DEFINED CONTRIBUTION PLAN
ISSUES: THE FISCAL CLIFF AND BEYOND

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Kent A. Mason
Overview

• Fiscal cliff
• Tax reform
• Retirement plan reform
• Council agenda
Fiscal Cliff

- Numerous possible threats/opportunities.
- Three ideas are currently being discussed more than others:
  - Administration’s 28% proposal
  - Cap on deductions/exclusions
    - Flat dollar cap
    - 2% (or 5%) of adjusted gross income (“AGI”) cap
Fiscal Cliff

28% Proposal:

• Mechanics: double taxation
• Effect on plan incentives
• Revenue: $584 billion (Administration’s estimate)
Fiscal Cliff

Flat dollar cap on deductions and exclusions:

- Originally only itemized deductions
- Possible caps: $25,000 - $50,000? Other caps?
- Mechanics
- Effect on plan incentives
- Revenue: unofficial estimate of $50,000 cap only on itemized deductions: $749 million
Fiscal Cliff

2% of AGI cap on value of deductions, credits, and exclusions

- Other possible cap floated: 5%
- Mechanics
- Effect on plan incentives
- Revenue: Administration: $400 to $500 billion at 2% if charitable contributions are excluded and it only applies to taxpayers over $200,000/$250,000
Illustrations of 2% of AGI cap. The chart below translates the 2% of AGI cap into an equivalent dollar cap on deductions and exclusions (disregarding the credit component of the proposal, which could lower the cap). As shown, the cap varies based on a taxpayer’s AGI and marginal income tax bracket. The formula for determining any such cap is:

\[ \text{AGI} \times 0.02 = \text{cap} \]

<table>
<thead>
<tr>
<th>AGI</th>
<th>Marginal income tax bracket</th>
<th>Equivalent cap on deductions and exclusions</th>
</tr>
</thead>
<tbody>
<tr>
<td>$22,000</td>
<td>15%</td>
<td>$2,933</td>
</tr>
<tr>
<td>$100,000</td>
<td>28%</td>
<td>$7,142</td>
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<tr>
<td>$200,000</td>
<td>33%</td>
<td>$12,121</td>
</tr>
<tr>
<td>$500,000</td>
<td>35%</td>
<td>$28,571</td>
</tr>
</tbody>
</table>
Fiscal Cliff

- Political outlook
Tax Reform

Proposals could also come up in fiscal cliff negotiations

- 28% proposal or caps
- Reducing DC plan limits to lesser of $20,000 or 20% of pay
- Refundable tax credit in lieu of exclusion/deduction
- Other limit approaches
- Require portion of all 401(k) contributions to be made in form of Roth contributions
- Allow Roth employer contributions
- Restrict stretch IRAs
- Consolidation of 401(k), 403(b), 457(b), perhaps SEPs and SIMPLEs
Pension Reform

- Concerns about coverage and adequacy of current system
- Proposals to address current shortcomings through structural reform
- Auto IRA
- Senator Harkin’s USA Retirement Fund proposal
Pension Reform

USA Retirement Fund proposal

• Employers must sponsor a plan or Fund with auto enrollment and a minimum level of employer contributions
• Employees can opt out of participation
• Funds would be run by Boards made up of employee, retiree, and employer representatives
Pension Reform

USA Retirement Fund proposal

• Boards would have all fiduciary and administrative responsibilities. Employers would have none.
• No participant direction of investments.
• DC plans.
• Must pay annuities.
Pension Reform

USA Retirement Fund proposal

- Political outlook
- Council position being formulated
Pension Reform

• Respond to coverage and adequacy concerns
• Respond to other critiques, including recent Danish study
Council Agenda

• **Objective:** to respond effectively to critiques

• **Affirmative agenda:** being formulated. Considering, for example:
  
  ▪ **Increase participation**
    • Encourage and expand auto enrollment and auto escalation
  
  ▪ **Address cost and fiduciary liability issues**
    • Fiduciary safe harbors, e-delivery, notice consolidation
  
  ▪ **Encourage small plan coverage**
    • Start-up credit
    • MEPs
  
  ▪ **Financial literacy**
  
  ▪ **Portability**

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