President Obama's Budget Proposals Would Impact Qualified Contracts in Many Ways

Every year, the Executive office prepares a budget for the Federal government. In so doing, potential tax policy changes are revealed. While most of the proposals are not adopted 'as is', the proposals do show thinking of the current Administration and – most importantly – are shared by some representatives in Congress. Translation – some of this will likely pass as part of compromise this year.

Be prepared for what might be coming towards you to enhance our software solutions for many types of retail qualified contracts. For the retail insurance industry, this means annuities.

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The Stretch IRA – Restrict it

The stretch IRA has become a favorite estate planning tool through which IRA value can be passed to any living beneficiary under life expectancy calculation for that recipient. Small amounts result in less tax bite. The younger the recipient, the more valuable the tool. The budget proposal repeats last year's recommendation to stunt this option – to limit the use of stretch IRA to spouses only. All others will have to follow a 5-year rule at maximum to liquidate all proceeds from an inherited asset and in the process, expose that money to income tax. Translation: Here is one more choice to be restricted during claims adjudication for IRA annuities.

The Backdoor Roth IRA – Eliminate it

One option now available to income taxpayers is achieving Roth treatment through a back-door method. The first step of the strategy is purchase a nondeductible IRA and then in the second step, quickly exercise a 'conversion' option to change the funds to Roth classification. Yes, the contribution is not tax- deductible but the second-step of conversion ensures that future asset growth enjoys tax-free distributions. The budget proposal recommends elimination of this 'special backdoor method' to accomplish extra Roth funds. Translation: one more form of conversion to be distinguished from other 'normal' conversions when changing IRAs into Roth IRAs. Some types will be allowed, some will not.

Minimum Required Distributions – Required on Roth

Since their introduction in the late 1990s, IRA Roth accounts have never had a minimum required distribution rule. All Roth money could be held untapped as long as the original owner wished and if unused at death, the proceeds would be inherited by a beneficiary and tax-free to the fortunate recipient. The budget proposal would require Roth IRAs to function just like pre-tax IRAs – that is in the year reaching age 70 and ½, a minimum required distribution would be mandated. Translation: more functionality to turn on for Roth IRAs to mirror the processing of traditional IRAs.

Limit New IRA contribution Limits with an overall 'cap' in value

This cap limit concept is another holdover from the Obama recommendation from last year, but with specific narrowed focus. The budget proposal recommends a cap for <u>new</u> contributions for any IRA plan when there is already at least $3.4 million of value present. The difficulty here is that the overall limit is proposed to cross all types of plans, not just IRAs, even when managed in various locations. Translation: this will require some client-level type of reporting outside the pure account monitoring within a single contract.

Elimination of minimum required distributions for plans less than $100,000

Here is one proposal to relax rules instead of adding new restrictions, but it still requires new functionality. In an effort to reduce the impact of forcing taxpayers to take money out of small plans, the budget proposal repeats last year's recommendation to stop requiring distributions from small accounts below $100,000. Translation: expect some exception processing for any notification of MRDs from software notifications.

Summary – Not all of these will pass, but some may be included in Congressional proposals this year. Stay tuned for impacts to your administration solutions.

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