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Key Legislative Developments Affecting Your Human Resources

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President Unveils FY 2016 Budget; House Votes to Repeal ACA

Tax reform, employee benefits, and labor and employment-related changes were prominently featured in the FY 2016 budget proposed by the White House. Also this week, the House of Representatives voted to fully repeal the Affordable Care Act.

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FY 2016 Budget Proposal

President Barack Obama released his proposed budget for federal FY 2016 this week. The budget includes a number of provisions relevant to employers and employee benefit plans. Among other items, the budget includes tax reform proposals that would limit the tax benefits of employer-provided health and retirement coverage, retirement plan simplification proposals, higher employment taxes, paid leave initiatives, new overtime and worker classification rules, and an increase in the federal minimum wage — described more fully below.

What's the likelihood the president's budget proposals will be enacted?

With Republicans now in control of both chambers of Congress, there is little chance that any of the budget proposals discussed in this article will be enacted.

For example, while both political parties are interested in tax reform, they do not agree on top-line goals for reform — such as the amount of revenue that a reformed tax code should raise. While the president's budget released this week calls for raising an additional $640 billion in revenue to pay down federal deficits, Republicans generally favor revenue-neutral tax reform — meaning tax reform on net does not raise or lose additional revenue as compared to current law. Without agreement on a key top-line goal such as the amount of revenue that a reformed tax code should raise, the prospects for comprehensive tax reform are poor.

Some retirement simplification and tax relief proposals in the president's budget might find their way into retirement legislation if Congress decides to pursue it. Chairman Orrin Hatch (R-UT) of the Senate Finance Committee is interested in retirement reform and simplification — see our **November 14, 2014** *Legislate* for more information on a bill that he introduced in the prior Congress.

Documents released by the White House on the proposed budget include an overview of the budget, fact sheets for the various federal agencies, a summary of the tax proposals, and a lengthy appendix (almost 1,400 pages) that provides more details on the various proposals in the budget.

Tax Reform

The budget calls for tax reform focused on helping middle class and working families. To that end, the budget proposes to increase existing tax credits for families with children, provide a new $500 tax credit for families with a second income-earner, simplify tax benefits for education, and expand the benefits of the earned income tax credit (EITC) for families that do not have children. These tax breaks would be paid for by increasing the maximum tax rate on capital gains to 28% (after taking into account the Affordable Care Act's 3.8% tax on net investment income), imposing a new fee (seven basis points) on the liabilities of large financial firms, curtailing stepped-up basis for inherited assets, scaling back estate tax exclusions, and other tax-raising proposals.

In addition to reforming taxes to aid the middle class and working families, the budget proposal also seeks to increase revenue specifically to reduce the outstanding federal deficit. Towards this end, almost $640 billion would be raised primarily by limiting the value of certain tax exclusions and deductions to the 28% tax rate. Among the tax exclusions targeted by this proposal are tax excludable contributions for employer-provided health coverage (including premium conversion contributions under a cafeteria plan) and elective salary deferral contributions to 401(k) and similar plans. Employee contributions to HSAs and IRAs would also be affected by the proposal. Contributions to retirement plans and IRA accounts that are limited by this cap would give rise to "basis" in the account — thus requiring additional recordkeeping. This proposal has been included in prior Obama budget proposals and is estimated by the Office of Management and the Budget to raise $603 billion over 10 years. Under the current income tax brackets (for the 2015 taxable year), the limitation would affect families (filing jointly) earning at least $230,451 and unmarried taxpayers earning at least $189,301.

Retirement

The president's budget includes a number of proposed changes for retirement plans that seek to expand coverage or limit the tax benefits for retirement savings:

Part-time workers. 401(k) plan sponsors would be required to permit employees who work at least 500 hours per year for at least three years to make salary deferral contributions to the plan. Employer contributions and matching contributions would not be required. Nondiscrimination testing relief would be provided — similar to the current rules applied to plans that cover otherwise-excludable employees. In addition, these employees would be excluded from top-heavy vesting and benefit requirements.

State retirement initiatives. The budget would set aside $6.5 million — and give DOL waiver authority over inconsistent federal laws — to assist states in implementing laws that automatically enroll workers in IRAs or create other retirement savings vehicles.

Mandatory auto-IRA. Employers that do not sponsor a tax-qualified retirement plan, SEP, or SIMPLE would be required to automatically enroll employees in payroll deduction IRAs at default rate of 3% of compensation. Employees would be able to opt-out or change their contribution percentage. The proposal would apply to employers in business for at least two years with more than ten employees. Employers with retirement plans that do not cover their entire workforce would be required to participate, although certain types of workers would be disregarded — such as those who haven't completed the plan's eligibility period, are nonresident aliens, or are covered by a collective bargaining agreement. To address employer concern over selecting IRA vendors and investments, a low-cost, standard type of default investment and a handful of standard, low-cost investment alternatives would be prescribed by statute or regulation. Tax credits would be available for small employers to assist with auto-IRA administrative costs; for small employers finally opting to adopt their own plan, the proposal would expand the credit for retirement plan adoption costs.

