401(k) *is*

How America Saves

Sixty-seven million Americans now participate in private sector, employer-based defined contribution retirement plans. In the 30 years since 401(k) plans gained acceptance, 401(k) plans have become the most popular defined contribution savings arrangement. Over $4 trillion has been accumulated in 401(k) and similar retirement savings plans. Trillions more has been accumulated through these workplace savings arrangements, then rolled over to IRAs.

401(k) plans are primarily a middle class benefit.

Almost 75% of 401(k) plan participants make less than $100,000 per year. Nearly 40% make less than $50,000.

Seventy-eight percent of all full time workers have access to a workplace retirement plan, with 84% of those workers participating. For private-sector workers, 73% of full time workers have access and 80% of those participate. Given these high rates of participation, it's no surprise that the overwhelming majority of participants are far from wealthy. In fact, almost 75% of participants in 401(k) and profit sharing plans make less than $100,000 per year. Thirty-eight percent make less than $50,000. (See Chart 1)

401(k) plans are effective at helping workers at *all* income levels save for retirement.

Workers making $30,000 to $50,000 per year are more than 14 times more likely to save if there is a 401(k) plan at work.

401(k) and similar plans have been remarkably successful in getting workers to save for retirement. In fact, the primary factor in determining whether or not a worker is saving for retirement is whether or not they have a retirement plan at work. Data prepared by the Employee Benefit Research Institute (EBRI) shows that over 70% of workers earning from $30,000 to $50,000 participated in employer-sponsored plans when a plan was available, whereas less than 5% of those without an employer plan contributed to an IRA. (See Chart 2)

The tax incentive that powers 401(k) plans is a *deferral – not* a permanent exclusion.

Taxes deferred on retirement savings today will help retirees pay their fair share of income taxes in the future, when balances are paid out (and taxed) to provide income in retirement.

Unlike deductions for mortgage interest or charitable contributions, which are permanent deductions, the incentives for retirement savings are *a deferral*. Contributions (and earnings) are taxed at ordinary income rates when withdrawn from the retiree's plan. As a result, tax revenue that *appears* to be gained in the short-term budget window from cutting retirement savings is *not* a long-term gain to the treasury.

401(k) tax incentives are *more progressive* than current marginal income tax rates.

> *Taxpayers making less than $50,000 per year pay only 8% of income taxes, but receive 30% of the current year tax benefit. Taxpayers making less than $100,000 pay only 26% of income taxes, but get over 60% of the tax benefit that powers 401(k) plans.*

Another unique feature of the retirement savings tax incentives is non-discrimination rules that encourage employers to contribute on behalf of non-highly paid employees, and limit the amount of pay that can be counted toward benefits. As a result, the current tax incentive for employer-sponsored defined contribution plans is *more progressive* than the current income tax system. Based on an analysis by a former JCT economist, taxpayers making less than $50,000 pay only 8% of income taxes, but receive 30% of the tax incentives for defined contribution plans. Households making less than $100,000 pay 26% of income taxes, but get over 60% of the benefit of this tax incentive. (See Chart 3)

Proposals to reduce or reconfigure incentives would hurt workers with modest income.

There have been recent proposals to achieve short-term budget savings by reducing the annual limits on contributions to 401(k) and similar plans. The President's Deficit Reduction Commission and others have suggested limiting contributions to 401(k)'s to the lesser of $20,000 or 20% of income. An analysis by EBRI shows that these reduced limits would result in lower account balances at retirement for all income groups. Younger workers in the lowest income quartile in a small plan could expect a 14% reduction in account balances at Social Security normal retirement age if this proposal became law. (See Chart 4)

> *Reducing contribution limits, or converting the exclusion to a credit, would substantially decrease retirement savings for **all** income groups.*

