

# From the Hill to the Street:

*Politics, Taxes, and Retirement: An Insider's Perspective*



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# Deficit Outlook (in billions of dollars)

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2008 budget deficit	\$ 455
2009 budget deficit	\$ 1,400
2010 budget deficit	\$ 1,300
2011 budget deficit	\$ 1,300

Total debt outstanding is now 100% of GDP for only the second time in history (other was during WWII)

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Sources: Budget of the U.S. Government, Mid-Session Review, Fiscal Year 2012, Office of Management & Budget (Aug. 2011) Andrew Friedman, *The Washington Update*.



# Deficit Reduction

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“Our nation is on an unsustainable fiscal path. Even after the economy recovers, federal spending is projected to increase faster than revenues.”

## *The Moment of Truth*

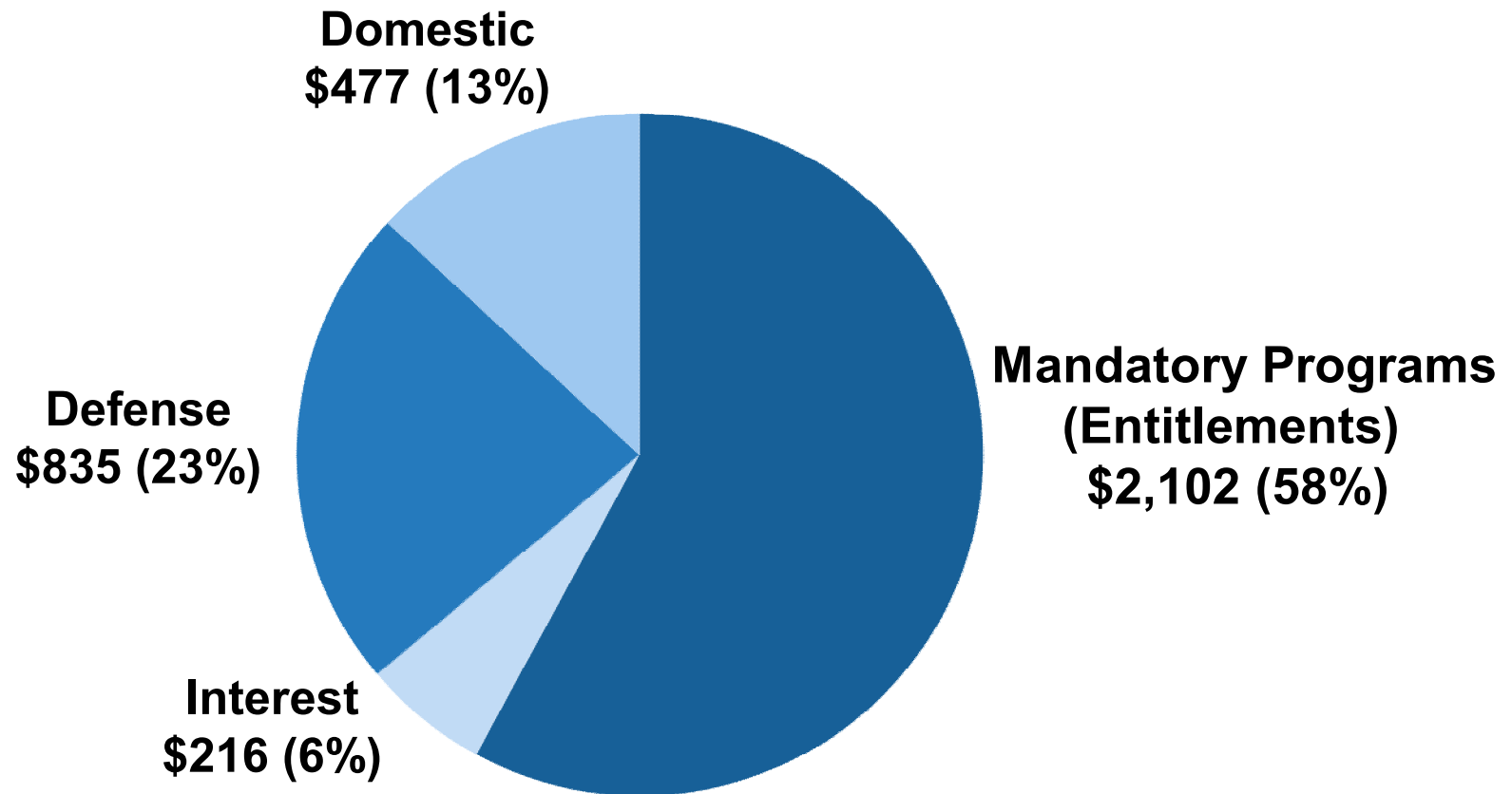
Report of the National Commission on Fiscal Responsibility  
(December 2010)

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Source: Andrew Friedman, *The Washington Update*.



