The Big Beautiful Bill and Retirement Planning

Quick-Take: The new Tax Bill did not directly make any changes to IRAs and other retirement plans, but it indirectly creates more incentives to save for retirement and to convert traditional IRAs to Roth IRAs.

Background: The One Big Beautiful Bill (or referred to in the press as OBBBA- I have a different acronym, but I will spare you) did not make any direct changes to retirement plan contribution and distribution rules, unlike the SECURE and SECURE 2.0 Acts. However, OBBBA adds many new deductions that create opportunities to save for retirement, and particularly Roth conversions. There are 3 or 4 new indirect implications for retirement savings and Roth conversions.

Rothification: No changes were made to the Roth retirement saving rules under OBBBA. Since the 2017 Tax Act there has been a steady flow of new rules from Congress to encourage more Roth retirement savings. For example, we now have the Roth 401(k) account, the Roth SEP IRA, and the Roth SIMPLE IRA. With the SECURE 2.0 Act we now have rules that require any 'catch-up' contributions to a 401(k) account must be made with after-tax dollars, i.e., the catch-up contribution must be a Roth contribution, if the individual's income is above $145,000 for the prior calendar year. What is important to remember is that all these retirement savings feature that encourage Roth contributions are not because Congress wants individuals to have a financially secure retirement. No, the real reason for all these *Roth Rules* is Congress' incessant need for tax revenues, to offset other tax 'breaks' under the 2017 Tax Act. Roth retirement savings means paying taxes now on the contribution, to create tax revenues. Yes, many years into the future those Roth retirement accounts will deliver (if you trust Congress to not change the rules) tax-free earnings in the owner's retirement years. That, apparently, will present a revenue problem for future members of Congress, long after the current crowd of legislators who came up with OBBBA have retired from Congress (with their defined benefit pensions intact.) While OBBBA did not directly add any new Roth rules, it indirectly continues to encourage retirement savers to convert to Roth accounts.

Roth Conversions: The OBBBA removed the 2026 *sunset* for the 'lower' income tax rates and the broader federal income tax brackets under the 2017 Tax Act, which were made permanent. The lower income tax rates will no longer disappear. This means that there may be more conversions of traditional IRAs to Roth IRAs due to the prevailing lower federal income tax rates, and because the lower tax rates and broadened tax brackets are permanent, more traditional IRA owners may feel comfortable engaging in *serial* Roth IRA conversions over several years.

Tax Rates and Broadened Tax Brackets: In addition, with the increase in the SALT deduction (from $10,000 to $40,000,) and the new rules that there will be no income tax imposed on tips and overtime pay, those rules will lower an individual's taxable income. With lower taxable income, and the continuation of lower marginal income tax rates will lead to an individual's lower income tax 'bill' which will make it financially easier for an individual to convert his/her traditional IRA to a Roth IRA.

Impact of Phaseout Rules: Planning with tax advantaged retirement accounts will indirectly be encouraged due to the several phaseout of some other new tax savings and deduction opportunities. OBBBA has many new provisions with income limits, or *phaseouts.* Phaseout examples include the $6,000 senior bonus deduction, the elimination of the $40,000 SALT deduction if income exceeds a specified amount, or tax-free tip income, all of which disappear if the individual has too much taxable income. Planning with tax advantaged accounts, i.e., contributions to 401(k) or IRAs, or health saving accounts reduces an individual's taxable income; making deductible contributions to a 401(k) or a traditional IRA will better preserve some of these new deductions that might otherwise be lost due to the income phaseout rule.

Example: Ned, age 75, makes a qualified charitable distribution (QCD) from his traditional IRA. That QCD reduces Ned required minimum distribution (RMD) for the calendar year. With that QCD, Ned may now become eligible for the $6,000 bonus senior deduction. Had Ned not made the QCD, his reported taxable income would have been too large, and Ned would not have qualified for this new senior deduction (which is in addition to Ned's standard deduction) This senior deduction phases out completely if Ned's modified adjusted gross income exceeds $175,000.

Example: Sally, age 25, works two part-time jobs. She works as a receptionist half days for her employer, and she waits tables in the evening. Sally should consider contributing to a health savings account (HSA) which will reduce her reportable taxable income. With her HSA contribution, Sally can remain eligible for the new income tax exemption for her tip income. That HSA contribution will keep Sally's income under the phaseout range so all her tip income from waiting tables at night will be income tax-free.

Conclusion: The opportunity to make tax advantaged contributions to retirement accounts is improved due to many of the deduction features of OBBBA. Roth conversions seem to be encouraged by the new deductions and tax-free income provisions. Even smaller changes to the tax law, like the $1,000 'above the line' charitable contribution deduction, coupled with the enhanced standard deduction, could prompt an individual to convert his/her traditional IRA to a Roth IRA. In sum, more opportunities to save for retirement exist under OBBBA along with Roth conversions. I was hoping for simplification of the retirement plan contribution and distribution rules, but alas Congress did not have the time apparently to make life easier for advisors.

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