American Heritage Securities, Inc.

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POLICY WATCH: 2014 Budget Reform

Obama's proposed cap on retirement savings could affect you

Now that the debt crisis is resolved, Congress is likely to take up the president's 2014 budget reform proposals. Obama's budget proposal offers changes to Medicare and Social Security and includes tax increases primarily targeting high-income households and corporations.

1. Social Security COLA

The budget also proposes changing the way inflation is measured to shrink cost-of-living adjustments for retirees receiving Social Security benefits.

Why: The use of a chained consumer price index for Social Security and other programs, like Supplemental Security Income and veterans pensions, would reduce government deficits by $230 billion over 10 years. It would reduce the annual COLA by small amounts every year. Those in agreement with a chained COLA believe that the inflation measure used currently overstates inflation because it doesn't fully account for the way that people substitute different goods and services when prices change. AARP asserts that these cuts would have a catastrophic impact on older Americans who are the least able to absorb cuts to their benefits because they rely on Social Security for their income and have higher out-of-pocket medical expenses.

2. A $3.4 Million Cap

The budget proposes a $3.4 million retirement savings cap would allow an account holder to generate an annuity of $205,000 a year.

Why: The cap would raise about $9 billion for the federal government over the next 10 years by prohibiting taxpayers from taking advantage of the pre-tax deferral in their 401(k) or defined contribution pension plans after they cross a $3.4 million threshold. Obviously only a small percentage of people would be affected by the cap itself. However, small businesses would lose because company-sponsored retirement plans are the only way small-business owners can generate tax-deferred savings. Without an incentive to keep the plan, many small-business owners may either shut down the plan or reduce contributions for workers.

3. Automatic Enrollment in IRAs

Employers in business for at least two years, with more than 10 employees, would be required to offer an automatic IRA option to employees on a payroll-deduction basis. Employer already offering a plan which excludes segments of its employees would have to begin to extend the plan to all employees.

Why: Obama wants to turn the tide on a rising retirement crisis in the United States. According to a Treasury report, the number of U.S. workers participating in an employer-sponsored retirement plan has remained stagnant for decades at about 50% of the total workforce. The administration believes that by forcing small companies to offer automatic enrollment in an IRA, the number of people saving for retirement will rise.

4. Elimination of Stretch IRA
The Obama budget eliminates the stretch IRA which allows beneficiaries to stretch the proceeds from an inherited retirement account over their lifetime. Instead, non-spouse beneficiaries of retirement plans and IRAs must take full distribution of their inheritance within five years of the account holder’s death. There would be exceptions for disabled or chronically ill individuals, beneficiaries not more than 10 years younger than the participant, or an IRA owner or a child while under age 18

Why: Beneficiaries forced to take a distribution of large sum of money early will be taxed at a higher rate than they would be if they take money out gradually.

There's nothing to do right now but wait and see.