# 2011 Federal Spending (\$3.6T) (in billions of dollars)



Sources: Budget of the U.S. Government, Mid-Session Review, Fiscal Year 2012, Office of Management & Budget (Aug. 2011). Andrew Friedman, *The Washington Update*.



# Health Care Reform

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- *Employer mandate*: Must provide employee health coverage or pay special tax (“pay or play”)
  - Exemption for businesses with < 50 employees
- *Individual mandate*: Requires everyone to have insurance (or pay penalty)
  - Prohibits insurers from denying coverage based on pre-existing conditions

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Source: Andrew Friedman, *The Washington Update*.



# Health Care Reform

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- Establishes state-run “exchanges” to facilitate insurance purchases at competitive prices
- Provides premium subsidies for families with income below \$88K
  - Provides free insurance for families with income below \$30K

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Source: Andrew Friedman, *The Washington Update*.



# Health Care Reform – Supreme Court

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- Five justices held that Congress *does not* have the power under the Commerce Clause to require individuals to purchase insurance.
- *But* Chief Justice Roberts held that the penalty imposed on people who do not buy insurance is in effect a tax, which Congress has the power to impose under its taxing authority.
  - Roberts thus joined the justices who believed that the individual mandate is permissible under the Commerce Clause. With five justices thus upholding the law (albeit for different reasons), the law survived.

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Source: Andrew Friedman, *The Washington Update*.





# Health Care Reform

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- *Total cost: \$1 trillion over ten years.*
- To be paid for by:
  - New 3.8% Medicare tax on taxable investment income (interest, dividends, capital gains, etc) for families with AGI > \$250K, beginning in 2013
  - Reduced Medicare outlays

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Source: Andrew Friedman, *The Washington Update*.



# 2012 Elections

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- Percent of Americans who consider themselves:
  - Democrat: 35%
  - Republican: 34%
  - Independent: 31%

*Key to election is how the Independents vote.*



# 2012 Elections – Congress

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## – House:

- Current Republican majority: 50 seats
- Up for election: 435 seats

## – Senate (2010-2011):

- Current Democrats majority: 6 seats
- Up for election: 33 seats (23 Ds, 10 Rs)
- Incumbents not running: 10 seats (7 Ds, 3 Rs)

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Source: Andrew Friedman, *The Washington Update*.



# 2012 Elections

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- Republicans unlikely to get veto-proof or filibuster-proof majorities in Congress
- So Democrats should continue to have a seat at the table regardless of the outcome of the presidential election

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Source: Andrew Friedman, *The Washington Update*.



# November – December 2012:

## The Mother of All Lame Duck Sessions

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- Sequestration cuts about to take effect
- Government budget needed for 2012
- Debt limit may need to be increased again
- Bush tax cuts about to expire

“A perfect storm set up for December 2012.”

Jacob Lew, White House Chief of Staff (December 2011)

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Source: Andrew Friedman, *The Washington Update*.



# Taxes

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- If the Bush tax cuts expire, taxes go up *across all income levels*, not just for affluent earners
  - Expiration of all the cuts raises \$3.6T in revenue, which (coupled with the spending cuts of the debt limit deal) provides declining deficits through 2015
  - Unwinding tax increase (perhaps with tax reform effort) in 2013 is possible but politically difficult
- New 3.8% tax on taxable investment income under health care reform law also takes effect in 2013



# Taxes

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## – If Congress does not act:

- The top tax rate on ordinary income rises from 35% to almost 44% -- *an increase of almost 25%*.
- The top tax rate on capital gains rises from 15% to almost 24% -- *an increase of almost 60%*.
- Top dividend tax rate increases from 15% to almost 44% -- *an increase of almost 300%*.
- Estate tax exemption drops from \$5M to \$1M and rate rises from 35% to 55% -- *an increase of over 55%*.

