

BENEFIT BYLINES

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Important Note

This issue of *Benefit Bylines* was originally intended to be a sequel to ABP's Winter 2012/2013 newsletter which focused on the looming "fiscal cliff" crisis and the *Save My 401(k)* campaign. However, literally as we were about to go to press, the Obama Administration issued its proposed 2014 fiscal year budget. Among other controversial items, the proposed budget includes retirement plan provisions that are highly problematic. This somewhat delayed Spring newsletter has been updated to inform readers about the Administration's retirement proposals and their likely implications to plan sponsors and participants in the event that they are approved by Congress. ■

Fiscal Cliff Avoided (but impasse remains on Federal taxes and expenditures)

Look Back

In the Winter Edition of *Benefit Bylines*, we encouraged our readers to become actively engaged in the *Save My 401(k)* campaign sponsored by the American Society of Pension Professionals & Actuaries (ASPPA). At that time, the nation was about to fall off what became known as the "fiscal cliff." As a reminder, the "Bush Era Tax Cuts" were set to expire at the end of 2012, resulting in major tax increases for all workers, the elimination of extended unemployment benefits, the elimination of corporate tax breaks, and other negative consequences. There was much heated debate, both before and after last year's presidential election, regarding the need for permanent actions to address the budget deficit, tax reform, and whether "fixes" should focus primarily on tax increases or expenditure reductions.

In recent years, numerous proposals involving both direct and indirect Federal expense reductions have been put forth by members of Congress and others. Targets for direct expense savings include defense spending, entitlement spending, and other Federal programs. Indirect expenditures under review have included deductions for items such as home mortgage interest, health insurance, and retirement savings, to name a few.

Last year, ASPPA initiated the *Save My 401(k)* campaign to educate plan sponsors, plan participants and Washington officials about the important role that 401(k), 403(b) and other similar arrangements play in providing retirement security for American workers. (Continued on Page 2)

Obama Administration Budget Includes Disturbing Retirement Provisions

On April 10, 2013, the Obama Administration released its budget outline for fiscal year 2014. Among many other controversial proposals, that outline includes two key provisions that would seriously impact the tax incentives for retirement savings.

28% cap on individual deductions and exclusions

The first proposal, which was also in the 2013 budget proposal, would place a 28% cap on individual deductions and exclusions, including elective deferrals for retirement savings. This means that if a participant has a marginal tax rate above 28%, that person would essentially be paying a surtax on employee contributions to a qualified retirement plan equal to the applicable marginal rate less 28%. So, a taxpayer in a 39.6% marginal tax bracket would pay up to 11.6 % tax on deferrals that were historically not taxed at the time of contribution. Given that ordinary income tax would still be paid on future distributions from the retirement savings account, those taxpayers impacted by this provision would end up being subject to double taxation on their deferrals. (Continued on Page 2)

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This campaign was motivated by the aforementioned proposals in the name of tax reform and deficit reduction. Some of these proposals, if enacted, would have a severely negative impact on workers' long-term retirement security. One proposal included serious consideration of substantially reducing the amount of deductible contributions that workers could make to their employer's 401(k), 403(b) or similar savings plan. Ironically, these proposals appeared to be gaining traction at the same time concerns were being expressed by others in Congress about insufficient retirement savings by workers and the looming crisis with Social Security. So, the ASPPA *Save My 401(k)* campaign and other educational and lobbying efforts were intended to point out the short-sightedness of attempting to address one financial crisis (the budget deficit) by actions that worsen another looming crisis (the long-term retirement security of the working American).

Fiscal Cliff Avoided

At the absolute last minute (January 1, 2013), Congress passed the "American Taxpayer Relief Act of 2012," and the President signed it into law on January 2, 2013. (Yes, the title of the Law references 2012 but it was actually adopted in 2013.) This legislation avoided the fiscal cliff (actually just postponed it), in part, by extending what became known as the "Sequestration" deadline by two months – from January 1, 2013, to March 1, 2013. You may recall that the Budget Control Act of 2011 set in motion such drastic cuts in expenditures on programs cherished by Republicans and Democrats that it would surely force a compromise on the budget (more on that in a separate article). In addition, major provisions of the Taxpayer Relief Act are listed below:

- *Made middle-class tax cuts (often referred to as the "Bush Era Tax Cuts") permanent for middle-class taxpayers.*
- *Raised the marginal income tax rate for taxpayers earning more than \$400,000 (single) or \$450,000 (married filing jointly) from 35% to 39.6%.*
- *Raised the tax rate on capital gains and qualified dividends for taxpayers at the above income thresholds from 15% to 20%.*
- *Increased the estate tax rate from 35% to 40% exempting the first \$5 million for individuals and first \$10 million for couples.*
- *Ended the payroll tax holiday by reinstating the employee Social Security withholding tax rate of 6.2% (was previously reduced to 4.2%).*
- *Extended federal unemployment benefits through 2013.*
- *Made the \$1,000 child tax credit permanent.*
- *Extended the opportunity to make tax-free charitable distributions from IRA accounts through the end of this year.*
- *Permitted employers sponsoring 401(k), 403(b) or governmental 457 plans to offer an in-plan Roth conversion option with fewer restrictions.*
- *Made permanent the alternative minimum tax (amount) exemption limit, indexing it to inflation.*

