MEMO

CONGRESSIONAL SPENDING & THE IMPACT TO SAVERS

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Over the past year, Congress has been busy debating new tax and spending packages, in part based on President Biden's Build Back Better agenda. The packages authorize new spending toward the expansion of health care, education, family leave, climate change initiatives, and more.

Naturally, to fund this new spending, the bills have also included a multitude of new and expanded tax proposals for individuals and corporations. Significantly, many of these tax provisions have targeted IRAs, 401(k)s, and other retirement savings vehicles.

At a high level, these proposals represent a significant change in the way Washington views saving for retirement. The House Democrats stated one goal of these initiatives is to "avoid subsidizing retirement savings" once account balances reach high levels.[1] In my opinion, Congress has shifted from incentivizing Americans to save for the future to penalizing Americans who have successfully saved.

LEGISLATIVE RISK

In my analysis, the current crop of tax and spending provisions dramatically increase the legislative risk associated with tax-deferred savings vehicles, like IRAs and 401(k)s. Legislative risk is the risk of Congress changing the rules, and those changes negatively impacting your retirement approach. As our elected officials pass new laws around retirement accounts, there is a risk those laws could leave savers with fewer retirement assets – and less retirement income – than planned.

Many savers want to understand the complete set of risks they may face in retirement. Unfortunately, too many Americans do not fully understand legislative risk, and how it can impact their assets.

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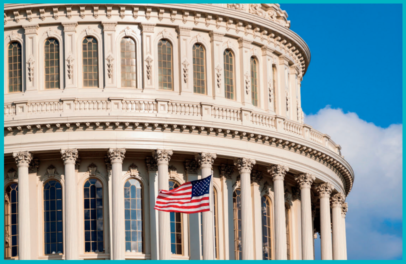

TAX PROVISIONS

With this in mind, let's look at some of the recent retirement tax proposals from Washington.

Congress has discussed a new Required Minimum Distribution (RMD) applicable at any age for certain savers. Essentially, any saver with combined retirement assets above a certain cap must withdraw 50% of the excess above the cap from their accounts each year. This will convert those tax-advantaged funds into annually-taxable funds. Another proposal stipulates that once a saver reaches a certain dollar threshold in retirement funds, they will be prohibited from saving any additional funds in Traditional or Roth accounts – regardless of their age or career status.

Finally, Congress has discussed limiting the ability of certain savers to convert tax-deferred assets into Roth accounts. For couples filing jointly with more than $450,000 in income (or individuals with more than $400,000 in income), Roth conversions from qualified accounts would be prohibited, so that savers could not convert tax-deferred funds into tax-free funds.

ASSESSING THE IMPACT

A few important thoughts on these proposals and new bills we may see in the months and years ahead.

Some in the media have suggested that savers with lower retirement assets don't need to worry about the tax changes discussed in these proposals. However, this is where the talking heads don't fully understand legislative risk.

As we work to mitigate legislative risk in our retirement approaches, we must consider not just the provisions being discussed today, but how those provisions may develop, expand, and change in the future. This is especially true for Qualified accounts like 401(k)s and IRAs where new laws can take immediate effect.

> **In these accounts, savers could find themselves accessing their retirement funds under a completely different set of rules than they were promised when saving those funds.**

Why do I feel so strongly the legislative risk of Qualified accounts has increased dramatically in today's legislative environment?

As is often the case with federal legislation, the challenge is getting a new framework passed into law. In this case, the challenge is getting the House and Senate to agree we should limit the growth and value of retirement accounts.

Less challenging, in my opinion, is the task of simply choosing the limit. In recent discussions, Congress chose a cap of $10 million in retirement assets. However, I believe that number could easily be adjusted down in the future – to $8 million, or $5 million, for example. Again, the challenge is enacting into law the framework to limit account size. After that, it's just about picking the size.

