

February 26, 2024 – Wealth Planning Commentary

Legislative and Tax Updates

News outlets recently published some alarming articles related to 401(k)s, private placement life insurance (PPLI) and inherited IRAs. At first glance, the articles appear to surface serious threats to these accounts and products. But it's a lot of noise and shouldn't cause concern at this time.

The most noteworthy 'rabble rousing' headline is on the topic of 401(k)s. The Center for Retirement Research at Boston College and The Manhattan Institute for Policy Research both suggested the elimination of the 401(k). The increased tax revenue from former tax deductible 401(k) deferrals could help fund social security. For some reason, perhaps due to a slow news cycle, the idea went mainstream. It's true that the Social Security Fund is in trouble. Without intervention, Social Security benefits are expected to be reduced by 20% in 2034. The research organizations proposed that voters and politicians find the idea of removing pre-tax 401(k)s more appealing than increasing income taxes.

First, don't panic. Congress supports the 401(k). One only needs to reference the recently passed bipartisan Secure Act 2.0. The legislation allows Americans to defer even more than was previously allowed to tax-advantaged retirement plans. Voters in both low and high tax states love retirement accounts. Many clients of ours defer every dollar of salary they can to retirement plans and enjoy the tax deduction. There is an entire industry built around retirement plans and private companies will likely aggressively lobby against any reduction of 401(k)s benefits. While two respected organizations suggested taking away tax deferred savings, it's very unlikely the 401(k) will go away anytime soon.

A lesser known but powerful product was in the news last week. The Senate Finance Committee Chairman (Democrat Ron Wyden) published a scathing report on private placement life insurance, otherwise known as PPLI. PPLI is a type of variable universal life insurance that allows ultra-wealthy clients to invest in alternatives and other assets, as well as marketable securities. Alternative assets can grow faster than investments that are typically available in a standard variable universal life (VUL) policy. Growth within insurance products is tax free. Another advantage the PPLI has over the standard VUL is that the cost of insurance is far lower and the drag on investment growth is minimal. PPLI owners can borrow against the cash value. So, the assets grow tax free, and the owner can gain liquidity without triggering taxes from capital gains. PPLIs policies are for the UHNW. Premiums are between \$3-5mm at a minimum.

Senator Wyden plans to introduce legislation in the next few months to crack down on PPLI policies. The proposed legislation would eliminate the tax-favored status of PPLI, preventing them from being treated as life insurance contracts. According to Finseca, the life insurance industry's legislative advocacy organization, the probability of Congress passing any such legislation this year is very low. However, PPLI is clearly on Congress' radar and a bill limiting PPLI may pass down the road. It's important to understand that there is regulatory risk associated with PPLI and that policies may not be grandfathered if new legislation is eventually passed.

Lastly, a reminder that this year, the IRS is expected to mandate annual RMD for IRAs inherited by non-eligible beneficiaries if the deceased was taking RMD. The rules only apply to accounts inherited after 2020, and non-eligible beneficiaries are mostly anyone except the surviving spouse. The IRS hasn't issued any guidance on this topic since last year. The Secure Act of 2020 eliminated the stretch IRA for non-eligible beneficiaries and implemented the 10-year rule. The rules mean that the account must be depleted within 10 years of inheritance. However, the law was vague on whether annual RMD applies, and the IRS is trying to clarify the issue.

Our takeaway is that non-eligible beneficiaries are not required to take a distribution yet. The IRS has so far waived any potential penalties. But that doesn't mean you shouldn't take a distribution. To minimize taxes over the 10-year depletion period, one might consider taking a distribution if income is a low-income year.

In summary, clients shouldn't worry about these headlines this year. Beyond the lack of support for any reduction in the benefits of PPLI policies or 401(k) plans, Congress is gridlocked. House Republicans are currently working with one of the narrowest margins in U.S. history, and the Democrats hold a slim majority in the Senate. If the IRS decides to mandate annual RMD for IRAs inherited after 2020, take it.

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