American Benefits Council

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Talking Points on Retirement Plan Tax Incentives

As Congress considers reform of the tax code – or retirement policy in a tax reform context or otherwise, we urge lawmakers and their staffs to remember the following:

Voluntary, employer-sponsored defined contribution and defined benefit retirement plans are the foundation of our nation's retirement system. More than 130 million active and retired workers (and their spouses) are now covered by nearly 900,000 employer-sponsored retirement plans nationwide, and 46 million households now own some kind of Individual Retirement Account (IRA), many comprised of assets that have been "rolled over" from employer plans.

The voluntary, employer-sponsored system gives companies the flexibility to tailor their plans to diverse and evolving employee populations. Employers have a unique understanding of the retirement needs of their employee population and provide innovative solutions to help employees. Having a strong retirement plan also benefits employers by helping them attract and retain talent and by providing their employees with financial security and confidence as they prepare for retirement.

The U.S. successfully encourages employer plan sponsorship by providing tax incentives to sponsor plans that deliver meaningful benefits to Americans up and down the income scale. This tax structure also provides powerful motivation for individuals at all income levels to save for their retirement in employer-sponsored retirement plans. Roughly eight in ten employers recently said that the deferral/ exclusion of employee and employer contributions from income taxation are important in their company's decision to sponsor a defined contribution plan, and more than 80 percent of defined contribution-owning households view the immediate tax savings from their retirement plans as an important incentive to contribute.

Retirement plan contributions are deferrals, not exclusions or deductions. Contributions and investment earnings accumulate tax-free until the participant receives a benefit payment – often decades down the line – at which point it is taxed as ordinary income rather than capital gains.

Because retirement plan tax incentives are deferrals, it is misleading to compare them with other types of "tax expenditures" with which they are often erroneously compared. Under current tax expenditure methodology, these deferrals of tax are in many cases scored as an immediate federal revenue loss. But unlike almost all other exclusions from income taxation, the majority of this tax revenue on contributions to retirement plans is not permanently "lost."

Retirement plan incentives are not strictly "regressive." The analysis that supports this perception is narrow and misleading, especially when derived from the flawed tax expenditure measurement described above. When the employer-sponsored system is viewed in combination with Social Security, the total tax benefits for retirement are very well distributed.

Contributions are limited and rules promote fairness. Individual contributions to defined contribution plans and IRAs are subject to coverage, participation and nondiscrimination rules to ensure that they are fairly distributed among plan participants. By establishing retirement plans, employers bring many millions of low- and moderate-wage earners and new retirement savings into a secure and efficient retirement income system.

Retirement tax incentives lead to long-term economic gains. Not only do the financial assets held in retirement plans now total more than $17 trillion – providing an important and ready source of investment capital for American businesses – analyses have also shown that a dollar contributed to a retirement plan produces greater tax revenue in the future than if it were taxed beforehand.

Employer-sponsored retirement plan coverage is quite strong. While the most commonly cited figures suggest that the current system provides insufficient coverage, these figures significantly understate the extent of benefits received from employer plans because they *overstate* the effect of certain coverage gaps and *understate* the accumulation of benefits for households and over a full working life.

Changes to retirement savings tax policy, should focus exclusively on addressing coverage gaps rather than disrupting the gains made – and yet to be made – by the vast majority of plan participants. To address participation rates among part-time workers, lower-income individuals and employees at smaller firms, removing impediments to plan sponsorship should be the first step.

Promoting retirement savings must remain one of our nation's top policy priorities. Any changes made should preserve and build upon our existing and successful tax incentive structure so it works even more effectively to facilitate retirement plan coverage and savings for American families.