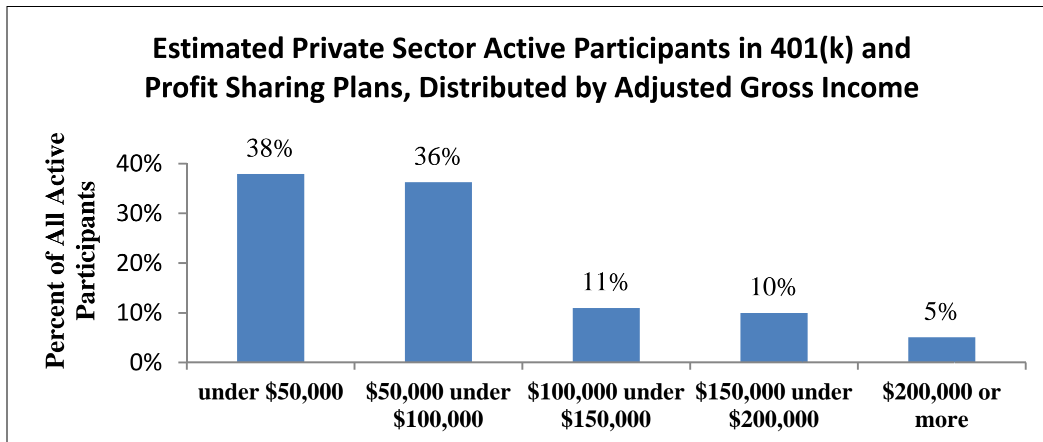
A proposal authored by William Gale of the Brookings Institution would replace the income exclusion for contributions with a uniform refundable credit. The proposal suggests an 18% credit would raise substantial revenue and do no harm to those in the 15% or lower tax brackets. This proposal would be a "raiser" in the budget window, but it would do serious damage to plan participants in the 15% tax bracket. First, an 18% credit on contributions that will be taxed at a higher rate when distributed at retirement effectively assesses a penalty tax on contributions for those above the 15% bracket. Taxpayers in higher brackets should question why it's a good idea to contribute at all. If higher income employees are not contributing, no employer contributions will be required to pass nondiscrimination tests. Furthermore, eliminating the income exclusion for employer contributions would subject those contributions to FICA, seriously complicating administration and increasing the tax burden on both employers and employees. This refundable credit would be a poor substitute for current employer contributions, and workers in all income groups would end up with lower account balances at retirement. Workers in the lowest income quartile in small plans would be hit hardest, with account balances at Social Security normal retirement age reduced by more than 35%. (See Chart 5)

401(k) is how America saves.

401(k) and similar plans have been remarkably successful in getting workers at all income levels to save for retirement. Proposals to raise money in the budget window by reducing savings incentives are short-sighted, producing only *short term* deficit reduction, with losses outside the budget window, and causing serious long-term damage to the retirement security of tens of millions of working Americans.

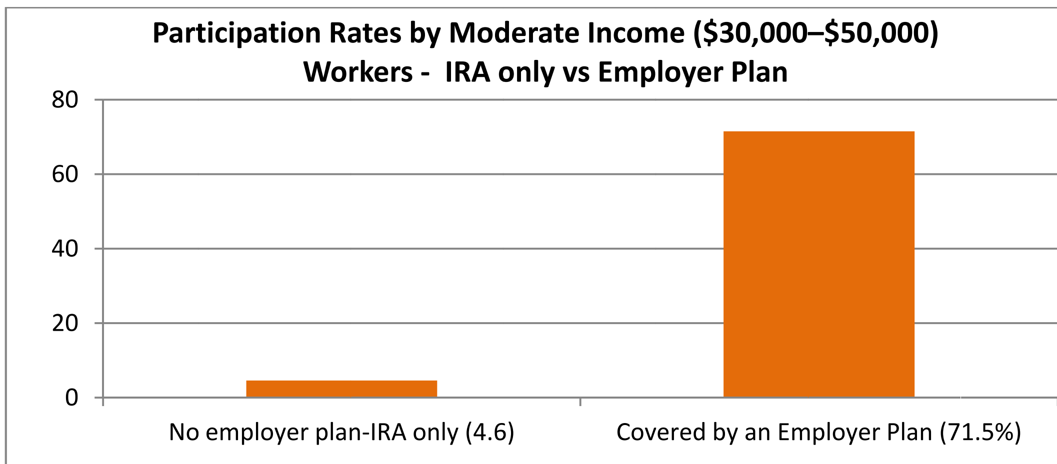
For more information, call Judy Miller at 703-516-9300 x. 152 Email: jmiller@asppa.org

Chart 1



Source: Internal Revenue Service (IRS) Statistics of Income Division (SOI)

Chart 2



Source: Employee Benefit Research Institute (2010) estimate using 2008 Panel of SIPP (Covered by an Employer Plan) and EBRI estimate (Not Covered by an Employer Plan-IRA only).

