

MEMO# 28729

February 11, 2015

Retirement Plan Proposals in Obama Administration FY 2016 Budget

[28729]

February 11, 2015

TO: OPERATIONS COMMITTEE No. 5-15

BANK, TRUST AND RETIREMENT ADVISORY COMMITTEE No. 4-15

BROKER/DEALER ADVISORY COMMITTEE No. 6-15

TRANSFER AGENT ADVISORY COMMITTEE No. 7-15 RE: RETIREMENT PLAN PROPOSALS IN OBAMA ADMINISTRATION FY 2016 BUDGET

President Obama's fiscal year 2016 budget [\[1\]](#) contains several items related to retirement plans and IRAs, some repeated from past budgets and some new for this year. With the Republican-controlled Congress, the President's budget is unlikely to advance, although various individual proposals could be (and have been) included in other proposed legislation. The following is a list of proposals from the FY 2016 budget relating to defined contribution (DC) plans and individual retirement arrangements (IRAs) that may be of interest to Institute members.

- Automatic IRAs. As in prior years, the Administration proposes to require employers that do not currently offer a retirement plan to automatically enroll workers into a payroll deduction IRA program, at a default contribution rate of three percent. Employees could opt out or elect a different contribution rate. Certain very small and new employers would be exempt. Small employers (no more than 100 employees) that offer an automatic IRA arrangement (whether or not required to do so) would be eligible for a business tax credit for the employer's expenses associated with the arrangement, up to \$1,000 per year for three years. These employers also would be eligible for a credit of \$25 per participating employee, up to a total of \$250 per year for six years.
- Additional tax credits. The Administration proposes to increase the small employer pension plan startup credit to a maximum of \$1,500 per year for three years (up from \$500 per year) and to extend the credit to a fourth year for any small employer adopting a new qualified plan, SEP or SIMPLE plan during the three years beginning when it first offers or is required to offer an automatic IRA arrangement (see above). In addition, the proposal would include a new credit for small employers that add automatic enrollment to a new or existing DC plan, of \$500 per year for up to three years.

- Expand penalty-free withdrawals for long-term unemployed. The Administration proposes to expand the existing exceptions to the early distribution penalty tax to withdrawals by long-term unemployed individuals from IRAs, 401(k) plans, or other tax-qualified DC plans for any use (in addition to the existing limited exception for IRA withdrawals used to pay for health insurance premiums while unemployed). Long-term unemployment would be unemployment for at least 27 weeks (or, if less, the maximum period of unemployment benefits available under applicable state law) and the distributions would be limited to 50 percent of the value of all of an individual's IRAs or 50 percent of the value of the vested account balances in all of an individual's tax-qualified retirement plans, subject to an aggregate annual maximum of \$50,000. The first \$10,000 of distributions would not be subject to the 50 percent limitation.
- Coverage of part-time workers. The Administration proposes to require qualified retirement plans to permit employees to make elective deferrals if they have reached at least 500 hours of service per year with the employer for at least three consecutive years. Plans also would be required to credit a year of vesting service (for purposes of any employer contributions) for each year in which an employee has at least 500 hours of service. There would be nondiscrimination testing relief (including from top-heavy testing) associated with these new requirements.
- Facilitate annuity portability. The Administration proposes to permit DC plans to allow participant distributions of annuities (through direct rollover to an IRA or other retirement plan) when the annuity is no longer offered as an investment under the plan, regardless of whether the participant is otherwise eligible for a distribution. This proposed change is intended to encourage plan sponsors to offer annuity options in their plans.
- Simplify required minimum distribution (RMD) rules. The Administration proposes to exempt individuals from RMDs if the aggregate value of an individual's IRA and tax-qualified plan balances does not exceed \$100,000 (measured as of the beginning of the year in which the individual reaches age 70-1/2 or dies, with additional measurement dates if amounts, other than earnings, are credited to the accounts that were not previously taken into account). The proposal also would apply the RMD rules to Roth IRA owners during their lifetimes (as with designated Roth accounts in 401(k) plans).
- Indirect rollover of inherited IRA and plan balances. The Administration proposes to permit non-spouse beneficiaries of IRAs or qualified plans to roll over balances to inherited IRAs by indirect (60-day) rollover. This proposed change is intended to harmonize the rules for spousal and non-spousal beneficiaries.
- Limit on value of certain tax preferences. The Administration proposes to limit the tax rate at which individuals in the top three income tax brackets (33, 35, and 39.6 percent) can benefit from itemized deductions and other tax preferences to 28 percent. The limit would apply to all itemized deductions and other specified deductions and exclusions, including the exclusion for employee contributions to DC plans and IRAs. Under the proposal, if the limit reduces a taxpayer's deduction or exclusion for contributions to retirement plans or IRAs, the taxpayer's basis will be adjusted to reflect the additional tax imposed.
- Accelerate required distributions to non-spouse beneficiaries. The Administration proposes to require non-spouse beneficiaries of IRA owners and retirement plan participants to take inherited distributions over no more than five years, eliminating the so-called "stretch IRA." There would be exceptions to the five-year rule for beneficiaries who are disabled, chronically ill, no more than ten years younger than the decedent, or minor children. After attaining the age of majority, a minor child would then have to take distributions over no more than five years. The five-year limit

