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EMPLOYEE BENEFITS UPDATE

February 2015

The President's Fiscal Year 2016 Budget
Key Retirement Initiatives

Executive Summary

President Obama's fiscal year 2016 budget was released February 2, 2015 and contained a number of provisions directed at retirement plans, some of which have been raised previously. Given the Republican-controlled Congress, it remains to be seen if any of the proposals will gain significant traction, but they do give us a sense of the administration's wish-list. Stay tuned to see which of the following proposals are enacted, and which ones end up being used as bargaining chips in the budget process.

Earlier this month, President Obama unveiled his budget proposal for the 2016 fiscal year. We will continue to monitor the initiatives that potentially impact retirement plans and savings in the event that they become enacted as part of the budget process or as part of other legislation, but in the meantime, we have briefly summarized a number of the key proposals below:

- **Expansion of Eligibility for Long-Term Part-Time Workers in Retirement Plans.** Retirement plans would be required to allow workers who have worked at least 500 hours per year for three consecutive years with the plan's sponsoring employer to be eligible to make employee contributions to the plan, if they desired. Employers would not be required to provide employer contributions (such as matching contributions), but they would need to credit such workers with a year of service for vesting purposes for each year in which they worked at least 500 hours.

- **Creation of Auto-Enrollment IRAs for Certain Small Businesses.** Employers that have been in business for at least two years and that have more than ten employees would be required to offer an automatic IRA option unless they already sponsor another retirement plan such as a 401(k) or 403(b) plan. Employees would fund these automatic IRAs via payroll deductions, and would have the choice between setting up a traditional or Roth IRA at their desired rate of contribution. In the absence of an election, employees would automatically be enrolled at a default rate of 3%, and contributions would be made to a Roth IRA. Employers would not be required to provide employer contributions, foot the bill for compliance with qualified plan requirements, or assume liability or responsibility for eligibility determinations. Small employers with 100 or fewer employers would receive tax credits for expenses associated with establishing the automatic IRAs and receive additional non-refundable credits per employee.

- **Creation of Additional Tax Benefits for Small Employers Establishing Retirement Plans or Adding an Auto Enrollment Feature.** Employers with 100 or fewer employees who adopt a new qualified retirement plan (other than an automatic IRA) within three years of first being

required to offer an automatic IRA arrangement would be entitled to a tax credit equal to 50% of the start-up costs associated with adopting a new qualified retirement plan, up to a maximum of $1,500 per year for four years. The proposal would also include an additional credit of $500 per year for up to three years for small employers who either adopt a new plan with an auto enrollment feature or add such a feature to an existing plan.

- **Expansion of Penalty-Free Withdrawals for Long-Term Unemployed.** The 10% early distribution penalty that typically applies to qualified plan and IRA distributions made before age 59-½ would not apply to distributions made to individuals who have been unemployed for long periods of time. The exception would require that an individual be unemployed for more than 26 weeks and receive unemployment compensation; that the distribution occur in either the year the unemployment compensation was paid, or the following year; and that the distribution be limited to certain amounts.

- **Elimination of Required Minimum Distributions (RMDs) for Total Retirement Accounts Equal to $100,000 or Less.** Individuals with $100,000 or less (as adjusted for inflation) across all of their tax-favored retirement accounts (*e.g.,* IRAs, 401(k) plans, etc.) would be exempt from required minimum distributions, which generally require that individuals begin taking distributions from their retirement accounts after age 70-½ or face penalties. Defined benefit pensions that have already begun to be paid in the form of a life annuity would be excluded from this calculation. Required minimum distributions would phase in for total cumulative balances across all retirement accounts between $100,000 and $110,000 (as adjusted for inflation).

- **Prohibition on Roth Conversions of After-Tax Amounts.** After-tax money held in a traditional IRA or employer-sponsored retirement plan would no longer be eligible for conversion to a Roth account. This would eliminate the so-called "back-door" Roth IRA approach, whereby some taxpayers make after-tax contributions to traditional IRAs and then convert them to Roth IRAs.

- **Increased Transferability of Annuities.** If an employer-sponsored retirement plan decided to offer an annuity option within the plan, but at some later point changed its mind, plan participants would be eligible to roll over the annuity to an IRA or other retirement account via a direct rollover without triggering the 10% early distribution penalty. This distribution would be allowed even if such a distribution would be prohibited otherwise.

- **Elimination of Deductions for Dividends on Stock of Publicly-Traded Companies Held in ESOPs.** In general, publicly-traded companies would no longer be allowed to claim a deduction for dividends paid that are attributable to stock held in an ESOP (employee stock ownership plan).

- **Elimination of the Preferential Tax Treatment for Net Unrealized Appreciation.** The budget proposes to eliminate the tax break for net unrealized appreciation, which generally provides an individual with the opportunity to pay lower capital gains rates instead of ordinary income tax rates on appreciated employer stock that is held inside an employer-sponsored retirement plan, such as an ESOP. As proposed, this rule would not affect taxpayers who are age 50 or older as of December 31, 2015.

- **$3.4M Limitation on Retirement Savings Contributions.** An individual would not be permitted to make any new contributions to any tax-favored retirement accounts once the individual exceeded an established cap. The cap would be calculated by determining the lump-sum payment it would take to produce a joint and 100% survivor annuity of $210,000 per year, beginning when an individual turns age 62. Currently, this would cap retirement savings at approximately $3.4 million. If an individual reached the maximum permitted accumulation, no further contributions

or accruals would be permitted, but the individual's total tax-favored retirement savings could continue to grow with investment earnings. Further, adjustments to account for cost-of-living increases would also apply.

- **Require Form W-2 Reporting for Employer Contributions to Defined Contribution Retirement Plans.** Employers would be required to report any amounts that they contribute to an employee's defined contribution retirement plan (such as matching contributions or discretionary profit-sharing contributions) on the employee's Form W-2.

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In addition to these retirement-plan items, the President's budget also proposes changes to dependent care assistance account plans, how the IRS classifies workers from independent contractors, and numerous other features of the current tax law that affect personal income tax planning. If you have any questions about how these proposals could potentially impact your organization and your benefit plans, please let us know.

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