

DEFINED CONTRIBUTION PLAN ISSUES: THE FISCAL CLIFF AND BEYOND

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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



Fiscal Cliff

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:

$$\frac{\text{AGI} \times .02}{\text{Tax bracket}} = \text{cap}$$

AGI	Marginal income tax bracket	Equivalent cap on deductions and exclusions
\$22,000	15%	\$2,933
\$100,000	28%	\$7,142
\$200,000	33%	\$12,121
\$500,000	35%	\$28,571



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**