would not apply in the case of a participant whose benefits are determined under a binding annuity contract in effect on the date the proposal is enacted.

- Cap on total accrual of tax-favored retirement benefits. The Administration proposes to impose a cap on the total aggregate value of account balances and accrued benefits under retirement plans (DC and defined benefit plans) and IRAs. The cap would be equivalent to the dollar amount needed to buy an annuity with annual income equal to the maximum annual defined benefit plan benefit under Internal Revenue Code section 415 (currently \$210,000) payable as a joint and survivor benefit commencing at age 62. Under this formula, the maximum permitted accumulation for a 62-year-old today would be approximately \$3.4 million. (For an individual who is currently younger than age 62, the maximum permitted accumulation would be even lower.) Individuals reaching the cap would be prohibited from making further contributions or receiving further accruals under their plans, but the individuals' accounts could continue to accumulate investment earnings. Because the cap would be recalculated each year, losses in an account or adjustments to the defined benefit plan annual limit, for example, could result in a permitted resumption of contributions or accruals for a taxpayer previously limited by the cap.
- Limit Roth conversions to pre-tax dollars. The Administration proposes to prohibit the conversion of after-tax or nondeductible contributions held in traditional IRAs or plans to a Roth IRA. Only pre-tax amounts could be converted to Roth. This would eliminate the so-called "back-door Roth IRA." It apparently also would eliminate the ability to direct a rollover of after-tax amounts in a plan to a Roth IRA as permitted under IRS Notice 2014-54. [2]
- Require W-2 reporting for employer contributions to DC plans. The Administration proposes to require employers to report amounts contributed by the employer to an employee's DC plan accounts on Form W-2 (as they already are required to report an employee's elective deferrals to a retirement plan on Form W-2).
- Encourage state retirement savings initiatives. The Administration would provide \$6.5 million to the Department of Labor (DOL) to allow a limited number of states to implement state-run automatic IRAs or retirement plans for private-sector workers. [3] The proposal also would provide DOL with authority to temporarily waive ERISA section 514 preemption of state laws relating to employee benefit plans. [4]
- Repeal exclusion of net unrealized appreciation (NUA) in employer securities. The Administration proposes to repeal the current exclusion from income for NUA in employer stock received as part of a lump sum distribution (currently the NUA is taxed as a capital gain when the employer stock is sold). The proposal would repeal the exclusion for participants who have not reached age 50 by December 31, 2015.

While not technically "retirement" related, we also note that the Administration's budget would repeal Coverdell education savings accounts (ESAs) – going forward, no new contributions would be allowed to Coverdell ESAs.

Elena Barone Chism
Associate General Counsel

endnotes

[1] The FY 2016 budget is available here:
<http://www.whitehouse.gov/sites/default/files/omb/budget/fy2016/assets/budget.pdf>. The Office of Management and Budget's Analytical Perspectives document is available here:

<http://www.whitehouse.gov/sites/default/files/omb/budget/fy2016/assets/spec.pdf>. The Treasury Department's General Explanations document (known as the "Green Book") is available here:
<http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2016.pdf>.

[2] See [Memorandum](#) to Pension Members No. 38-14 [28403], dated Sept. 24, 2014.

[3] For example, the Illinois legislature recently passed legislation to create a state-run retirement program for private-sector workers in the state. See [Memorandum](#) to Pension Members No. 2-15 [28650], dated Jan. 8, 2015.

[4] For further detail see FY 2016 Congressional Budget Justification, Employee Benefits Security Administration at <http://www.dol.gov/dol/budget/2016/PDF/CBJ-2016-V2-01.pdf> (page 6, numbered as EBSA-2).