What the Taxpayer Relief Act Did and Did Not Do

The Taxpayer Relief Act did, at least temporarily, avoid having the country fall off the fiscal cliff. As illustrated in the above list, the Act also extended or made permanent many of the less controversial provisions of the Bush tax cuts that had been in place for more than a decade. The Act included two retirement-related provisions. First, it liberalized the rules for internal plan conversion of pre-tax accounts to Roth accounts in 401(k) type plans. Second, it extended the opportunity to make non-taxable distributions from IRA accounts to qualifying charities through 2013. Both of these provisions will be discussed in the Summer issue of *Benefit Bylines*. Significantly, the Taxpayer Relief Act did not reduce any of the current contribution or compensation limits affecting retirement plans. But, as discussed elsewhere in this newsletter, that battle is far from being over. ■

(Obama Administration Budget Includes Disturbing Retirement Provisions - continued from page 1)

\$3 million cap on value of benefits

The second proposal would cap the value of an individual's retirement savings across all qualified plans and IRAs at the amount required to purchase an annuity equal to the maximum defined benefit payable at age 62 under the 100% joint and survivor form of payment. For 2013, the statutory maximum permissible defined benefit is \$205,000 per year. The lump sum value of this benefit on a 100% joint and survivor basis using current rates is \$3.4 million. Accordingly, taxpayers impacted by this provision will be those with retirement accounts from all sources in excess of \$3.4 million. Both the maximum benefit and its equivalent lump sum value will change from time to time for cost of living adjustments and changes in annuity purchase rate assumptions.

The cap works by limiting future tax-deferred contributions for these taxpayers. If the annuity payable at age 62 that could be purchased by an individual's account balances at the end of the previous tax year, plus any benefit accrued to date in a defined benefit plan, exceeds the dollar limit (\$205,000), no additional contributions or benefits could be accrued in any of the tax favored accounts for the following year. Accounts could continue to grow with investment earnings, but if any additional contributions or benefit accruals occur during the year, the taxpayer would have to include these excess accumulations in income and would have to withdraw the excess contribution or accrual.

Although the stated intent of the proposals is to target tax preferences primarily used by wealthy Americans, the proposals will impact taxpayers across the income spectrum by giving business owners and other decision makers less incentive to maintain retirement plans that benefit all workers. This is discussed more fully in the companion article titled "ABP Analysis and Opinion". ■

ABP Analysis and Opinion – The Obama Budget and More

The Administration's Rationale

In explaining the reason why the Administration believes that a cap is required on aggregate tax favored retirement savings, the following language appears in the Treasury Department's explanatory "Green Book":

"The current law limitations on retirement contributions and benefits in each plan in which a taxpayer may participate do not adequately limit the extent to which a taxpayer can accumulate amounts in a tax-favored arrangement through the use of multiple plans. Such accumulations can be considerably in excess of amounts needed to fund reasonable levels of consumption in retirement and are well beyond the level of accumulation that justifies tax-advantaged treatment of retirement savings accounts. Requiring a taxpayer who, in the aggregate, has accumulated very large amounts within the tax-favored retirement system to discontinue adding to those accumulations would reduce the deficit, make the income tax system more progressive, and distribute the cost of government more fairly among taxpayers of various income levels, while still providing substantial tax incentives for reasonable levels of retirement savings."

Targeting Business Owners Does Not Make Sense

As evidenced by the above statement, the Administration's retirement proposals are being presented as part of an overall package of tax code changes intended to restore equality between wealthy and middle-income taxpayers while helping to reduce the deficit. This "tax the rich" strategy is likely to be an easy sell to those voters who are not aware of all of the issues, but it is clearly short-sighted.

Let's ignore for a moment the fact that employer and employee contributions to retirement accounts generally defer but do not avoid Federal taxation. Many of the people who would be most directly impacted by the double taxation of 401(k) type deferrals and the cap on aggregate retirement savings are business owners and executives. The tax code provisions that enable business owners and executives to accumulate substantial retirement savings for themselves have historically been conditioned on the employer also making meaningful contributions on behalf of rank and file employees. These were conscious decisions by both Republican and Democratic controlled Congresses and Administrations for many decades. These rules were intended to encourage employers to voluntarily sponsor retirement plans for their workers and to encourage workers themselves to save for retirement.