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Many experts agree Congress will need to raise additional tax revenue in the near term. Our national debt has swelled to more than $30 trillion. Democrats largely acknowledge the tax provisions in these bills fall short of raising enough revenue to cover their price tags.[2] What's more, the bills are riddled with "trick accounting" to hide their true cost. In recent legislation, Congress has artificially lowered the price tags on these bills by phasing out some of the social welfare benefits a few years down the road. However, as we all know, once a new benefit is in place, it is politically challenging to eliminate it. President Biden has said tax and spending bills under his administration will have a zero-dollar cost,[3] indicating his commitment to raising additional tax revenue to fund new spending.

Simply put, there's every reason to believe Washington will be searching for more tax revenue in the near term. And recent Congressional debate shows retirement accounts are a key place Congress may look.

ADDRESSING LEGISLATIVE RISK

So what does this mean for American savers?

> **If you want to address the complete set of risks potentially facing your retirement funds, you may want to consider strategies that mitigate tax and legislative risk.**

Many savers choose to address the risk of variable taxes in retirement by incorporating tax-free strategies into their retirement approaches. Tax-free assets can serve as a hedge against rising taxes in the future. Since Roth IRAs, Roth 401(k)s and other tax-free savings vehicles are funded with post-tax dollars, no taxes are due on the funds when withdrawn in retirement. That means if Congress raises taxes in the future, funds in tax-free accounts would not be impacted.[4]

INCORPORATING TAX-FREE STRATEGIES

Diversifying the tax status of your retirement assets could be as important as diversifying other areas of your retirement approach.

Many savers understand they could need asset diversification to safely grow and protect their funds in retirement. That's why retirement accounts often include a mix of stocks, bonds and other fixed-income instruments. Diversification in asset type helps mitigate the risk of an underperforming market, or low-interest rate growth. Over the past two decades, many savers have also begun to understand the importance of diversifying their sources of income in retirement. Some savers want guaranteed income from a pension or annuity along with more variable income coming from a managed account.[5]

In my opinion, tax diversification is just as important to the success of your retirement approach as asset diversification and income diversification. By ensuring a portion of your retirement funds are in tax-free accounts, you can better protect yourself from the risk of rising taxes in the future and the legislative risk of what bills Congress might pass next.

In this way, some savers may use tax-free retirement assets as a hedge against both rising taxes and legislative changes. If this is a strategy that appeals to you, please consult a qualified financial professional about your individual situation.

WHAT COMES NEXT?

The debate in Washington has uncovered areas where Congress may be looking for new tax revenue in the years ahead - and retirement assets appear to be high on that list. I see a pattern emerging in Congressional thinking, where new spending requires new taxes – and new taxes often require identifying new areas to tax.

> **One thing is clear to me: The legislative risk facing Qualified accounts is significantly higher today than at any time in recent memory. And if you aren't prepared, you may not be protected.**

Reducing legislative risk is a natural evolution of preparing for retirement. As I mentioned, many savers address market risk through a balanced portfolio and asset allocation, and increasingly savers have sought to address income risk through annuities. Now, as you prepare for the complete risks of retirement, you may also need to address tax and legislative risk. This can help you protect your retirement funds from the whims of Washington – now and in the years ahead.

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1 "Responsibly Funding Our Priorities Section-by-Section," Fact Sheet, U.S. House Committee on Ways and Means, published September 15, 2021. Available online: https://waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/SubtitleISxS.pdf

2 "No, the $3.5 Trillion Spending Bill Does Not Cost $0," The Cato Institute, October 8, 2021

3 President Biden remarks to reporters, September 24, 2021. Transcript available at https://factba.se/biden/transcript/joe-biden-remarks-coronavirus-pandemic-september-24-2021

4 Contributions to a Roth IRA or 401(k) are subject to strict limitations by the IRS. Please consultant a tax professional about your situation. This paper does not consider every product or feature of tax-deferred or tax-free accounts and is for illustrative purposes only. It should not be deemed a representation of past or future results, and is no guarantee of return or future performance. Your tax bracket may be lower or higher in retirement.

5 This paper is not intended as a complete examination of any savings approach, account or asset type. Many assets have fees, limitations and/or qualifying requirements associated with them. Please consult with qualified professionals about your individual situation.