**President Obama's 2016 budget targets retirement accounts**

President Barack Obama's fiscal year 2016 budget was unveiled Monday to the American public, along with the Department of Treasury's Greenbook, which provides further explanation and details of the proposals in the president's budget.

In truth, the president's budget is really more of a wish list than anything else, but it's a good indication of where the administration is headed.

This year's version of the budget includes a number of provisions targeting retirement accounts. That's no surprise, as provisions aimed at retirement accounts have been a regular feature in budgets in recent years. What is a surprise, however, is how many proposals are targeting retirement accounts and how many new proposals there are. All told, this year's budget features over a dozen provisions that, if they were to become law, could directly impact your retirement savings.

Below you will find a complete list of these provisions, as well as some commentary:

**1. Eliminate the special tax break for NUA**

**The proposal —** Net unrealized appreciation, or NUA, one of the biggest tax breaks in the entire tax code for some retirement account owners, would be eliminated if this proposal were to become law. To be eligible to use the provision, which allows you to pay tax on some of your retirement savings at long-term capital gains rates, you must have appreciated stock of your employer (or former employer) inside your employer's (or former employer's) sponsored retirement plan and follow certain rules. Any plan participants 50 or older by the end of 2015 would still be eligible for the special NUA tax break, provided they meet all the rules.

**Comment —** The tax break for NUA has been around for decades, and now it suddenly finds itself under attack. Although those 50 and over would be exempt, younger savers who invested in the stock of their company within their retirement plan would miss out on the tax break.

© Jonathan Ernst/Reuters President Barack Obama waves as he arrives via Marine One helicopter at the White House in Washington October 14, 2014.

**2. Limit Roth conversions to pretax dollars**

**The proposal —** After-tax money held in your traditional IRA or employer-sponsored retirement plan would no longer be eligible for conversion to a Roth account.

**Comment** – For years, many taxpayers who have been restricted from making contributions directly to Roth IRAs (because their income exceeded their applicable threshold) have instead, made contributions — often nondeductible (after-tax) — to traditional IRAs. Then, shortly thereafter, they have been converting those contributions to Roth IRAs. This two-step process, widely known as the backdoor Roth IRA, would be all but eliminated by this provision.

Perhaps the only bit of good news to come out of this provision is that for years some have questioned whether or not such conversions amounted to step transactions. While the administration doesn't explicitly say otherwise, it's inclusion of this provision appears to be a tacit endorsement of that strategy. There is no reason to create a rule to stop something that is already forbidden.

**3. ‘Harmonize’ the RMD rules for Roth IRAs with the RMD rules for other retirement accounts**

**The proposal —** To further "simplify" the RMD rules, the administration seeks to impose required minimum distributions for Roth IRAs in the same way they are imposed for other retirement accounts. In other words, this proposal would require you to take distributions from your Roth IRA once you turn 70 ½ in the same way you would for your traditional IRA and other retirement accounts. If, however, you are already 70 ½ at the end of this year (2015), you would be exempt from the changes that would be created by this proposal.

**Comment —** This is one of the most egregious proposals in the entire budget. Countless individuals made Roth IRA conversions over the last 17 years, and many of them did so, in part, due to the fact that Roth IRAs have no required minimum distributions. To change the rules now, after people have already made these decisions, would be terribly unfair and would constitute a tremendous breach of the public's trust. At the very least, the administration should grandfather any existing Roth IRA money into the "old" rules should this provision ever become law.

**4. Eliminate RMDs if your total savings in tax-favored retirement accounts is $100,000 or less**

**The Proposal —** If you have $100,000 or less across all your tax-favored retirement accounts, such as IRAs and 401(k)s, then you would be completely exempt from required minimum distributions. Defined benefit pensions paid in some form of a life annuity would be excluded from this calculation. Required minimum distributions would phase in if your total cumulative balance across all retirement accounts is between $100,000 and $110,000. Those amounts would be indexed for inflation.

**Comment —** There's really no reason why someone with a $15,000, $20,000 or even $100,000 IRA should be forced to withdraw specified amounts from their retirement account each year. It simply creates complexity without any real benefit. Sure, some will argue that $100,000 amount should be higher, but in the end, a line had to be drawn somewhere. There will always be those on the other side.