Aggregate savings cap. Aggregate defined benefit and defined contribution benefit accumulations in all tax-preferred retirement savings vehicles — IRAs and tax-qualified plans — would be limited to no more than the current law Section 415(b) defined benefit limit. The limit for 2015 is an annuity payable at age 62 of $210,000. Account balances in IRAs and defined contribution plans would have to be converted to an equivalent annuity to apply the cap. The limit would apply at the individual taxpayer level.

Limits on lifetime distributions. Beneficiaries would generally be required to take a full distribution of inherited IRAs and accrued benefits in tax-qualified retirement plans within five years of the death of the account owner or plan participant. Exceptions would apply for certain beneficiaries — surviving spouses, minor children, disabled individuals, and beneficiaries who are no more than 10 years younger than the decedent. For example, upon the death of a participant receiving a 15-year certain and life option, the remaining period certain benefit would need to be compressed into a five year payment period for the beneficiary, unless the beneficiary is eligible for a longer distribution period.

Roth conversions. The budget would prohibit “back-door” Roth conversion of after-tax amounts held in a traditional IRA.

PBGC Premiums in President’s Budget

The FY 2016 budget proposes giving the PBGC authority to set premiums for both single-employer and multiemployer plans. The PBGC would take into account the risks that different plan sponsors pose to the insurance program when setting premiums. The budget proposal contemplates an additional $19 billion in premiums over the next 10 years, pro-rated between single and multiemployer plans based on the size of the deficits in the respective PBGC programs.

Dividends paid to ESOPs. The budget would repeal the deduction available to publicly traded corporations for dividends paid on stock held by an ESOP.

Net unrealized appreciation in employer stock. The budget would repeal the exclusion for net unrealized appreciation in employer stock.

The budget also includes a number of simplification and tax relief proposals for retirement plans:

Annuity portability. This proposal would allow participants to roll over an annuity or other lifetime income investment into an IRA or other retirement plan if their current retirement plan discontinues the annuity or lifetime income investment.

Minimum required distribution rules. Small aggregate accumulations in tax-preferred retirement savings vehicles would be exempt from the required minimum distribution rules — generally, aggregated accounts with $100,000 or less, with a phase-in for aggregate accumulations between $100,000 and $110,000.

Rollover of inherited accounts. Present law restricts the types of rollovers available to non-spouse beneficiaries. The proposal would permit 60-day rollovers by non-spouse beneficiaries.

Early retirement distribution penalties. Individuals unemployed for at least 26 weeks would generally be eligible for an exception to the 10% additional tax on retirement distributions before age 59 ½.

Foreign pensions. Foreign pension funds would be exempt from US taxes on gains from the sale of real property located in the US.

Lastly, the budget would require W-2 reporting of all contributions made on behalf of an employee to a defined contribution retirement plan.

Health and Welfare

The budget would eliminate dependent care FSAs — generally funded by employee pre-tax contributions through a cafeteria plan, and described by the proposed budget as “poorly targeted and complex.”

The savings from eliminating dependent care FSAs would be used to partially pay for tripling the existing child and dependent care tax credit (from $1,000 to $3,000 per child) for families with children under the age of five, and would make the full credit available for families with incomes up to $120,000.

Labor and Employment

The president’s proposed budget, which ends the sequester caps, includes increased funding for the DOL, EEOC, NLRB, OSHA, and OFCCP. The budget’s allocation of funding to certain labor and employment-related initiatives reflects the administration’s priorities for FY 2016, most notably:

State paid leave initiatives. The budget includes $2.2 billion in mandatory funding for the Paid Leave Partnership Initiative — which would assist up to five states in enacting their own paid leave programs. States would be eligible for grants to fund the initial set-up and half of the program benefits for three years. The grants could be used to cover leave programs that provide up to 12 weeks of benefits. The budget also includes an additional $35 million in State Paid Leave Funds to provide technical assistance and support to states that are building the necessary infrastructure for future paid leave programs.

Raising the minimum wage. The budget looks for legislation to increase the federal minimum wage to $10.10 per hour.

Enhanced whistleblower protections. The budget includes $3.4 million for OSHA to improve its enforcement of the non-discrimination and anti-retaliation provisions in 22 statutes.

Enforcement. The budget includes nearly $1.9 billion for the DOL’s various worker protection agencies, including an additional $49.6 million and more than 300 full-time employee equivalents for the Wage and Hour Division (most of which is for enhanced enforcement of key initiatives such as employee misclassification, fissured workplaces, and FMLA compliance).

Increased employer penalties. The budget also proposes strengthening DOL penalties for employer violations of health and safety, wage and hour, and retirement plan rules. For example, the budget would assess a $5,000 penalty (per violation) on employers that keep fraudulent or no wage and hour records.

New overtime rules. The budget proposes — without further details — that the secretary of labor will update the regulations that determine whether salaried workers qualify for minimum wage and overtime pay protections.

