Obama's Budget Too Austere for Retirement Industry

By Kerry Pechter *Thu, Apr 11, 2013*

There's outrage and indignation over the administration's call for a $3 million cap on lifetime accumulations in tax-favored accounts, but only a tiny number of accounts would be affected.

The Obama Administration proposed a budget for fiscal 2014 yesterday, and it included a handful of items related to retirement. One of those, a proposal to cap accumulations in IRAs and defined contribution plans, elicited outrage and protest from the 401(k) lobby.

The most offending proposal: "An individual's total balance across tax-preferred accounts" would be limited to about $3 million, or the amount needed to buy a joint-and-survivor life annuity "of not more than $205,000 per year" starting at age 62.

Several organizations within the tax-favored retirement industry issued announcements Wednesday protesting such a cap, which would not affect very many people. A release from the Employee Benefit Research Institute (EBRI) yesterday showed that only about in 1,000 (0.107%) of those who owned IRAs and 401(k)s had a combined accumulation of over $3 million.

The budget proposal also called for a cap of 28% on the ability of high-income taxpayers to reduce their tax liability through a variety of deductions, including employer-sponsored health and retirement contributions, and proposed a "Buffett Rule" under which the wealthy would pay no less than 30% of their after-charity earnings in taxes.

IRAs and defined contribution plans are affected, but not variable annuities. More information can be found in excerpts from the Office of Management and Budget's *Analytical Perspectives* and the Treasury Department's *Greenbook*.

'Just isn't fair'

But it was the cap on aggregated retirement account accumulations that provoked an outcry. Brian Graff of the American Society of Pension Professionals and Actuaries (ASPPA), a leading defender of existing savings incentives, argued that the proposal would give small business owners fewer rights than corporate executives.

"We think it is grossly unfair that a small business owner will be limited to retirement benefits that are nowhere near as valuable as executives' at large corporations," Graff said in a release. "Small business can't use the nonqualified deferred compensation arrangements that provide millions, even billions of dollars in retirement benefits to big corporate executives," Graff said in a release.

"Every time retirement plan limits are cut, the corporate CEOs get more nonqualified retirement benefits. It's the small business owners and their employees who lose out and it just isn't fair."

“The current tax code already has contribution limits to retirement savings programs, including IRAs, and, therefore, limits on account balances is detrimental to conscientious taxpayers who have made current sacrifices for future security,” said Robert Smith, president of the National Association of Insurance and Financial Advisors (NAIFA). “There should be no limit on the need that life insurance and annuities will address, so how can you limit the vehicles you use (such as IRAs) to address those needs?” Smith asked rhetorically.

A $3 million cap on IRA and/or 401(k) accumulations would affect only a fraction of a percent of Americans. The EBRI data released Wednesday showed that, according to most recent figures, only six in 10,000 (0.06%) IRA account owners had more than $3 million in IRA assets. Only about 41 in every million (0.0041%) 401(k) accounts are worth more than $3 million.

As for the rationale behind the limit, the Treasury’s *Greenbook* cited the current limit on defined benefit plan payouts to a $205,000-per-year joint-and-survivor life annuity for someone retiring at age 62, and said that there is currently no limit on the amount that a person can accumulate in a variety of different IRAs, defined contribution, and defined benefit plans.

“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 saving,” the Treasury Department said.

Here are the retirement-related items in the Obama budget for 2014:

Prohibit individuals from accumulating over $3 million in tax-preferred retirement accounts.

Under current rules, some wealthy individuals are able to accumulate many millions of dollars in these accounts, substantially more than is needed to fund reasonable levels of retirement saving.

The Budget would limit an individual’s total balance across tax-preferred accounts to an amount sufficient to finance an annuity of not more than $205,000 per year in retirement, or about $3 million for someone retiring in 2013. This proposal would raise $9 billion over 10 years.

Reduce the value of itemized deductions and other tax preferences to 28% for wealthiest families.

The Budget would limit the tax rate at which high-income taxpayers can reduce their tax liability to a maximum of 28%, a limitation that would affect only the top three percent of families in 2014.

This limit would apply to: all itemized deductions; foreign excluded income; tax-exempt interest; employer sponsored health insurance; retirement contributions; and selected above-the-line deductions. The proposed limitation would return the deduction rate to the level it was at the end of the Reagan Administration.

Observe the ‘Buffett Rule.’

The Budget also puts forward a specific proposal to comply with the Buffett Rule, requiring that wealthy millionaires pay no less than 30% of income—after charitable contributions—in taxes.

Establishes automatic workplace pensions and expands the Small Employer Pension Plan Startup Credit.

Under the proposal, employers who do not currently offer a retirement plan will be required to enroll their employees in a direct-deposit Individual Retirement Account (IRA) that is compatible with existing direct-deposit payroll systems. Employees may opt out if they choose.

[Businesses] with 10 or fewer employees would be exempt. Employers would also be entitled to a tax credit of $25 per participating employee—up to a total of $250 per year—for six years. The Budget will increase the maximum tax credit available for small employers establishing or administering a new retirement plan from $500 to $1,000 per year. This credit would be available for four years.

Switch to chained CPI for Social Security.

Beginning in 2015 the Budget would change the measure of inflation used by the Federal Government for most programs and for the Internal Revenue Code from the standard Consumer Price Index (CPI) to the alternative, more accurate chained CPI, which grows slightly more slowly.

Unlike the standard CPI, the chained CPI fully accounts for a consumer’s ability to substitute between goods in response to changes in relative prices and also adjusts for small sample bias.

The Budget only applies the change to non-means tested benefit programs. The switch to chained CPI will reduce deficits by at least $230 billion over the next 10 years.

Return estate tax to 2009 parameters and close estate tax loopholes.

The Budget returns the estate tax exemption and rates to 2009 levels beginning in 2018. Under 2009 law, only the wealthiest three in 1,000 people who die would owe any estate tax.

It would also eliminate a number of loopholes that currently allow wealthy individuals to use sophisticated tax planning to reduce their estate tax liability. These proposals would raise $79 billion over 10 years.

Strengthen the Pension Benefit Guaranty Corporation.

The Pension Benefit Guaranty Corporation (PBGC) acts as a backstop to insure pension payments for workers whose companies have failed. Currently, PBGC’s pension insurance system is itself underfunded, and PBGC’s liabilities exceed its assets. PBGC receives no taxpayer funds and its premiums are currently much lower than those a private financial institution would charge for insuring the same risk.

The Budget proposes to give the PBGC Board the authority to adjust premiums and directs PBGC to take into account the risks that different sponsors pose to their retirees and to PBGC.

[This reform] would require a year of study and public comment before any implementation and the gradual phasing in of any premium increases. This proposal is estimated to save $25 billion over the next decade.