**5. Create a 28% maximum tax benefit for contributions to retirement accounts**

**The proposal —** The maximum tax benefit (deduction or exclusion) you could receive for making a contribution to a retirement plan, like an IRA or 401(k), would be limited to 28%. Thus, if you are in the 28% ordinary income tax bracket or lower, you would be unaffected by this provision. However, if you are in a higher tax bracket, such as the 33%, 35%, or top 39.6% ordinary income tax bracket, you wouldn't receive a full tax deduction (exclusion) for amounts contributed or deferred into a retirement plan.

**Comment —** This one is sure to be another politically divisive aspect of the overall budget proposal. If this provision were to become law, it would create a terrible compliance burden for those in the highest tax brackets with respect to their retirement accounts. According to the Greenbook, if a tax benefit for a contribution to a retirement plan was limited by this proposal, it would create basis within a person's retirement account.

**6. Establish a cap on retirement savings prohibiting additional contributions**

**The proposal —** This proposal would prevent you from making any new contributions to any tax-favored retirement accounts once you 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 a year, beginning when you turn 62. Currently, this would cap retirement savings at approximately $3.4 million. The cap, however, would be a soft cap, as your total tax-favored retirement savings could exceed that amount, but only by way of earnings. Adjustments to account for cost-of-living increases would also apply.

**Comment —** While I understand the administration's reasoning behind this proposal, I'm not a big fan. I believe we should be inspiring people to save as much as possible for retirement, because as 2008 showed us, you never know when the next rainy day is going to come. Here's the bigger question though, at least for me: What happens if someone is over their applicable limit, but would otherwise be eligible to receive employer contributions, such as profit-sharing contributions, to their retirement account? It would appear that, under the proposal, these amounts would be forfeited altogether. That would be a completely unjust outcome and would be something either Congress or the regulations would have to address.

**7. Create a hardship exception to the 10% penalty for the long-term unemployed**

**Proposal —** A new 10% early distribution penalty exception would be created to help those with financial hardships due to being unemployed for long periods. The exception would apply to IRAs, as well as employer-sponsored retirement plans. To qualify, an individual would have to be unemployed for more than 26 weeks and receive unemployment compensation during that period (or less if due to State law). Furthermore, the distribution would have to occur in either the year the unemployment compensation was paid, or the following year.

Finally, the exception would be limited to certain amounts. All qualifying individuals would be eligible to use this exception for at least $10,000 of their eligible retirement account distributions. However, if half of their IRA balance or plan balance exceeded this amount, then that amount, up to $50,000, would be eligible for the exception.

**Comment —** It would seem pretty hard for either political party to fight against this provision too hard. No one likes to be looked at as kicking someone while they're down.

**8. Mandatory five-year rule for non-spouse beneficiaries**

**Proposal —** The overwhelming majority of non-spouse beneficiaries would be forced to empty their inherited retirement accounts by the end of the fifth year after the account owner's death. To be very clear, this provision would effectively mark the death of the "stretch IRA," and all the tax benefits that come along with it. The provision would, however, exempt certain beneficiaries, such as those that are disabled, chronically ill and aren't more than 10 years younger than the deceased retirement account owner from the more restrictive rules. Minor children would also be given a break, but would still be required to distribute their inherited retirement account no later than five years after they reach the age of majority.

The proposal wouldn't impact those who are already beneficiaries, but rather, only those who inherit in 2016 and beyond.

**Comment —** If retirement accounts are really for retirement, then as much as you may not like this provision (I don't either), it isn't an unreasonable position for the administration to take. Our government is broke and the stretch IRA, by providing tax benefits to individuals the accounts were never really intended to benefit, costs the government a lot of money. In fact, the budget proposal estimates that by implementing this change, it could collect almost an additional $5.5 billion dollars over the next decade.

One thing that some might find particularly irksome is that the proposal is included under the section of the budget entitled "loophole closers." Those beneficiaries who are stretching distributions aren't using any sort of gimmick or trickery to do so. They are following the law and regulations precisely as they were created and were intended to be followed. To claim otherwise casts those smart enough to maximize the value of their inherited accounts by stretching distributions in an unfairly negative light.

**9. Allow non-spouse beneficiaries to complete 60-day rollovers for inherited IRAs**

**The proposal —** Non-spouse beneficiaries would be allowed to move money from one inherited retirement account to another via a 60-day rollover, in a similar fashion to the way retirement account owners can move their own savings.