Government contract compliance. The budget calls for over $113 million to the Office of Federal Contract Compliance programs (OFCCP) to improve the agency's enforcement case management database system; narrow the wage gap; eliminate gender, racial, and ethnicity-based discrimination in the construction trades; and implement final regulations.

Expanded reemployment services and training opportunities. The budget provides a $500 million increase in discretionary spending for employment services for unemployed workers, as well as $16 billion in mandatory funding over 10 years for worker training through the workforce development system. Additional funding would be available for training, employment subsidies, and stipends for the long-term unemployed.

Apprenticeship and industry grants. The budget looks to provide over $2 billion in state grants to double registered apprenticeships over five years, and $100 million in discretionary spending to states, industry, and community-based organizations to develop or expand registered apprenticeship programs. The budget also provides $500 million in competitive grants for the development and adoption of industry-validated credentials, including $300 million for information technology jobs.

Jobs for disconnected youth and ex-offenders. The budget includes $3 billion in mandatory funding to expand job opportunities for disconnected youth through the Connecting with Opportunity Initiative, and $95 million to help ex-offenders secure employment.

Employment Taxes

The budget proposes several changes to employment taxes:

Worker classification. Currently the Department of Treasury and the IRS are prohibited from issuing regulations and other generally applicable guidance addressing worker classification. The budget would remove this prohibition. It would also repeal current rules that permit service recipients to treat service providers as independent contractors for federal employment tax purposes — rules that apply even if the workers are actually employees under common law rules or other statutes, as long as the service recipient has a reasonable basis for the treatment. This rule is often referred to as Section 530 relief — named for the section of the Revenue Act of 1978 that first enacted the rules and prohibited Treasury and IRS from issuing guidance. The budget would revise the Section 530 rules by allowing the IRS to require prospective reclassification of misclassified workers. The reduced employment tax liabilities for misclassification available under current law would be retained, but lower penalties would apply only if the service recipient voluntarily reclassifies its workers before being contacted by the IRS or other enforcement agency and had timely filed all required information returns (Forms 1099) for the misclassified workers.

SECA taxes for professional service businesses. Owners of professional service businesses organized as tax flow-through entities — such as S corporations, partnerships, and LLCs — would be subject to new SECA rules. Owners providing services who materially participate in the business would be taxed on their distributive share of the business' income; and owners who do not materially participate would be subject to SECA taxes on the amount equal to the reasonable compensation for any services they provide to the business. Professional service businesses would include businesses in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, investment advice or management, brokerage services, and lobbying. While distributions of compensation to owners of professional service S corporations would no longer be treated as wages subject to FICA taxes, they would be included in earnings subject to SECA taxes.

Unemployment insurance. For 2016, the budget would reinstate and make permanent the 0.2% FUTA surtax, raising the federal payroll tax on employers from 6% of the first $7,000 paid annually to each employee to 6.2%. The net federal FUTA tax would be 0.8%, since employers are generally permitted a credit for state unemployment taxes of up to 5.4%. For 2017, the budget would make a number of changes: increase the FUTA taxable wage base to $40,000 (up from $7,000) and reduce the net federal unemployment tax rate to 0.165% (on the expanded wage base), while also requiring that states have a minimum tax equal to 0.175% of the expanded FUTA wage base.

Tip credit. The budget would repeal the current income tax credit for FICA taxes an employer pays on tips, effective for taxable years beginning after December 31, 2015. Currently, eligible employers in the food and beverage service sectors may claim an income tax credit for FICA taxes paid on the portion of tips which, when added to the employees other non-tip wages, exceeds $5.15 an hour.

Employment tax credits. The budget would also permanently extend the Work Opportunity Tax Credit to apply to wages paid to qualified individuals who begin work for the employer after December 31, 2014. In addition, for individuals who begin work for the employer after December 31, 2015, the definition of a qualified veteran would be expanded.

Executive Compensation

The budget proposes taxing a "carried interest" as ordinary income. A carried interest is a partnership interest received in exchange for the performance of services.

The budget would also disallow deductions for interest paid on loans against corporate-owned life insurance covering the lives of key corporate officers and employees — other than for 20% owners of the business that owns or is the beneficiary of the policy.

Healthcare

The House of Representatives passed legislation (HR 596) this week that would fully repeal the Affordable Care Act. The bill was amended in the Rules Committee so that repeal would be effective 180 days after enactment—which is meant to give Congress time to develop an alternative to the health reform law. HR 596 passed on a largely party-line vote, with only no Democrats voting for repeal. The budgetary impact of the repeal bill are not yet known, as the official budget and revenue estimators for Congress — the Congressional Budget Office and the Joint Committee on Taxation — were not able to complete a cost estimate in time for the vote.

The legislation heads next to the Senate. Even if HR 596 could be passed by that chamber — which is unlikely as 60 votes are needed to end a filibuster of the legislation — the president would veto the bill. There are not enough votes in either chamber to override a presidential veto.

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