



## The Fiscal Cliff: Crisis Averted?

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Prior to founding the Multnomah Group in 2003, he served as a Vice President of Retirement Services and led the Portland, Oregon practice of a national retirement services firm where he was a founding member of their national investment committee which managed more than \$2.5 billion in qualified plan assets.

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# Gina Gurgiolo, JD, LL.M

Gina Gurgiolo is a Senior Consultant for the Multnomah Group, leading the firm's technical services department. Gina's retirement plans technical services background includes particular expertise in the tax-exempt and governmental sectors. Prior to joining the Multnomah Group in 2010, Gina managed the product portfolio for a national retirement services firm and directed the firm's plan administration unit serving the firm's largest clients. Prior to that, Gina managed the retirement plan compliance and regulatory policy functions at another national retirement services firm. In all, Gina has 13 years of holistic retirement plans experience.

Gina earned her JD from the University of Pittsburgh and her LL.M in taxation with emphasis in retirement plan and executive compensation law from the University of Denver. Gina is a member of the Portland Chapter of the Western Pension & Benefits Conference, and has been a conference speaker at multiple industry events.

# Agenda

- Fiscal Cliff 101
  - What is the Fiscal Cliff?
- American Taxpayer Relief Act of 2012
  - Almost Provisions
  - In-plan Roth Conversions
  - Participant Impacts?
- What's Next for the Markets?
  - Tax, Spending and Debt Ceiling Debates
  - Fiscal Policy
  - Market Impacts
- Questions and Answers

# Fiscal Cliff 101

What is/was the fiscal cliff?

- Term popularized by Fed Chairman Ben Bernanke in February, 2012
- Refers to steep decline in deficit anticipated if George W. Bush-era tax cuts expired on December 31, 2012
  - Estimated to raise taxes by \$494B in 2013
  - Coupled with mandatory spending cuts of \$1.2T set to go into effect on January 3, 2013
- Congressional Budget Office recently opined that the cliff would have led to recession and 9% unemployment in late 2013

# American Taxpayer Relief Act of 2012

- ATRA passed on January 1, 2013 in the twilight of the 112th Congress
  - Senate: 89 – 9
  - House of Representatives: 257 – 167
- Signed by President Obama and enacted on January 2, 2013
- ATRA resulted in a less severe decrease in the 2013 deficit relative to 2012 as compared to the sharp decline projected under the fiscal cliff
- Delays sequestration (i.e. automatic spending cuts) for 2 months
- For an easy summary of ATRA's provisions, read our January 2013 Benefits Digest article "[The Fiscal Cliff Act: A Thirteenth Hour Compromise](#)"

# Almost Provisions

- ATRA was introduced in its original bill form on July 24, 2012 spawning vigorous debate and numerous revised versions
- With regard to retirement plans, prior versions of ATRA included a modified salary deferral limits structure seeking to significantly reduce deferrals/increase taxable income
- In the final version of ATRA, the 3.8% passive income surtax imposed on certain higher income investors does not apply to retirement plan distributions

# In-Plan Roth Conversions

- The ATRA provisions most directly impacting retirement plans relate to in-plan Roth conversions
- A last minute addition to ATRA in an effort to capture additional short-term tax revenue
  - Estimated to produce \$12.1B in revenue over the next 10 years
- 401(k), 403(b) and governmental 457(b) plans may allow participants to defer on a Roth basis
  - After-tax deferrals separately recordkept as Roth source
  - Tax-free earnings at distribution if certain requirements are met
  - Requires plan amendment by employer
  - Available since EGTRRA 2001 and PPA 2006
- In-plan Roth conversions allow for current year taxation on amounts converted to Roth status
  - Prior to ATRA, in-plan Roth conversions required a distributable event precipitating an eligible rollover distribution under IRS Notice 2010-84
    - Converted amounts not subject to 10% distribution penalty
  - ATRA
    - Eliminated the distributable event requirement
    - Stated that conversions are not subject to the 3.8% surtax on investment income of certain higher income earners



# In-Plan Roth Conversions

- In-plan Roth conversions are irrevocable
- Participants may use in-plan Roth conversions to avoid the uncertainty of future tax rates
- Participants who expect to be in higher future tax brackets may convert to pay tax at their current/lower tax rate
- Available to surviving spouse beneficiaries and spousal alternate payees, but no other beneficiaries or alternate payees
- Check with retirement plan recordkeeper prior to adoption to ensure capabilities and ensure appropriate employer-level processes
  - Consider potential effects on distribution procedures and required 402(f) notice
  - Communicate effectively to participants to promote utilization
- Awaiting further clarifying guidance from the IRS

# Participant Impacts?

Will plan sponsors/participants take advantage of in-plan Roth conversion provisions?