Common sense says that if business owners/retirement plan sponsors who are facing higher taxes as a result of other tax code provisions are also told that they may no longer be able to contribute additional funds for their own retirement, they will be less inclined to contribute for their employees. And, given the challenges associated with sponsoring an employee retirement plan that complies with highly complex federal nondiscrimination requirements, common sense also leads one to believe that many employers will choose to no longer maintain plans for their employees. So, recognizing (a) that Social Security must somehow be modified to assure its survival and (b) that workers are struggling to save enough for retirement, does it really make sense for the Federal government to implement policies that discourage retirement savings and will result in reduced employee coverage and lower funding?

Will The Obama Budget be a Catalyst for Action and Compromise?

In an article appearing in the April 15, 2013, issue of BARRON'S, contributing author Jim McTague acknowledged that "A majority of Washington's pundits have pronounced President Barack Obama's \$3.8 trillion fiscal 2014 budget dead on arrival". However, McTague goes on to hypothesize that, in his view, the budget "will be the opening move as congressional Republicans and Democrats work to replace the budgetary meat cleaver better known as the sequester with a surgical instrument. Expect negotiations to become intense as citizens feel the pain of lost jobs and some disappearing government services."

ABP's Crystal Ball

In addition to having something for everyone to hate, the Obama budget has some provisions that both conservatives and progressives can embrace. While it is highly unlikely that the current budget proposal will be approved by Congress, there is some reason to be optimistic that it will stimulate more fruitful negotiations in the weeks and months ahead.

The danger, as we see it, is not that this specific budget proposal will survive. Rather, we are concerned in general that a final budget agreement will reflect short-term political solutions that may not be in the best long-term financial interest of the nation. More specifically, we fear that both conservatives and progressives may be tempted to reduce the budget deficit by taking actions that are inconsistent with a sound long-term retirement policy.

Almost by definition, the final budget will require compromise in many areas. This likely means that the status quo will not be maintained in the retirement area nor with many programs and other tax preference items that are highly valued by various constituents. Accordingly, educating and lobbying with our Federal policymakers about the importance of retirement savings and the vital role that small businesses (and small business owners) play will become even more crucial in the coming weeks and months. Please be sure to read the article titled "Grassroots Lobbying Works" for further insight about what ASPPA is doing and what you can do to help protect the private retirement system. ■

Grassroots Lobbying Works

First, thanks to the many ABP clients, their participants, and advisers who sent emails to their elected officials last December and January as part of the national *Save My 401(k)* campaign that was enthusiastically promoted by ABP. That campaign was organized by the American Society of Pension Professionals and Actuaries (ASPPA) with significant grassroots support from other organizations representing small businesses, retirement plan service providers, plan sponsors, and participants. Although the retirement provisions that are included in the Administration's 2014 budget came as a surprise to many of us, the *Save My 401(k)* campaign was successful in many respects.

According to ASPPA's Executive Director, Brian Graff, tens of thousands of emails were received by Congress. While the battle is clearly not over, there is a much keener awareness about the importance of 401(k) and similar savings plans by our legislators as a result of this campaign. Graff emphasizes the critical importance of continuing to maintain a highly visible presence on retirement issues. Although the Administration's current focus is on small

business owners and high wage earners, numerous other proposals have been put forth in Washington that would impact retirement plan participants and sponsors in different but significant ways.

Additional proposals affecting retirement savings will surely surface in coming months. If you have not yet contacted your government officials, please give serious consideration to doing so. In this highly politicized environment, the squeaky wheel principal does apply. As those in Congress engage in their re-election campaigns, they are particularly mindful of the messages they receive from their constituents.

ABP is confident that ASPPA will continue to take a leadership role on important issues facing plan participants and small employers who sponsor tax-qualified retirement plans. ASPPA has established itself as the premier organization in the country with respect to educating its members and government officials on technical and retirement plan policy issues. ASPPA is also recognized as a highly effective and well respected lobbying organization. In coming weeks and months ASPPA will no doubt be asking for support from service providers such as ABP, plan sponsors and plan participants to help educate governmental officials and lobby for a sound, common sense retirement policy. Please consider becoming engaged when this happens. ■

Associated Benefit Planners, Ltd.

Associated Benefit Planners, Ltd. (ABP) is an independent consultant and third party administrator (TPA) operating from offices located in Berwyn and King of Prussia, Pennsylvania. We specialize in the design and administration of employer-sponsored retirement/savings plans, including 401(k) arrangements. ABP also provides plan document and compliance support for Section 125 Plans and Employee Welfare Plans, operating on a fee-for-service basis.

ABP Division
215 West Church Road, Suite 200
King of Prussia, PA 19406
Phone (610) 687-5504 • Fax (610) 687-3993
abpmail@abp-ltd.com

PFS Division
850 Cassatt Road
100 Berwyn Park, Suite 225
Berwyn, PA 19312
Phone (610) 727-4949 • Fax (610) 727-4948

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