

May 14, 2009

## Obama Administration FY2010 Budget Proposals on Retirement Savings and Insurance Products

On May 11, 2009, the Treasury Department released its [General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals](#) (the so-called "Green Book") and the Office of Management and Budget published its [Analytical Perspectives](#) on the FY2010 budget, which together provide additional elaboration of the Administration's tax proposals for the next federal fiscal year. Important proposals relating to retirement savings and insurance products are summarized below. (Additional proposals that may affect the corporate tax treatment of retirement and insurance providers will be discussed in a separate alert.)

These publications also describe the Administration's proposals to reinstate the 36% tax bracket, the 39.6% tax bracket, the limitation on itemized deductions, and the personal exemption phase-out, as well as impose a 20% tax rate on dividends and capital gains, generally with respect to taxpayers with incomes exceeding \$250,000 (married filing jointly) or \$200,000 (single). Such proposals, if enacted, would of course bear on the calculus of affected taxpayers with respect to tax-favored retirement savings and insurance arrangements.

### Retirement Savings

These proposals, which are sourced in the work of the [Retirement Security Project](#) among others, together are estimated to cost \$70.9 billion in reduced tax revenues in FY2010 to 2019.

### Saver's credit

Effective December 31, 2010, the proposal would make the existing (nonrefundable) saver's credit for qualified retirement savings fully refundable and would provide for the credit to be deposited automatically in the qualified retirement plan account or IRA to which the eligible individual contributed. The proposal would also convert the current 10%/20%/50% credit for qualified retirement savings contributions, up to \$2,000 per individual, to a 50% match of such contributions up to \$500 per individual (indexed annually for inflation beginning in taxable year 2011). The eligibility income threshold would be increased to \$65,000 for married couples filing jointly, \$48,750 for heads of households, and \$32,500 for singles and married individuals filing separately, with the amount of savings eligible for the credit phased out at a 5% rate for adjusted gross income exceeding those levels.

The Administration's argument is that by simplifying and expanding eligibility for the credit, framing it more like a retirement plan matching contribution, and making it refundable, it will provide a more effective incentive to retirement savings for lower- and middle-income taxpayers. This proposal is also reflected in the [Savings for American Families' Future Act \(H.R. 1961\)](#), introduced in the House of Representatives by Congressman Earl Pomeroy in April.

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## Automatic enrollment in IRA

Effective January 1, 2012, employers in business for at least two years that have 10 or more employees would be required to offer an automatic IRA option to employees on a payroll-deduction basis, under which regular payroll-deduction contributions would be made to an IRA.

- If the employer sponsors a qualified retirement plan or SIMPLE IRA plan for its employees, it would not be required to provide an automatic IRA option, except to the extent the qualified plan excluded from eligibility a portion of the employer's work force or a class of employees such as all employees of a subsidiary or division.
- Employers would be allowed a temporary tax credit for making automatic payroll-deposit IRAs available to employees, in the amount of \$25 per enrolled employee up to \$250 each year for two years. The credit would be available both to employers required to offer automatic IRAs and employers not required to do so (for example, because they have fewer than ten employees).

Employees would receive a standard notice and election form informing them of the automatic IRA option and allowing them to elect to participate or opt out.

- Any employee who did not make an election would be enrolled at a default rate of 3% of the employee's compensation.
- Employees filing an election could opt for a lower or higher contribution rate up to the IRA dollar limits.
- Employees could opt out any time.
- A national Web site would provide information and basic educational material regarding saving and investing for retirement, including IRA eligibility, but, as under current law, individuals (not employers) would bear ultimate responsibility for determining their IRA eligibility.
- Employee contributions would qualify for the saver's credit (to the extent the employee and the contributions otherwise qualified), and the proposed expanded saver's credit would be deposited to the IRA to which the employee contributed.

In general, payroll deductions would be transmitted by direct deposit to IRA accounts for the employees at, as the employer determined:

- A single private-sector IRA trustee or custodian designated by the employer;
- The IRA provider designated by each employee for his or her contributions; or
- A savings vehicle specified by statute or regulation (a low-cost, standard default investment with several investment options), for employers that prefer not to select a default investment for their employees.

## Insurance Products

These proposals are ordered by the revenue estimates for FY2010 to 2019 associated with that proposal.

- **Corporate owned life insurance (COLI).** Internal Revenue Code (IRC) § 264(f) disallows a pro rata portion of a business's general interest expense deduction based on unborrowed cash values in life insurance policies it owns—essentially, a proxy tax on earnings credited to those policies. Current law provides an exception to that rule for policies insuring 20% or greater owners, employees, officers and directors, if certain requirements are met.

For contracts entered into after the date of enactment, the proposal would repeal the exception from the pro rata interest expense disallowance rule for contracts covering employees, officers or directors, other than 20% owners of a business that is the owner or beneficiary of the contracts. If adopted, the proposal would functionally limit new COLI cash value policies to small businesses, which typically use these policies for business continuation, buy-sell, credit support or similar purposes, and deny these products to larger businesses. [Scored at \$8.4 billion.]

- **Dividends-received deduction.** For taxable years beginning after December 31, 2010, the proposal would modify an insurance company's dividends-received deduction for separate accounts supporting both variable annuities and variable life insurance, in a manner generally intended to produce a company's share of the deduction with regard to a separate account that approximates the ratio of the mean of the surplus attributable to the account to the mean of the account's assets. The proposal could materially affect the pricing of separate account products. [Scored at \$3.4 billion.]
- **Life settlement transactions.** For sales or assignment of interests in life insurance policies and payments of death benefits for taxable years beginning after December 31, 2010:
  - The proposal would require information reporting by the purchaser of an interest in an existing life insurance contract with a death benefit equal to or exceeding \$1 million—of the purchase price, the purchaser's and seller's taxpayer identification numbers, and the issuer and policy number—to the IRS, to the insurance company that issued the policy, and to the seller.
  - The proposal also would modify the IRC § 101(a) "transfer-for-value" rule so that secondary market purchasers could not avail themselves of the exceptions to that rule, and require information reporting by the insurance company upon payment of any benefits under policies transferred into the secondary market.

The IRS's recent revenue rulings on the tax consequences for secondary market transactions (click [here](#) for our alert on those rulings) appear to provide a springboard for these proposals. [Scored at \$812 million.]

- **Structured settlements.** The proposal would disallow any deduction for punitive damages paid or incurred by a taxpayer, whether upon a judgment or in settlement of a claim, on or after December 31, 2010. Where the liability for punitive damages is covered by insurance, such damages paid or incurred by the insurer would be included in the gross income of the insured person and the insurer would be required to provide information reporting. [Scored at \$307 million.]
- **"Private" separate accounts.** For taxable years beginning after December 31, 2010, the proposal would require information reporting by a life insurance company for each contract whose cash value is partially or wholly invested in a "private" separate account—any such account with respect to which a related group of persons own policies whose cash values, in the aggregate, representing at least 10% of the value of the separate account. The expressed purpose of the proposal is to better identify for the IRS contracts that may violate the "investor control" rules. It is unclear whether there would be exceptions for "private" separate account contracts held by retirement plans, VEBA's or other tax-exempt policyholders. [Scored at \$20 million.]

In addition to these proposals specific to insurance products, there are general proposals to require more information reporting of payments made to taxable corporations, starting in 2010 [scored at \$9.1 billion], and to increase certain information return penalties starting in 2011 [scored at \$376 million].



*If you have any questions about this development, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.*

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