

**The Savings Coalition of America**

**Submission to the President's Advisory Panel on  
Federal Tax Reform**

**March 11, 2005**

**Submitter Category:  
Organizations and Associations**

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March 11, 2005

The Honorable Connie Mack  
Chairman  
The President's Advisory Panel on Federal Tax Reform  
1440 New York Avenue NW  
Suite 2100  
Washington, DC 20220

Dear Chairman Mack:

On behalf of its 75 member organizations, the Savings Coalition of America (“Coalition”) is pleased to submit these comments in response to the February 16 request for comments by the President’s Advisory Panel on Federal Tax Reform (“Panel”). The Coalition is extremely encouraged by the Panel’s initiative towards tax simplification.

The Savings Coalition of America was established in 1991 to support incentives to increase the level of personal savings in the United States. It has actively supported the expanded Individual Retirement Account (IRA) provisions that increased contributions to spousal IRAs from \$250 to \$2000 in 1996; the increased income limits for IRAs and the establishment of the Roth IRA in 1997; and the recent increase in contribution limits for IRAs and the creation of catch up contributions in the 2001 tax bill.

The Panel’s first request for comments concerns the unnecessary complexity of the current system, aspects of the system that are unfair, specific examples how the tax code distorts important business or personal decisions and goals that the panel should try to achieve as it evaluates the existing tax system and recommends options for reform. While there are many aspects of the current system to be addressed, the

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Savings Coalition of America brings to your attention the provisions of the tax code that concern income eligibility for making contributions to IRAs and required minimum distributions from IRAs. Both are unnecessarily complex, unfair and distort personal financial decisions for Americans.

In 2001, the Congressional Joint Committee on Taxation made recommendations for tax simplification in which it recommended the elimination of income limits on all IRAs and the elimination of the age requirement for minimum required distributions and described the complexity surrounding these sections of the tax code. The Coalition shares the view that these sections of the tax code are complex and confusing and urges the Panel to review them.

### **Required Minimum Distributions**

Under present law, Americans who reach age 70 ½ are required to begin taking distributions from their IRAs. This is one of the most complex areas of tax law affecting retirees. For this reason, the staff of the Joint Committee on Taxation has recommended that the age limit for minimum required distributions be eliminated. One unintended consequence of the requirement is that individuals may be forced to take a distribution at a time when their investment has declined in value. Over the past several years, many retirees and workers about to retire have seen a drop in the value of their retirement nest eggs. Those subject to the requirement may be forced to realize losses on part of their investments at a time when they can least afford to do so. The minimum required distributions rules merely determine when taxes will be imposed on retirement savings, not if. When the IRA owner withdraws funds, it will be taxed as ordinary income.

In addition, tax reform should take into account such things as a longer life expectancy for most Americans. For example, as Americans live longer, we have learned that the minimum required distribution rules have become more burdensome and need to be eliminated or at the very least, changed to reflect gains in life expectancy.

### **Universally Available IRAs**

Currently the tax code has a number of income limits for eligibility to contribute to IRAs. In addition to different income limits for single and married Americans, there are different income eligibilities for the traditional, deductible IRA, the Roth IRA, the nondeductible IRA and conversions from the traditional to the Roth IRA. Income limits for the Coverdell Education Savings Accounts add further confusion. The lesson that we learned in the early 1980s, when IRAs were universally available to all Americans, is that more Americans saved. The universal eligibility led to mass marketing of these savings vehicles, which increased participation. When income limits were imposed after the Tax Reform Act of 1986, there was a precipitous drop in contributions to IRAs. The 1986 experience teaches us that limiting IRA eligibility based on income confuses people and scares them away from establishing a pattern of savings that IRAs would otherwise promote. One of the most important effects of the IRA cutbacks in the Tax Reform Act of 1986 is the fact that IRA contributions for those who continued to be eligible for deductible IRAs dropped by more than 40% in the first year and have since dropped by over 65%.

Members of the Savings Coalition believe that eliminating income limits and creating a universally available IRA will help more Americans save. An IRA that is universally available to all American workers would leave no doubt to their understanding of their eligibility. Universally available IRAs will be marketed and advertised on a massive scale and this advertising will have an ancillary benefit of educating people about the need to save. History demonstrates that the simpler it is to save, the more Americans are inclined to save.

Annual income limits are also unfair to taxpayers with fluctuating income. For many people, income fluctuates from year to year. A universally available IRA ensures that these individuals can make IRA contributions in the good years -- the years in which they actually have the financial resources to make a

contribution. This is particularly important for the self-employed and for individuals in cyclical industries like farming. It simply is not fair to these people to say you can have an IRA in the years that you don't have the resources to contribute, but if you have a good year then you can't have an IRA. Moreover, the uncertainty over whether an individual will be above or below the income limit tends to force potential savers to wait most of the year before determining whether or not to contribute, thus reducing the power of compounding interest. Americans tend to err on the side of caution, so an individual worried about possibly bumping up against the eligibility limit is more likely to skip saving altogether.

Another area of confusion with income limits are the restrictions, for joint filers, around contributing to an IRA and deducting it is limited by participating in an employer plan in addition to income. If one spouse is covered by an employer plan and the other is not, as long as their income is below \$150,000, the non-covered spouse is eligible to make a deductible traditional IRA contribution. If they are both covered, then the phase out is in place which eventually will be between \$60,000 and \$80,000. For making a Roth IRA contribution, income is considered. Over the limits the person simply can't make a contribution. Also, if a person is not covered, or both spouses are not covered by an employer plan, then there is no income limit to making a deductible traditional IRA contribution. This adds a layer of complexity and confusion to already complex eligibility requirements which can have the result of reducing Americans savings in these important savings vehicles.

In the end, income limits hurt all Americans. Right about the time someone starts getting interested in setting up a new IRA, they hear a disclaimer that only certain individuals are eligible for IRAs and that they should immediately check with an advisor to see if they qualify. That just scares people, especially middle income families that most need to start the retirement savings habit. They automatically assume that they are one of the ones that are excluded. Or they decide not to start the pattern of saving in an IRA every

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year because they will assume they won't be eligible next year and that, as a result, it is just not worth the trouble. And, in a vicious circle, that taxpayer confusion and uncertainty will lead to substantially less advertising that will probably not be sufficient to change Americans' savings attitudes.

Members of the Savings Coalition of America feel strongly that tax reform should encourage Americans to take more responsibility for their retirement. One way in which this can be achieved is to promote values that we all share; such as savings and thrift. When it comes to savings, our tax code should encourage Americans to save for their futures and make it easier to do so. The variety of income limits for current tax-favored savings vehicles are cumbersome and confusing and we encourage the Panel to recommending substantial simplification in this area. Provisions that encourage individually responsible behavior such as savings should apply to all Americans. Our current tax-favored savings vehicles already limit the amount that can be saved. We should not limit eligibility of the people who can save through them. That just makes them more confusing and frankly, penalizes success.

The Savings Coalition supports the President's Advisory Panel on Federal Tax Reform's goal towards tax simplification and offers its assistance in this effort. We look forward to working with you on this important initiative.

Sincerely,

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