November 24, 2021

House Version of "Build Back Better" Act Contains Retirement Plan and Benefits Provisions

On November 19, 2021, the U.S. House of Representatives passed H.R. 5376, the Build Back Better Act ("BBB Act" or "the Act"). Following quickly on the heels of the Infrastructure Investment and Jobs Act, the BBB Act contains several retirement and benefits provisions that may affect financial organizations, service providers, and consumers. This bill has gone through numerous revisions as it made its journey to the House floor for a vote. It will now go to the Senate, which will likely make further revisions. So the Act's final version—if passed by both the House and Senate—may be different from the current version.

Retirement Plan Provisions

- **Moving after-tax assets from eligible plans to a Roth IRA would be prohibited.** In 2010, Congress removed the income thresholds that prevented high-income individuals from converting Traditional IRA assets to Roth IRAs. But income limits still applied to *annual* Roth IRA contributions: so individuals who earned too much couldn't contribute to a Roth IRA. They could, however, make after-tax contributions to a Traditional IRA, and then convert the assets to a Roth IRA. (Detailed pro rata distribution rules applied to such conversions.) Effective January 1, 2022, the BBB Act would eliminate these "back door Roth" contributions.

  This proposed change would affect more than Roth IRA conversions. It would also prohibit employer plan rollovers of after-tax assets to designated Roth accounts or to Roth IRAs (sometimes called "mega back door Roths").

  Effective January 1, 2032, the BBB Act would also prohibit *any* Roth IRA conversions and in-plan Roth rollovers for the following high-income individuals. (Income limits would be indexed for inflation.)

  - Single filers with modified adjusted gross income (MAGI) over $400,000.
  - Joint filers with MAGI over $450,000.
  - Heads of households with MAGI over $425,000.

- **High-income individuals with large retirement balances could not contribute to an IRA.** To avoid subsidizing taxpayers with large IRA balances, this provision would disallow IRA contributions for those with combined IRA and defined contribution plan balances exceeding $10 million. This change would apply only to those whose annual income exceeds certain (indexed) amounts.
  - Single filers with modified adjusted gross income (MAGI) over $400,000.
  - Joint filers with MAGI over $450,000.

- Heads of households with MAGI over $425,000.

Certain types of "annual additions" would not be considered IRA contributions, and so would be unaffected by this provision. They would, however, be used to determine whether an individual's balance exceeds $10 million.

- Contributions to SEP and SIMPLE plans.
- Rollovers from other eligible plans.
- IRA assets received as the beneficiary of an eligible retirement plan.
- IRA assets received through a valid divorce or separation agreement.

Ineligible individuals who make IRA contributions would be subject to the six percent excess contribution penalty tax if they fail to remove the excess contribution by their tax return due date, plus extensions. This provision would also require defined contribution plan administrators to report to the IRS any participant or beneficiary balances of at least $2.5 million (indexed). This restriction on contributions for those with higher incomes and plan balances would not be effective until tax years beginning on or after January 1, 2029.

- **Additional RMDs would be required for high-income individuals with large retirement balances.** Using the same income limitations found in the previous two provisions, the BBB Act would require high-income individuals with retirement balances exceeding certain thresholds at the end of the preceding year to take additional required minimum distributions (RMDs) for the current year, irrespective of their age. This provision is intended to reduce the transfer of significant wealth through retirement plans and would limit tax-advantaged accounts to an amount that reflects more reasonable retirement needs. The proposed formula for these increased RMDs is a bit complicated.

  Individuals with combined IRA and defined contribution balances that exceed the "applicable dollar amount" would need to distribute 50% of the excess as an RMD. The applicable dollar amount would start at $10 million and would be indexed for inflation. Further, if the balance exceeded 200% of the applicable dollar amount (initially $20 million), an individual would need to satisfy the RMD by first distributing the lesser of

  - the amount needed to bring the total balance in all accounts down to $20 million (indexed), or
  - the aggregate balance in the Roth IRAs and then the aggregate balance in the designated Roth accounts.

  Once the initial distribution is made, the individual would then distribute 50% of the aggregate balance that exceeds $10 million. This second part of the distribution would be reduced by any amount that was distributed from the Roth accounts (under the previous step). In this second step, the individual could determine the accounts from which to take RMDs in order to fulfill the RMD requirement. The individual would also need to take the normal RMD—calculated without regard to the new provision.

  This increased RMD requirement would apply to all those with retirement balances exceeding the applicable dollar amount, even those not normally subject to RMDs (i.e., those under age 72). Individuals may have to take distributions for several years in order to whittle large balances down toward the $10 million (indexed) limit.

  There are some other notable details of this provision.

  - Mandatory 35% withholding would apply to the increased RMD amounts.
  - As with other RMDs, these additional RMDs would not be eligible for rollover treatment.
  - Employee Stock Ownership Plan balances—if invested in stock that is not readily tradable—would not be considered when calculating the special RMD.
  - Required Roth IRA or designated Roth account distributions would be treated as qualified (that is, tax free) distributions.
  - The 10% early distribution penalty tax would not apply (for affected individuals under age 59½).