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Source: Andrew Friedman, *The Washington Update*.



# Tackling The Retirement Crisis:

## *Obama Administration Policy Objectives*

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1. Broader Coverage
2. Increased Savings
3. Decumulation Planning
4. Tax Reform

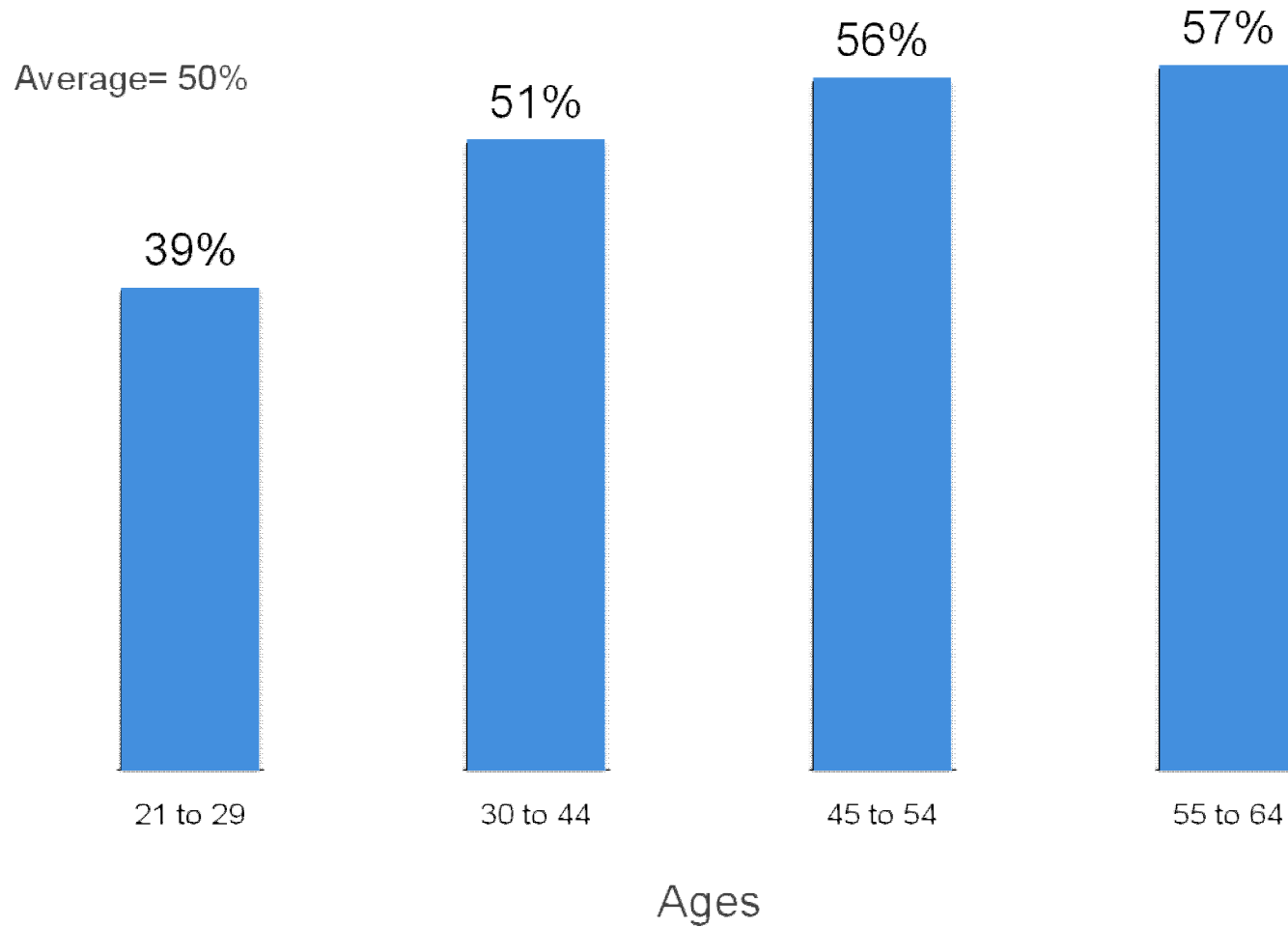
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Source: Marcia Wagner, *The Politics of Retirement*.





