Obama Proposed Budget Changes will Impact Your Qualified Contract Administration

Decades have passed without any serious regulatory disruption of the administrative rules for individual qualified contracts. If President Obama's proposed budget inclusions are passed, these peaceful days are over. Among many proposals, the spirit of three key proposed changes can be summarized as:

- Current Federal tax law allows qualified contracts to grow without any maximum value cap. A new cap will ensure that tax deferral is enjoyed only for 'reasonable' amounts.
- Federal tax law currently allows for a 'stretch' concept to be used on inherited qualified assets. Using stretch, any living beneficiary can receive payments over life expectancy. New restrictions will apply to when stretch concept can be used.
- Federal tax policy requires living owners of qualified assets (other than Roth) to take annual required minimum distributions after reaching age 70 and ½ regardless of size of the asset. New exceptions to grant relief for small accounts will be allowed – with new complex rules.

The Maximum Cap Concept

Reasoning behind the cap is there should be a maximum 'right size' to retirement assets allowed to accumulate on a tax-deferred basis. Proposed maximum cap for all qualified accounts -- IRA, 401k, 403b, 457, defined contribution/defined benefit plans – is $3.4 million. This number is based on some current interest rate assumptions and present value of life expectancy payouts of joint and survivor retirees. How data will be shared across contract types and institutions is yet to be described. Expect it to be another complex reporting requirement at minimum.

The 'Reduced Stretch' Concept

Stretch allows families to optimally plan for long-term enjoyment of retirement assets of a deceased. By using beneficiaries who are children and grandchildren, life expectancy payouts continue for decades allowing tax deferral on non-distributed assets along the way. New regulations will largely limit the 'endless stretch' by allowing only the surviving spouse to use a life expectancy stretch. Any beneficiary not a spouse of the deceased (or not meeting a myriad of special exceptions such as disabled, chronically ill, etc.) will be required to take all distributions from inherited retirement accounts – and pay taxes on proceeds – no later than 5 years after death of the deceased. This will require changes to your administration support of 'stretch' plus special exception rules to monitor and report.

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The 'Be Reasonable' RMD Rule

The RMD rule currently requires annual required minimum contributions begin at attained age 70 and ½ regardless of the size of the asset. This forces owners of low-value accounts to liquidate assets when preserving assets may be most important. Proposed regulation is to discontinue RMD requirements for a taxpayer who reaches age 70 and ½ and has assets of $75,000 or less. The rule would be disbanded if there are later additional contributions into the account. Read this as deceptively complex and a need to track asset values, potentially across contracts and organizations. At minimum, a new report will be required to government bodies with the purpose to monitor the new small-accounts exceptions.

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