Chart 3

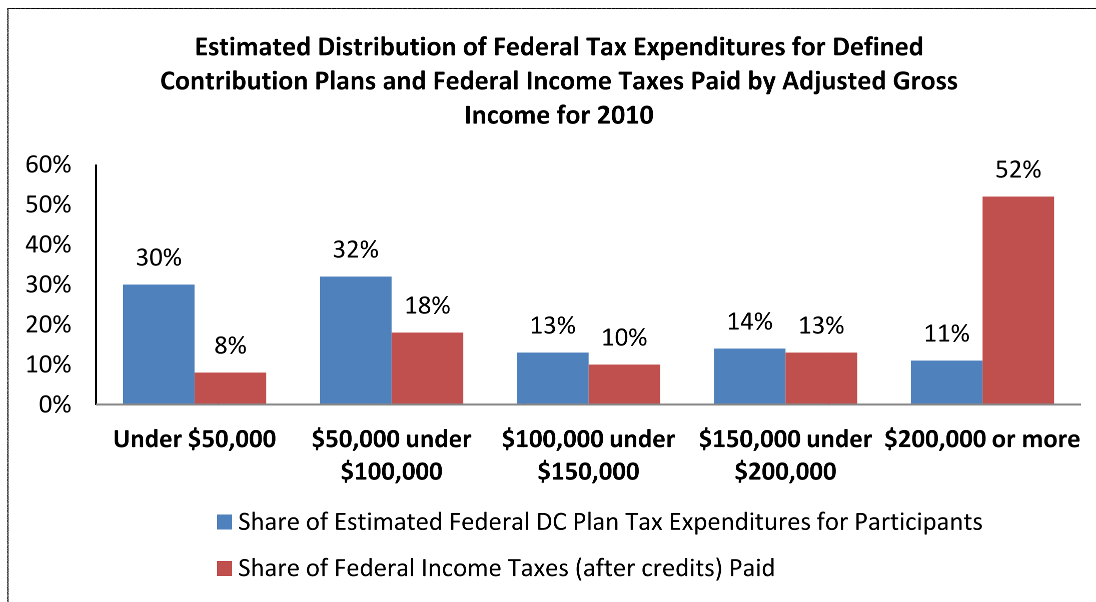


Chart 4

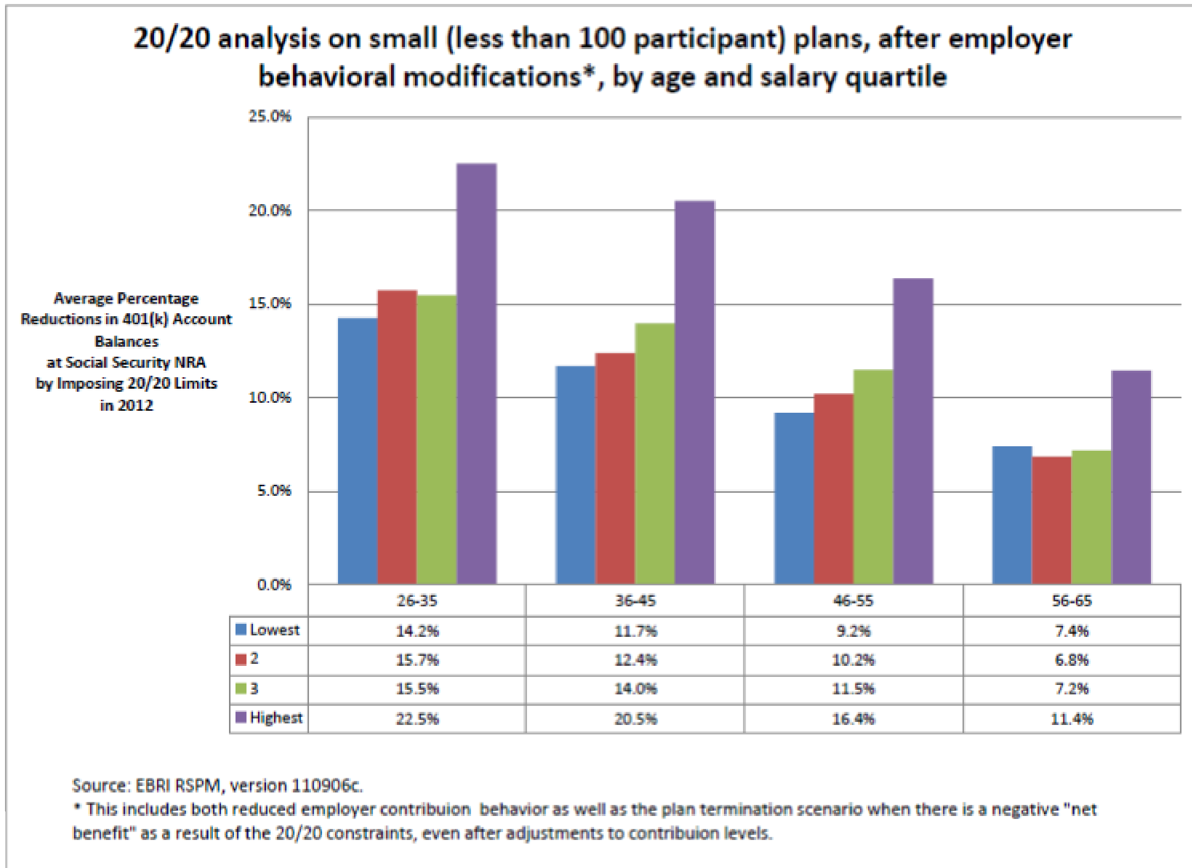