**Comment —** This proposal has been included in the president's budget for several years now. That it hasn't yet been passed into law is somewhat a testament to Washington's inability to accomplish just about anything constructive. There is absolutely no downside to including such a provision in the tax code, as the budget consequences would be "negligible." This is a provision that should be supported by everyone in Congress, regardless of whether they are blue, red, or somewhere in between, because it would eliminate one of the most common, damaging and irreversible mistakes made with inherited retirement accounts.

**10. Require retirement plans to allow participation from long-term part-time workers**

**The Proposal —** Retirement plans would be required to allow participation from workers who have worked at least 500 hours a year for three consecutive years with the sponsoring employer. Employees eligible to participate in a plan because of this provision wouldn't be required to receive employer contributions, however, including employer matching contributions. In other words, this provision would only require qualifying employees to be able to contribute their own funds to their employer's retirement plan.

**Comment —** While the goal of this provision — encouraging people to save more for their retirement — is certainly laudable, it's hard to imagine employers getting behind it. If they wanted to cover these employees now, they could. Although they're not required to do so, they certainly aren't prohibited from doing so either. A lot of it comes down to expenses. Part-time employees often have lower plan balances, which as the budget proposal points out, "can be costly to administer relative to the size of the balance."

**11. Require Form W-2 reporting for employer contributions to defined contribution retirement plans**

**The proposal —** Simply put, this proposal would require companies to report any amounts they contribute to an employee's defined contribution retirement plan (i.e., 401(k)) on the employee's Form W-2.

**Comment —** Would it be nice for an employee to see this information on the W-2? Sure, but it isn't that big of a deal.

**12. Mandatory auto-enrollment IRAs for certain small businesses**

**The Proposal —** Employers in business for at least two years and have more than 10 employees would be required to offer an automatic IRA option to its employees if it doesn't already offer another type of employer-sponsored retirement plan (i.e., 401(k), 403(b), SEP IRA). These automatic IRAs would be funded via payroll deductions. A standard notice would be provided to employees letting them know about the automatic IRA and would give them the opportunity to establish their own contribution rate or to opt out altogether. Employees would also be able to choose between allocating their salary deferrals to a traditional IRA and a Roth IRA. In absence of an election, employees would automatically be enrolled at a default rate of 3%, and contributions would be made to a Roth IRA.

To offset some of the costs associated with establishing the automatic IRAs and to further encourage employers to offer more robust retirement savings options, the proposal would also expand existing tax credits, while establishing some new ones as well.

**Comment —** One interesting aspect of this proposal is that the default option for the automatic IRA is a Roth IRA. This could lead to some unintended consequences. Unlike traditional IRAs, which have no maximum income limits for contributions (though in some cases deductions may be limited), Roth IRA contributions are prohibited once a person exceeds their applicable income threshold. If a person has exceeded their applicable threshold and errantly makes Roth IRA contributions anyway, those contributions are subject to a 6% excess contribution penalty every year until the problem is corrected.

To be sure, this provision is aimed at those with lower incomes, but there may be certain employees and small businesses making significant incomes. Or an employee with modest income could have a spouse who has high income, pushing the couple above their applicable Roth contribution income threshold. If that were the case, and 3% of the employee's paycheck was sent to a Roth IRA per this provision, it's possible that, without taking any action on their own, an employee's own salary could be diverted to a retirement account they're ineligible to contribute to — ultimately leading to penalties that the IRS has no authority to waive. That doesn't seem fair.

**13. Facilitate annuity portability**

**The Proposal —** If an employer-sponsored retirement plan decided to offer an annuity investment within the plan, but at some later point changed its mind and prohibited such an investment from being authorized to be held under the plan, participants would be eligible to roll over the annuity within their plan to an IRA or other retirement account via a direct rollover. This distribution would be allowed even if such a distribution would otherwise be prohibited.

**Comment —** In recent years, the administration has taken numerous steps to increase annuity options within retirement accounts for savers. This provision seems like the next logical step in that progression. Given that there is no requirement here for employers to offer annuity options, there would be no added expenses and the provision doesn't seem to favor either the wealthy or the poor, it would seem that our lawmakers should be able to get together on this one.

**14. Eliminate deductions for dividends on stock of publicly traded companies held in ESOPs**

**The proposal —** 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 employee stock ownership plan, or ESOP.

**Comment —** Publicly traded corporations (and their employees) may not like this one, but it makes sense as a matter of tax policy. There should be no additional tax incentive for a company to offer stock to its employees via an ESOP than there is to offer them the same stock via a 401(k) or other retirement plan.