# Workers with Employer-Sponsored Retirement Plans



Source: Investment Company Institute. Graph depicts private-sector wage and salary workers aged 21 to 64 whose employers sponsored retirement plans in 2010.



# Automatic IRAs

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## –Legislative History

- Auto IRAs proposal appears to be partisan.
- But had bi-partisan support in prior years.
- Increasing retirement plan coverage is shared policy goal.

## –Three Key Features

- Default contribution rate set at 3%.
- Post-tax Roth IRA would be default, but employee could choose pre-tax Traditional IRA.
- Multiple alternatives available for selecting Auto IRA provider.

Source: Marcia Wagner, *The Politics of Retirement*.



# Prospects for Auto IRAs

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## –Objections to Auto IRAs

- Burdensome mandate for small businesses with more than ten employees.
- Federal government control over assets.
- Role of private sector.

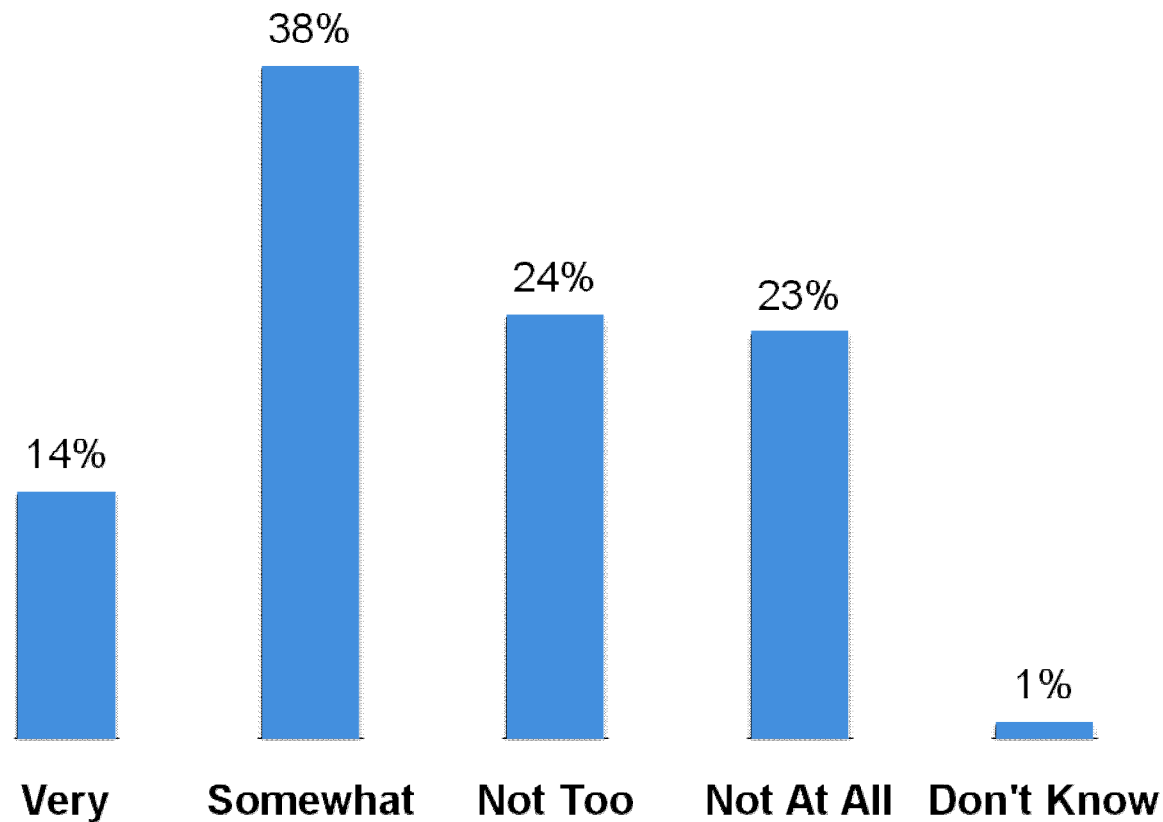
## –Partisan politics will continue in short term.

- But bipartisanship support typically emerges on retirement issues.