- Pre-ATRA underutilization
  - Is ATRA's liberalization enough to cause a shift?
- Can participants afford the tax bill?
  - IRS suggests increasing withholding to plan for tax liability

Will participants' tax burdens affect how they participate in the retirement plan?

- Some education campaigns encouraged a 2% deferral increase when the payroll tax rate was cut by 2%
  - Will participants decrease deferrals by 2% now?
- Retirement plan distributions are not subject to 3.8% surtax imposed on investment income of certain higher income earners

# What's Next for the Markets?

- ATRA provided (temporary) relief related to mandatory spending sequestrations
- The likelihood of a “Grand Bargain” appears low
- Debt Ceiling Debate Part 2
  - House of Representatives passed an extension through May 18, 2013 to provide an opportunity for a broad agreement on spending and tax policy

# Tax Debate Structure

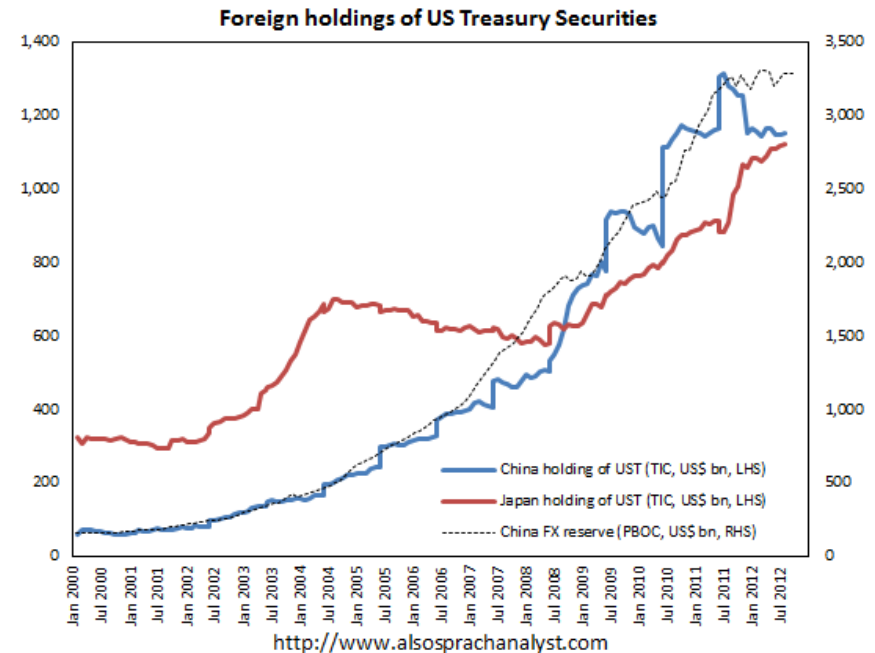
- Debates about taxes and deductions typically revolve around specific taxes and deductions and an assessment of the worthiness and impact of changes
- Urgency of the debt ceiling will make such an assessment unlikely
- More likely changes:
  - Hard cap on the dollar value of deductions
    - Already addressed by the Alternative Minimum Tax
  - Hard cap on the deduction “rate”
  - Discussion of exempting the deductions for municipal and other tax-exempt bonds

# Spending Debate Structure

- Best opportunities for agreement lie within Simpson-Bowles
- Sequestration would have impacted defense and discretionary spending
  - Immediate impact on GDP
    - Sequestrations to Defense and Non-Defense Discretionary would have had a \$93 B impact on GDP for 2013, roughly equal to 0.60% of GDP
- Possible alternative – modifications to eligibility and calculation of Mandatory Spending items
  - Chained CPI for Social Security
  - Extend the age for Social Security and Medicare

# Fiscal Policy

- Potential for Bernanke to retire at the close of 2013
- Likely replacement Janet Yellen, current Vice Chair of the Federal Reserve
- Monetary policy likely to remain consistent
- Continuation of Quantitative Easing
  - Treasury purchases
  - Mortgage-backed security purchases
- China's rate of growth and purchases of Treasuries have declined
  - Fed's purchase program has only augmented purchases from other sovereign entities



# Market Impacts

- Market volatility around critical fiscal policy deadlines
- Low inflation at least through 2013
- Negative real return on the risk-free rate
  - Pressure on the Euro and Yen
- Bank of Japan has announced the intent to stimulate the economy of Japan
- Heavier allocations to equities, real estate, and commodities in pursuit of return
- Modifications in investment strategy for tax sensitive investors

# US Stock Market Performance

Russell 3000 Index with Selected Headlines from 2012



Source: Russell Investment Group.

In US Dollars. Index is not available for direct investment. Performance does not reflect the expenses associated with management of an actual portfolio. Past performance is not a guarantee of future results.



# Questions & Answers

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