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Treasury Wants Lion's Share of High-Income Taxpayers' Retirement Savings

By: Eaton Vance on Washington | March 26, 2024

High-income taxpayers are again feeling the squeeze as the U.S. Treasury Department seeks to modify rules relating to retirement plans by preventing "excessive accumulations" in tax-favored retirement accounts and slamming backdoor Roth contributions in an effort to raise $23.6 billion between 2025 and 2034. These provisions were originally proposed to help fund the Build Back Better Act, which sought to invest $390 billion in childcare and universal preschool initiatives.

Here's a look at the potential impact of key proposals:

$10 million cap on IRA and defined contribution plan accumulations

The $10 million aggregate cap on accumulations in defined contribution (DC) plans and individual retirement accounts (IRAs) would apply to single taxpayers who earn modified adjusted gross income of $400,000 or more, heads of household with income over $425,000, and joint filers earning more than $450,000. Taxpayers with total accumulations exceeding the cap would be required to distribute 50% of the excess amount. Plan administrators would be required to report to the Department of Treasury if the vested account balance exceeds $2.5 million (adjusted for inflation).

Eliminate all Roth conversions for high-income taxpayers

High-income taxpayers (as defined above) would be prohibited from repositioning their assets in a traditional IRA or an eligible distribution from an employer-sponsored qualified retirement plan (QRP), such as a 401(k), 403(b), or governmental 457(b) to a Roth IRA.

Eliminate backdoor Roth contributions

The Treasury seeks to do away with a conversion that allows high earners to essentially contribute after-tax income to a traditional IRA and convert the contribution into a Roth IRA. Under current law, a taxpayer without any other traditional IRA assets may quickly make the conversion without any tax consequences. On the plan side, an individual who has already made the maximum permitted 401(k) contributions (Roth and/or pre-tax) may effectively exceed that limit by making after-tax contributions to the plan and then converting those contributions to Roth. The proposed budget would preclude both types of backdoor Roth contributions by prohibiting rollovers of after-tax amounts to Roth IRAs or Roth plan accounts.

Clarify disqualified persons for IRA prohibited transactions

The Treasury seeks to clarify that the individual for whom an IRA is maintained is always a disqualified person for purposes of prohibited transaction rules. This includes IRA owners and beneficiaries, if the owner has died.

Prohibit IRA purchase of a DISC or FSC ownership interest

The proposal would prohibit an IRA from holding an interest in a Domestic International Sales Corporation (DISC) or a Foreign Sales Corporation (FSC) that receives a payment from an entity owned by the IRA owner.

Extend the statute of limitations

The statute of limitations for a substantial error relating to valuation of assets in an IRA would be extended from three years to six years. The proposal would also extend the statute of limitations for the excise tax on prohibited transactions from three years to six years.

Bottom Line: The fiscal year 2025 budget proposal, which aims to whittle the federal budget deficit by a net $3.3 trillion over the next decade through additional tax reforms, sets its target on "the wealthiest Americans" to "finally pay their fair share." High-income taxpayers should speak with their financial advisors about potential impact of these proposed changes to their retirement savings.

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