Source: Marcia Wagner, *The Politics of Retirement*.



# Increased Savings: Worker Confidence in Having Enough Money to Live Comfortably Throughout Retirement



# Increasing Savings Thru Automatic Features ❏

## –Pension Protection Act of 2006

- Auto-Enrollment
- Auto-Escalation

## –Plan Sponsor and Advisor Initiatives

- Re-Enrollment
- Re-Allocation

## –Automatic IRAs

Source: Marcia Wagner, *The Politics of Retirement*.



# Automatic Enrollment and Escalation

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## –Negative Elections

- IRS issued guidance in late 1990's.
- Pension Protection Act of 2006 expands IRS guidance and offers fiduciary protection.

## –Problems

- Most plans set auto-contribution rates at 3%.
- 6% safe harbor rate provides “free pass” from discrimination testing.
- But few plans use safe harbor or auto-escalation.

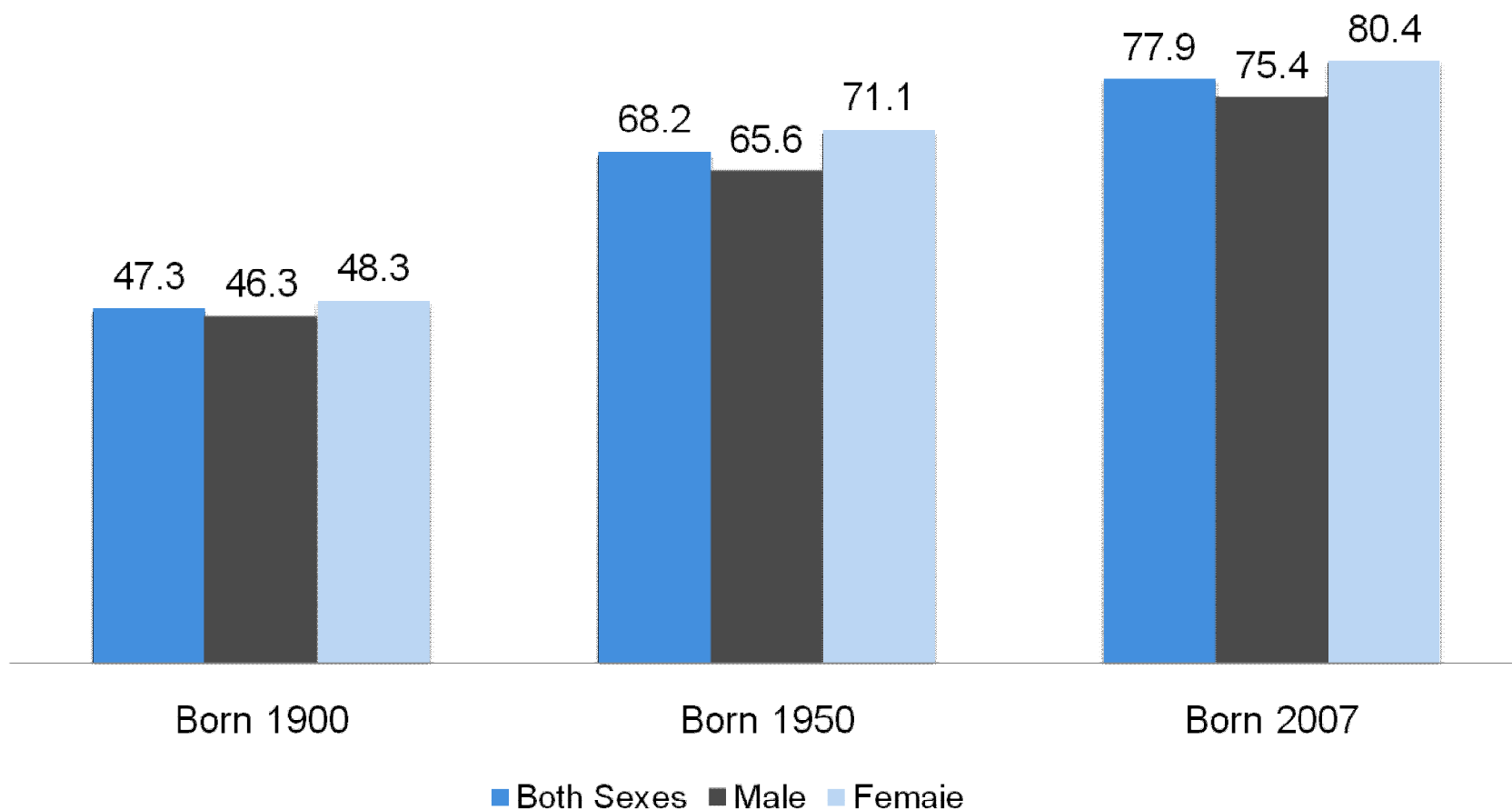
## –Automatic enrollment can significantly increase savings.