  This provision would apply to taxable years beginning on or after January 1, 2029.

- **Statute of limitations would increase to six years for IRA noncompliance.** This BBB Act provision would lengthen the current three-year statute of limitations to six years. The increase in the time that the IRS could continue to examine IRAs would apply to substantial errors (willful or otherwise) in reporting the value of investments and to the imposition of any tax associated with prohibited transactions under Internal Revenue Code (IRC) Section 4975. The six-year window would apply to taxes to which the current three-year period ends after December 31, 2021. Additionally, the new rule would allow taxes to be assessed up to six years after a return was actually filed, even if it was filed late.

- **IRA owners would be treated as disqualified persons under prohibited transaction rules.** This provision clarifies that, when determining whether an entity or individual has engaged in a prohibited transaction under IRC Sec. 4975, a disqualified person would include the IRA owner and those who inherit the IRA after the owner's death. This provision would apply to transactions occurring on or after January 1, 2022.
- **Prohibited transaction provision would be added for certain IRA investments.** Although this provision may affect few individuals, it would preclude an "investment, at the direction of a disqualified person, by an individual retirement account in an interest in a DISC or FSC that receives any . . . payment from an entity [that is] owned by the individual for whose benefit the account it maintained."
  A DISC is a Domestic International Sales Corporation, and an FSC is a Foreign Sales Corporation. These business entities were created to promote U.S. exports—and they were given substantial tax incentives. If an IRA owned (all or a portion of) a DISC or FSC, the IRA would not only reap significant tax benefits each year for the business, but the IRA would also accrue tax-deferred (or tax-free) growth.

  Because of the potential for an IRA owner or other disqualified person to structure these types of investments in a way that was not originally intended, the BBB Act would prohibit this transaction, effective for stock or other interests acquired or held on or after December 31, 2021.
- **Rules would be modified to limit losses from wash sales of certain assets.** Wash sales rules limit the deduction that a taxpayer can take for an investment loss if the taxpayer (or the spouse) acquires the same or similar assets within 30 days of selling the original assets. While these rules have typically been applied to stock transactions, the BBB Act would specifically include "any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary." In addition, this definition "include[s] contracts or options to acquire or sell, or notional principal contracts in respect of, any specified assets."

  Presumably, this new rule was designed to reduce the tax advantages of speculating in such assets as cryptocurrencies and nonfungible tokens (NFTs). The BBB Act would also preclude "related parties" from conducting wash sale transactions on a taxpayer's behalf. These parties would specifically include (among others) the taxpayer's IRAs, HSAs, 529 plans, and qualified retirement plans (such as 401(k) plans).

  This provision would apply to sales, dispositions, and terminations of assets on or after January 1, 2022.

Other BBB Act Provisions

- **Four weeks of paid leave for all workers.** Currently, public entities and private companies with 50 or more employees must offer up to 12 weeks of time off under the Family and Medical Leave Act (FMLA). This, however, is unpaid time off. The BBB Act would provide *paid* leave. Eligible individuals could receive up to four weeks of paid leave in a 52-week period. This leave provision would be paid directly through a new federal program or through each state (or employer), which would be reimbursed for most of the costs. The following details would also apply.
  - Payment amounts would vary depending on a worker's weekly income, from approximately 90% of pay down to 53% of pay. Lower-paid worker would receive the higher percentage, and the benefit percentage would shrink for those with higher weekly pay. No amounts would be paid based on wages that exceed $1,192 weekly (1/52 of $62,000 in 2024, subject to indexing).
  - Unlike the FMLA, all workers would be eligible for the BBB Act's paid leave, including self-employed business owners.
  - As with the FMLA, leave could be taken for events such as the birth or adoption of a child, the worker's own serious health condition, or to care for a family member with a serious health condition. The BBB Act would also expand the definition of "family members" to those whose care would qualify for paid leave.

  This provision would become effective January 1, 2024.
- **Fringe benefits for bicycle commuting.** The Tax Cuts and Jobs Act of 2017 repealed employer-provided benefits for workers who commute by bicycle. The BBB Act would reinstate and expand this benefit. Employers could once again reimburse employees' expenses associated with the purchase, lease, rental,

improvement, repair, or storage of bicycles that are used to commute from home to work or to a mass transit facility. Based on the projected adjustment for 2022, the reimbursement could go up to approximately $80 per month.

Takeaways

The Build Back Better Act is advancing through the budget reconciliation process, which allows the Senate to pass the bill with a simple majority. The Senate will likely make changes to the House version, meaning that the two chambers of Congress will have to reconcile their bills' differences so that they can vote on identical bills. If the House and Senate can agree to terms, we expect that the final bill will contain at least some of the provisions discussed above. Because Congress must address other pressing legislative matters, such as a defense spending bill and the national debt ceiling, the BBB Act may not receive immediate attention. However Congress acts, Ascensus will continue to follow this bill. Visit ascensus.com for the latest developments.