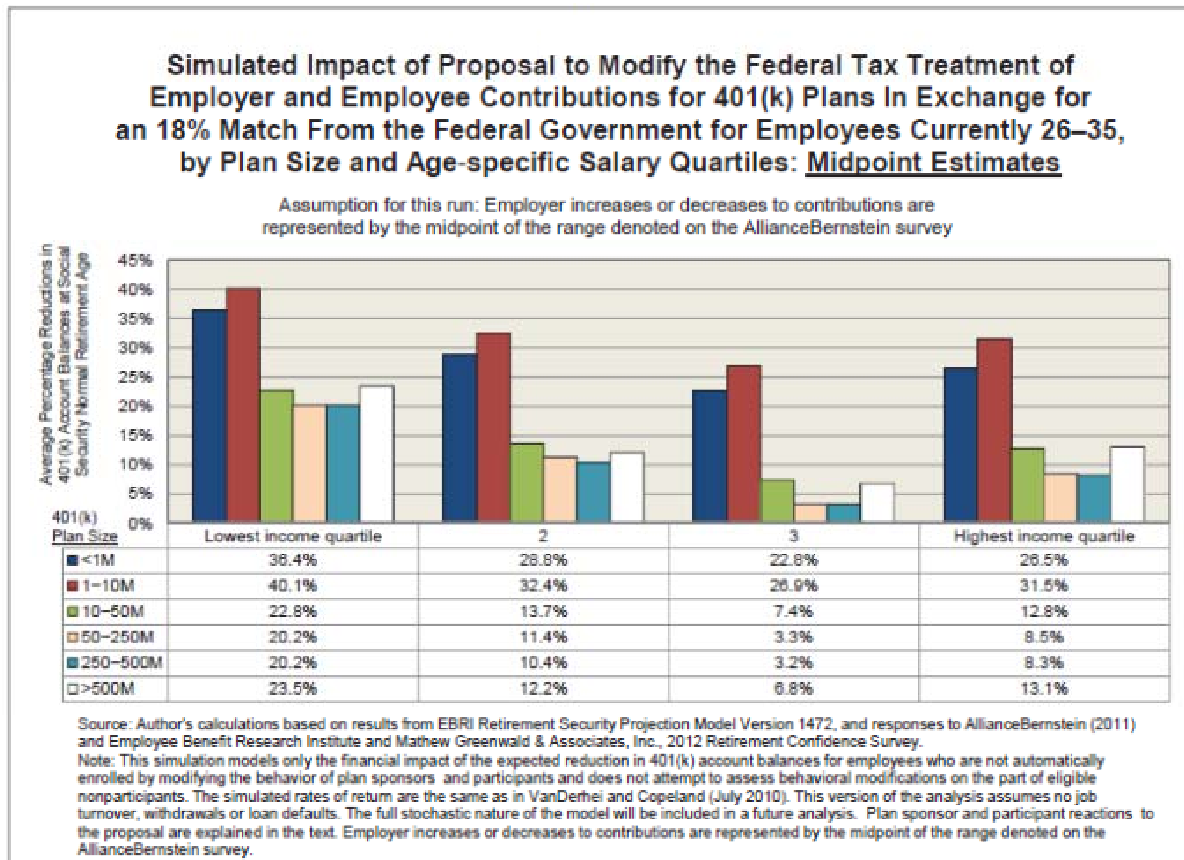


Chart 5



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