# Decumulation Planning: Life Expectancy in the United States



For All Races, In Years



# Longevity Annuities

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- IRS proposal would relax required minimum distribution (RMD) rules for plans.
- Longevity annuities provide income stream for later in life.
  - But RMD rules mandate start at age 70 ½.
- Proposed Regulations
  - Exception from RMD rules for longevity annuity investments.
  - Limit investment to \$100,000 or 25% of account.
  - Must start no later than age 85.

Source: Marcia Wagner, *The Politics of Retirement*.





# Default Annuities

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–Should annuity option be default for plan?

–Possible Approach: Amend QDIA Rules

- Permit annuity option to qualify as QDIA.
- Critics argue annuities not appropriate for all.
- Default annuity investments not easily reversed.

–Possible Approach: 2-Year Trial Period

- Retirees receive annuity during trial period (unless they opt out).

Source: Marcia Wagner, *The Politics of Retirement*.



# Tax Reform

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## –Impact of Plan Contributions on Federal Deficit

- \$70.2 Billion Annually.
- \$361 Billion 2011 – 2015.

## –Plan Limitations That Can Be Reduced to Lessen Deficit

- Annual Additions from All Sources - \$50,000.
- Elective Deferrals - \$17,000.
- Plan Sponsor Deduction – 25% Compensation of All Participants.
- Compensation Counted to Determine Benefits/Contributions - \$250,000.

Source: Marcia Wagner, *The Politics of Retirement*.



# Tax Reform

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- National Commission on Fiscal Responsibility  
(20/20 Cap) – Lesser of \$20,000 or 20% Compensation.
- Brookings Institution
  - Make All Employer and Employee Contributions Taxable.
  - Refundable Tax Credit Deposited to Retirement Savings Acct.
- Obama Administration – 7% on Employer and Employee Tax Contributions for High Earners Only.

Source: Marcia Wagner, *The Politics of Retirement*.



# State-Sponsored Plans for Private-Sector

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- Secure Plan Proposal.
  - Proposed by National Conference on Public Employee Retirement Systems.
  - Provide coverage for employees of small employers.
  - Seeks to benefit from economies of scale.
  - Cash balance plan: 6% annual credits; minimum 3% interest credits.
  - Funding shortfall would ultimately fall on states.
- Define Contribution Initiatives.
- Fiduciary Implications.
  - Potential state liability for selection of investment alternatives.
  - State must ensure that plan avoids prohibited transactions.
  - Bonding.
  - Administrative duties allocated between state and employer

Source: Marcia Wagner, *The Politics of Retirement*.



# Republican Reaction to Tax Proposals

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- Republican budget does not directly address.
- Romney Campaign favors lower tax rates and broader base but no focus on retirement plans expenditure.
- Senator Hatch skeptical of changing current limits.
- Summing Up
- Soak the rich schemes may defeat themselves.
- 20/20 Cap may be enacted.
- Consequences of lowered contributions
  - Private Retirement Plan System gets smaller
  - Reduced Role for Employers.

Source: Marcia Wagner, *The Politics of Retirement*.



# Summing Up

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- Broader Coverage Through Auto IRA's Has Bi-Partisan Support But is Unlikely in Current Form
- Push for auto-features within DC Plans expected to continue.
- Consensus emerging on lifetime income options.
  - Proposal for longevity annuities to be finalized in near future.
  - Guidance on decumulation education expected from DOL.
  - But debate on use of annuities as QDIA likely to follow.
- Administration May Limit Deductions for High Income Employees

Sources: Andrew Friedman, *The Washington Update*. Marcia Wagner, *The Politics of Retirement*.



# Disclosure

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