President Obama Proposes Radical IRA/Pension Law Changes
excerpt from April 2013 Pension Digest

President Barack Obama released his proposed 2014 fiscal year budget on April 10, 2013, He was over 64 days late as federal law requires him to furnish his proposed budget by February 4th. He is suggesting some radical changes with respect to IRAs and pension plans. In July of 2007 President George W. Bush had suggested some radical changes. None of his proposals were adopted. President Obama has adopted one of these changes – requiring certain small employers to automatically enroll employees to make IRA contributions. Time will tell if any of President Obama's proposals will be adopted. Within this article, the term IRA account holder also means a pension participant. As you will observe, many of these proposed changes are complicated. Different rules for different classifications.

Proposed change #1. Certain Non-spouse Beneficiaries Must Use 5-Year Rule.

For IRA account holders dying after December 31, 2013, a non-spouse beneficiary no longer would be able to use the life distribution rules to withdraw funds from the inherited IRA or from the pension plans. Rather, the president's proposal would generally require the use of the 5-year rule. This applies to all IRA types. There would be two exceptions. First, any beneficiary who is disabled, chronically ill, or within 10 years of the age of the IRA accountholder would be able to use the life distribution rule beginning in the year following the year of the IRA accountholder's death. Second, an inheriting IRA beneficiary who is a minor will have to take required distributions as under existing law using the life distribution rule with a major change. All distributions must be completed no later than the end of the fifth year after the individual reaches the age of majority. The Obama administration has estimated this change would raise tax revenues by an additional 4.9 billion over the next 10 years.

Proposed change #2. No RMD for Individuals with IRA and Pension Balances if Balance Less Than $75,000.

The RMD Requirement would be eliminated for some IRA accountholders. It would only apply to an IRA accountholder who attains age 70½ or older during 2014 or a subsequent year. The general rule would be: an individual would not be required to take an RMD if as of January 1 of the year he or she attains age 70½ his or her combined account balances in IRAs and pension plans was $75,000 or less. Once calculated the individual would not be required to take an RMD for subsequent years unless additional contributions were made to the IRA and/or other pension accounts and these contributions resulted in the $75,000 limit being exceeded. That is, increases in the account balance on account of investment gains would not require a person to start taking required distributions. This would be a complicated rule and additional guidance would need to be furnished. For purposes of the determining a person's aggregate balance as of January 1, the person's would aggregate the account balances of all IRAs, including Roth IRAs and the balances of all qualified pension plans with one exception. A person would be able to exclude from the RMD calculation any amount in a qualified defined benefit plan if such benefit amount was already in pay status.

Proposed change #3. Certain Small Employers Would be Required to Sponsor an IRA Program for Employees.

President Obama is again seeking a law requiring certain small employers to sponsor an IRA program requiring the employees to have a certain percentage withheld from their wages (i.e. automatic enrollment) and such amounts would then be contributed via direct deposit into their respective IRAs. An employee would have the right to elect to not be automatically enrolled or to opt out. An employer would have the right and duty to establish an IRA on behalf of each eligible employee. The employer would be protected from claims of liability regarding investment and compliance issues as long as the employer followed set rule and procedures. An employer would be required to sponsor an automatic IRA plan if it had more than 10 employees an no other retirement plan. A primary purpose of the new law may well be to induce an employer with no other plan to establish one – a SEP, SIMPLE, profit sharing or 401(k) plan.

Copyright © Collin W. Fritz & Associates, Ltd. "The Pension Specialists"

Proposed change #4. Maximum Balance Limit to Apply to IRAs and Pension Plans

Commencing January 1, 2014, in general, a new maximum account balance limit of $3.4 million would apply to a person. A person would be required to aggregate their balances in any defined benefit plan, defined contribution plan, 403(b), 457, and IRAs. No additional contributions could be made once the $3.4 million limit is reached. There would substantial unspecified administrative duties on account of this new law. It appears an individual would be required to share IRA balances with his or her employer's plan. There would be excess contribution rules applied if the 3.4 million limit was exceed-ed. The $3.4 million limit is not really $3.4 million as this limit is the actuarial equivalent of a joint and 100% survivor annuity paying an annual amount of $205,000 commencing at age 62. Since interest rates are currently low, the $3.4 million limit would become smaller if the interest rate increased. The Obama administration has estimated this change would raise tax revenues by an additional 9.0 billion over the next 10 years.

Proposed Change #5. A Limit to be placed on Various Itemized Deductions and Above the Line Adjustments For High Income Individuals.

In order to have individuals with higher incomes pay more income taxes, a new limit would be imposed on the benefit that such a person can realize by taking a tax deduction or an above the line adjustment. The benefit can never exceed 28%. This proposed change is called the Buffet Rule. For example, if a person is in the 36.3% marginal tax rate, he or she will need to pay income tax on the amount in excess of the 28% as he or she is not allowed to claim a tax deduction or claim the tax benefit for the above the line adjustment. An above the line adjustment is a deduction claimed which reduces one's gross income in determining modified adjusted gross income. It would apply to HSA contributions, IRA contributions, elective deferral contributions to a 401(k)plan, and to employer contributions for medical insurance coverage. If a person would have to pay income tax on an IRA or pension plan contribution because of this new tax, then the person will have basis. The proper records would need to be maintained. This 28% limit would apply to married couples with taxable incomes in excess of $223,050 and individuals with taxable income exceeding $183,250. The Obama administration has estimated this change would raise tax revenues by an additional 529 billion over the next 10 years. Obviously, this is the main tax revenue raising change.

Change #6. Revise Formula so COLAs Would be Smaller

Under current tax law and social security law, various benefits and tax income limits are revised according to certain cost-of-living formulas. Social security benefits are generally revised on an annual basis. Various income limits for pensions and IRAs are revised each year. HSA limits are revised each year. Revising the COLA limit formula will have the effect that social security benefits paid to retirees will not increase as much as they otherwise would have. Revising the COLA limit as proposed is estimated to reduce the federal deficit by $230 billion over the next 10 years.

Change #7. Cut-back on Deductions for ESOP Dividends

Under current law, C corporations are permitted to claim a tax deduction for employer stock held in an ESOP (Employee Stock Ownership Plan) if certain conditions are met. However, there have been quite a few cases where such corporations have gone bankrupt or lost substantial value. ESOPs can be very complicated. Both the IRS and the DOL have problems administering these plan. There are quite a few administrators within the Obama administration who would like to see fewer ESOP plans. One way to achieve this goal is to eliminate one of the principal tax benefits associated with SOP, the tax deduction for certain dividend payments. The Obama administration has proposed retaining the dividend deduction if the C corporation has annual receipts of $5 million or less, but eliminating the deduction if annual receipts are more than $5 million. The proposals by President Obama to change certain laws governing IRAs and pension plans most likely will not be adopted in 2013 or 2014. A political compromise by the Democratic Senate and

Copyright © Collin W. Fritz & Associates, Ltd. "The Pension Specialists"

the Republican House is very unlikely. Things will change if the Democrats regain control of the House of Representatives while retaining control of the Senate or the Republicans gain control of the Senate while retaining control of the House of Representatives in November of 2014. As the amounts within IRAs and pension plans grow, one can expect the politicians will look to these funds as a source of tax revenues and there will be suggested changes. Time will tell what changes are adopted.

Copyright © Collin W. Fritz & Associates, Ltd. “The Pension Specialists”