsor and attained age 70-1/2. In addition, RMDs must be made to 5% owners of the plan sponsor without regard to termination of employment, and complicated rules apply to distributions made after a participant's death. The 2016 Budget would eliminate RMDs to an individual if, as of a measurement date, the individual's aggregate value of IRA and qualified plan accumulations (disregarding the value of any defined benefit plan benefits that have already begun to be paid in any life annuity form) does not exceed \$100,000, and the RMD requirements would phase in ratably for individuals with aggregate benefits between \$100,000 and \$110,000.

In addition, the 2016 Budget would make the RMD rules, subject to the exemption described above, applicable to amounts held in Roth IRAs. Relatedly, individuals could not make additional contributions to Roth IRAs after attaining age 70-1/2.

- *Comment:* This provision likely would have no effect for many taxpayers, because individuals who have actively and meaningfully participated in qualified plans and IRAs over the course of their working lives will have accumulated amounts in excess of the applicable threshold and, thus, will remain subject to the current RMD rules.

Automatic Enrollment in IRAs and Financial Incentives for Small Employers to Provide Retirement Plans. The 2016 Budget would require employers who have been in business for at least two years and who have more than ten employees to offer an automatic IRA option, pursuant to which contributions would be made on a salary reduction basis, unless the employee opts out. Employers offering a qualified retirement plan, a SEP or a SIMPLE to its employees would be exempt from this requirement, unless it excludes from participation in its existing arrangement employees other than those who are covered by a collective bargaining agreement, are under age 18, are nonresident aliens or have not completed the plan's eligibility waiting period. In such a case, it would have to offer the automatic IRA arrangements to those excluded employees.

The 2016 Budget also provides various financial incentives for employers to implement certain retirement plans or plan features. First, small employers (those that have no more than 100 employees) that offer an automatic IRA arrangement could claim a temporary non-refundable tax credit for the employer's expenses associated with the arrangement up to \$1,000 per year for three years. These employers would also be entitled to an additional non-refundable credit of \$25 per enrolled employee up to \$250 per year for six years. The credit would be available both to employers required to offer automatic IRAs and employers not required to do so (e.g., they do not have more than ten employees).

Second, in conjunction with the automatic IRA proposal, to encourage employers not currently sponsoring a qualified retirement plan, SEP, or SIMPLE to do so, the non-refundable "start-up costs" tax credit for a small employer that adopts such an arrangement would be tripled from the current maximum of \$500 per year for three years to a maximum of \$1,500 per year for three years. The expanded credit would extend to four years (rather than three) for any employer that adopts a new qualified retirement plan, SEP, or SIMPLE during the three years beginning when

it first offers (or first is required to offer) an automatic IRA arrangement. This expanded credit for “start-up costs” of small employers would be allowed against administrative costs and employer plan contributions. Like the current “start-up costs” credit, the expanded credit would encourage small employers to adopt a new 401(k), SIMPLE, or other employer plan and would not apply to automatic IRAs or other payroll deduction IRAs.

Finally, small employers would be allowed a \$500 credit per year for up to three years for new plans that include auto-enrollment. This credit would be in addition to the credit for “start-up costs.” Small employers would also be allowed a credit of \$500 per year for up to three years if they added auto-enrollment as a feature to an existing plan.

Elimination of Deduction for Dividends on Stock of Publicly Traded Corporations Held in ESOPs. Generally, a corporation is not entitled to a deduction for dividends it pays on its stock. However, an exception to this rule applies to certain dividends paid on stock held under a qualified employee stock ownership plan (“ESOP”). The 2016 Budget would deny this deduction for stock held by an ESOP that is maintained by a publicly traded corporation.

- **Comment:** ESOPs have been afforded the dividend deduction and other incentives to employers to encourage employee investment in employer stock, because that ownership has been considered to enhance employee productivity and company performance. The Administration questions whether the degree of employee ownership of employer stock provided through an ESOP in a publicly traded company is sufficient to bring about these benefits and, therefore, whether the sponsors of these ESOPs deserve to receive the dividend deduction. This provision, however, should not affect those sponsors who have established ESOPs as an efficient means of transferring ownership of all or a part of their business, because those transactions are rarely, if ever, effected by publicly traded companies.

NEW PROVISIONS

Facilitating Annuity Portability. The 2016 Budget would permit a plan to allow participants to transfer a distribution of a lifetime income investment through a direct rollover to an IRA or other retirement plan if the annuity investment is no longer authorized to be held under the plan, without regard to whether another event permitting a distribution (such as a severance from employment) has occurred. In other words, a person holding an annuity contract in his or her qualified plan account, which the plan no longer allows, could take a distribution of that annuity contract and roll it over to an IRA even if the participant is not otherwise entitled to a plan distribution. The distribution would not be subject to the 10% additional tax on early distributions, regardless of the participant’s age or circumstances at the time of distribution. By requiring the distribution to be accomplished through a direct rollover to an IRA or other retirement plan, the proposal would keep assets within the retirement system to the extent possible.

- **Comment:** The provision is intended to enable a participant to retain his or her annuity investment and not have to liquidate it simply because a plan no longer permits the investment. It reflects the Administration’s targeted efforts over time to enhance the extent to which defined contribution retirement plans offer distribution alternatives that provide a lifetime stream of income.

