



## AMERICAN BENEFITS COUNCIL

December 30, 2012

### IMPORTANT ISSUES TO CONSIDER REGARDING TAXATION OF RETIREMENT CONTRIBUTIONS AND BENEFITS

The American Benefits Council (The “Council”) represents retirement plans across the country that provide retirement security to millions of Americans. We recognize and support policymakers’ need to examine all tax provisions and spending programs to protect our economy from falling off the so-called “fiscal cliff”. We urge Congress and the Administration to reach a fiscally responsible agreement as quickly as possible. However, if the revenue for that agreement is derived from the private retirement system, there are great risks that we will be jeopardizing the retirement system that has achieved so much and will ultimately cost the government much more money.

Workplace retirement plans improve workers’ standard of living during retirement so that they depend less on government programs. Before revenue- raising proposals are considered that could inadvertently harm these plans, we ask that lawmakers consider the following issues regarding the taxation of retirement contributions and benefits:

- **Current tax incentives for retirement are working well.** Current tax incentives for retirement have successfully helped millions of American families to accumulate savings and have improved their retirement security. The Bureau of Labor Statistics reported that 78 percent of full-time workers have access to a retirement plans and of those 84 percent participate in a plan.<sup>1</sup>
- **A disciplined source of savings.** 401(k) plans represent the most disciplined source of individual savings in the United States. While Americans are sometimes criticized for being spendthrifts, they have demonstrated, through payroll deduction contributions to retirement plans, disciplined savings habits that can be sustained for decades.

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<sup>1</sup> Bureau of Labor Statistics, *Employee Benefits Survey: Retirement Benefits, March 2011: Retirement Benefits: access, participation and take-up rates: National Compensation Survey, March 2011.*

- **Retirement plans defer tax.** While scored as a “revenue loser,” plans are *tax deferred*, meaning that *taxes are paid* to the U.S. Treasury when the savings are distributed at retirement. Taxes are deferred only as long as the savings remain in the plan. No tax is paid with respect to almost any other tax expenditure.
- **Tax incentives for retirement encourage plan sponsorship.** Tax incentives for retirement are the principal reason why companies establish and keep 401(k) and similar plans.<sup>2</sup> A 2012 survey found that 85 percent of respondents said that saving enough for retirement was even more important than owning a home<sup>3</sup>.
- **The benefits in 401(k) plans are very progressively distributed.** Thanks to stringent non-discrimination rules and safe harbors, which carefully balance the benefits between higher and lower paid workers, the tax incentives for retirement flow overwhelmingly (89%) to taxpayers whose income is under \$200,000.<sup>4</sup>
- **Taxes are paid at ordinary income rates.** When an individual takes a distribution from a retirement plan, the U.S. Treasury will be paid, at ordinary income tax rates, *not capital gains rates*.
- **Limits on deductions and exclusions could cause some small and medium sized companies to discontinue plans.** If a limitation on deductions and exclusions includes retirement savings, many companies will terminate existing plans and fail to establish new plans, since plans would lose substantial value to the small business owners or senior management of a company. Small business owners, for example, will generally not keep a plan that costs the business but does not grant a benefit to the owner. A recent survey from Mathew Greenwald & Associates on behalf of the American Benefits Institute found that eight in ten employers said that exclusion of employee contributions (81%) and employer contributions (77%) from current taxation is important to their company’s decision to sponsor a plan – and therefore provide a means of retirement savings to their workforce.<sup>5</sup>

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<sup>2</sup> Attitudes of Employee Benefits Decision Makers Toward Retirement Plan Tax Proposals (Survey prepared by Mathew Greenwald & Associates Inc. and designed in collaboration with the American Benefits Institute).

<sup>3</sup> National Association of Home Builders, *NAHB National Survey*, Public Opinion Strategies, Lake Research Partners, January 2 – 5 2012.

<sup>4</sup> *Estimated Benefits of Tax Expenditure Estimates for Defined Contribution Plan Participants and Retirees with Account Balances*, prepared for The American Society of Pension Professionals and Actuaries (ASPPA).

<sup>5</sup> Attitudes of Employee Benefits Decision Makers Toward Retirement Plan Tax Proposals (Survey prepared by Mathew Greenwald & Associates Inc. and designed in collaboration with the American Benefits Institute).

- **Limits on deductions and exclusions could result in some double taxation of retirement contributions.** By partially taxing the contributions of some individuals (those above or partially above the limit) when they are contributed to the plan and then fully taxing all distributions from the plan, retirement savings would be subject to double taxation. This could make retirement savings *disadvantageous* and could lead to a dramatic reduction in the formation of plans among small businesses and could undermine large employers' commitment to their plans.<sup>6</sup>
- **The alternative to double taxation is unworkable.** The only alternative to double taxation would be to create an elaborate system for tracking the amounts already taxed and the degree of taxation. This elaborate system would have to be maintained exclusively by individuals, since plan sponsors would have no access to employees' tax brackets or other deductions and exclusions. Such a system would be riddled with errors at best; at worst, it would simply be unworkable. Hence, double taxation seems inevitable.
- **Limiting deductions and exclusions would create immense compliance problems.** Even with double taxation, the likelihood of compliance problems is immense, again because the plan will not be able to report to employees or the IRS the amount of taxable income that a particular employee has. The administration of this entire complicated system falls on the employee who will, moreover, have to pay tax on amounts of money he has not received and has no right to receive until the future.
- **Nearly ten trillion dollars are currently deposited in 401(k) plans and IRAs.** Nearly \$10 trillion currently has been saved in workplace retirement plans and in individual retirement accounts, evidencing the great success of the current system. This \$10 trillion also represents a *significant contribution to the capital markets*. Retirement plan investments in our economy help companies to grow in size, employ more workers and compete in today's global marketplace.

Raising short-term revenue from the retirement system would have long-term adverse consequences. We urge members of Congress and the Administration not to proceed in this direction.

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<sup>6</sup> Attitudes of Employee Benefits Decision Makers Toward Retirement Plan Tax Proposals (Survey prepared by Mathew Greenwald & Associates Inc. and designed in collaboration with the American Benefits Institute).