Require Retirement Plans to Allow Long-Term Part-Time Workers to Participate. The 2016 Budget would expand access to employer-sponsored retirement plans for part-time employees by requiring employers with retirement plans to permit employees who have worked for the employer for at least 500 hours per year for three or more consecutive years to make

voluntary contributions to the plan. The proposal would also require a plan to credit, for each year in which such an employee worked at least 500 hours, a year of service for purposes of vesting in any employer contributions; the proposal does not, however, require the employer to make contributions on behalf of these employees (though it is unclear how these part-time employees would be required to be treated for purposes of applicable non-discrimination testing).

Limit Roth Conversion to Pre-Tax Dollars. Taxpayers are eligible to make contributions to a Roth IRA only if their modified adjusted gross income does not exceed an established threshold. There is no similar limit on a taxpayer's ability to contribute to a traditional IRA, though contributions by individuals earning in excess of a specified threshold are made on an after-tax basis. Also, there are annual limits on the amount that can be contributed during any year to a designated Roth account under a qualified plan, but there is no similar limit on the amount that can be contributed to the plan, if the plan allows, on an after-tax basis.

Individuals can convert amounts held in a traditional IRA to a Roth IRA. Similarly, if a plan so allows, a participant can convert amounts held on his or her behalf under the plan into amounts held in a designated Roth account. The 2016 Budget would allow Roth conversions only with respect to amounts that would be includible in income if the amounts were distributed to the individual. Thus, the proposal would prohibit Roth conversions of amounts contributed to IRAs or qualified plans on an after-tax basis so that taxpayers would be precluded from circumventing restrictions on their ability to make Roth contributions in the first instance.

Expand Penalty-Free Withdrawals for Long-Term Unemployed. Early withdrawals from a qualified retirement plan or an IRA are subject to a 10% additional tax, unless an exception applies. One exception is for an IRA distribution after separation from employment if, among other things, the aggregate of all distributions made in each year in the two-year period that includes the period during which the individual received unemployment compensation for at least 12 weeks does not exceed the premiums paid during the taxable year for health insurance. This exception applies only to distributions from IRAs; it is not available for distributions from a qualified retirement plan.

The 2016 Budget would expand this exception from the 10% additional tax to cover more distributions to long-term unemployed individuals from an IRA, not just those sufficient to cover the cost of health insurance coverage. The exception would also apply to distributions from a 401(k) or other qualified defined contribution plan. An individual would be eligible for this expanded exception with respect to any distribution from an IRA or qualified defined contribution plan if: (1) the individual has been unemployed for more than 26 weeks by reason of a separation from employment and has received unemployment compensation for that period (or, if less, for the maximum period for which unemployment compensation is available under State law applicable to the individual), (2) the distribution is made during the taxable year in which the unemployment compensation is paid or in the following taxable year, and (3) the aggregate of all such distributions does not exceed specified limits.

Repeal of Exclusion for Net Unrealized Appreciation in Employer Securities. If a participant receives a distribution from a qualified plan that includes shares of the stock of the employer maintaining the plan, some or all of the net unrealized appreciation ("NUA") in the employer securities is excluded from the participant's gross income in the year of the distribution. NUA is the excess of the market value of the employer stock at the time of distribution over the cost or other basis of that stock to the trust. NUA is generally taxed as a capital gain at the time the employer stock is ultimately sold by the recipient. The 2016 Budget would repeal this exclusion from gross income for participants who had not yet attained age 50 as of December 31, 2015; older participants would be unaffected by this proposal.

Require Form W-2 Reporting for Employer Contributions to Defined Contribution Plans.

The 2016 Budget would require employers to report on an employee's Form W-2 for any taxable year the amount of all contributions made on the employee's behalf to a qualified defined contribution retirement plan. The Administration believes that this change would provide individuals with a better understanding of their overall compensation and retirement savings. In addition, it is thought to facilitate compliance with the annual limits on allocations under defined contribution plans.

TAKE AWAYS

- The Administration's proposals may face strong legislative resistance by Republican Congressional majorities, particularly to the extent any provisions are characterized as constituting a tax increase.
- These proposals are important, however, because they may indicate significant changes to the laws affecting retirement plans and related financial planning, particularly if tax reform efforts gain steam.
- Because these provisions could affect AALU members who consult on retirement plan administration and/or financial planning relating to retirement plans, AALU will remain vigilant in monitoring of legislative activity and interacting with those who will craft pertinent legislation.

DISCLAIMER

This information is intended solely for information and education and is not intended for use as legal or tax advice. Reference herein to any specific tax or other planning strategy, process, product or service does not constitute promotion, endorsement or recommendation by AALU. Persons should consult with their own legal or tax advisors for specific legal or tax advice.

The AALU *WRNewswire* and *WRMarketplace* are published by the Association for Advanced Life Underwriting® as part of the *Essential Wisdom Series*, the trusted source of actionable technical and marketplace knowledge for AALU members—the nation's most advanced life insurance professionals.

WRM #15-06 was written by Greenberg Traurig, LLP

Jonathan M. Forster
Martin Kalb
Richard A. Sirius
Steven B. Lapidus
Rebecca Manicone

Counsel Emeritus

Gerald H. Sherman 1932-2012
Stuart Lewis 1945-2012