March 15, 2013 Capitol Hill Event
Retirement Savings: Perspectives for Tax Reform

On March 15, 2013, the Savings Coalition of America hosted a "Lunch and Learn" briefing session for Hill staff and members of the Coalition. The session focused on three important topics that are likely to be part of the retirement policy discussions taking place in the context of tax reform – the success of the current system, the process of evaluating the cost of retirement tax incentives, and efforts by plan sponsors and administrators to increase retirement plan participation and savings.

Speakers at the event were Peter Brady (Senior Economist, the Investment Company Institute), Judy Xanthopoulos (Economist and Principal at Quantria Strategies, LLC and Optimal Benefit Strategies, LLC), and Pamela Everhart (Senior Vice President, Benefit Policy Development and Thought Leadership for Personal and Workplace Investing, Fidelity Investments). Randy Hardock (Partner, Davis & Harman LLP) introduced the speakers and facilitated the discussions.

Peter Brady (ICI and a former economist at the Department of Treasury and at the Federal Reserve Board)

Peter Brady said that the current retirement system is a success and challenged press reports that suggest Americans are not preparing for their retirement and that the savings situation is worsening in the U.S. Arguing that these reports are at odds with academic research and data analyzed by ICI, Peter said evidence shows that households are generally able to maintain their standard of living in retirement and that measures such as income, wealth, and poverty rates show that to date, successive generations have actually become better off over time. In fact, most households today have more assets earmarked for retirement than in the past.

Peter noted that it can be difficult to measure retirement preparedness since individuals' investments/savings habits change over their life cycle. Merely looking at average retirement savings can distort the picture. Workers typically focus more on saving for retirement later in their working careers (when they have higher earnings and generally fewer obligations). Younger workers on the other hand often save to fund education and home purchases and raise children early in their careers, but that does not mean they will not be prepared by the time they reach retirement age.

Describing the U.S. retirement system as a pyramid, Peter said that the importance of the individual components that make up the pyramid vary across households, with Social Security continuing to provide the highest income replacement for the lowest income retirees. However, a vast majority of Americans supplement their Social Security income, with more than 80% of households having an IRA or employer-sponsored plan. Homes continue to be a valuable asset in retirement, with 80% of retirees owning their home.

Peter predicted that the shift by private-sector employers from DB plans to DC plans will not have a significant effect on retirement preparedness, noting that studies comparing the two types of plans show that many workers are better off with DC plans.

Peter briefly touched on the subject of the tax treatment of retirement savings, stating that current revenue estimates of the cost of current retirement tax incentives are overstated. In addition, he argued that the real tax benefit for retirement savings is deferral on inside build up, not the upfront reduction in tax liability. He equated the benefit to being roughly equivalent to getting a zero rate of tax on investment income.

Read Peter's Presentation

Judy Xanthopoulos (Quantria Strategies, LLC and Optimal Benefit Strategies, LLC and a former economist with the Congressional Joint Committee on Taxation)

Judy Xanthopoulos expanded further on Peter's point with respect to the tax treatment of retirement savings. Judy described the methodology used by the government to measure tax expenditures and revenue estimates, and discussed the flaws in the process which ultimately overstate the true costs of retirement tax incentives. Judy also discussed the differences between tax expenditures and revenue estimates.

Judy explained that a tax expenditure is a theoretical concept designed to compare tax benefits to outlay programs. Essentially, it is intended to be a tool for economists to compare different provisions, not drive policy decisions. She added that the number assigned to a tax expenditure has nothing to do with the amount of revenue that can be raised by amending or deleting a tax benefit.

She further explained that tax expenditure calculations differ substantially from the revenue estimating process in specific ways. For example, tax expenditure calculations do not incorporate taxpayer behavior changes in response to changes in tax provisions, nor do such calculations take into account interaction with other Federal taxes such as FICA, excise taxes, and estate and gift taxes. As a result of these and other differences, the revenue estimate for repealing a special tax provision can, in many cases, produce considerably less revenue when compared to a tax expenditure estimate. This is particularly true with respect to the retirement savings tax expenditure which is among the largest items in the tax expenditure list under current methods for measuring tax expenditures.

Judy said one reason for the exaggerated cost associated with the retirement savings tax expenditure is that a significant portion of the tax benefit is deferral of tax until retirement, **i.e.,** it is not a permanent exclusion from tax. However, neither the Joint Committee on Taxation nor the Department of Treasury accurately reflect this deferral. Because they measure all tax expenditures on a cash-flow basis, the cost of tax expenditures that do not provide a permanent tax benefit are inflated. She went on to explain that a current tax deduction or credit permanently reduces the amount of income that a taxpayer will pay, while a deferral provides a reduction in current taxes which will be included in taxable income in a later year. She stated that a more appropriate methodology for determining the retirement savings tax expenditure would be to provide a present-value measure which would take into account the taxes that will eventually be paid on retirement plan distributions. If the methodology was changed, she estimates that the real cost would be approximately 25% of the expenditure amount listed in the Joint Committee on Taxation's pamphlet.

Read Judy's Presentation

Pamela Everhart (Fidelity Investments)
Pam discussed the ways that plan sponsors and plan administrators are using modern technology to reach plan participants and educate them about the importance of retirement savings and about their savings options. Fidelity's experience suggests that plan participants seek retirement savings guidance during all stages of their savings. She said that participants need different savings tools depending at what point they are in their life, and said that sponsors and administrators need to think about helping participants based on each individual's circumstances. She explained that Fidelity is consistently refining its message to see what works and they have found that the savings tools they provide participants need to be quick and simple to use.

Pam said younger participants often seek advice about how to manage debt, and added that Fidelity is developing "tools" to specifically address that issue. She remarked that these types of issues need to be tackled before these participants can even consider setting aside money for retirement.

Fidelity's outreach programs vary depending on the participant. For example, Fidelity found that younger participants are more web-based, and respond well to apps and videos. Older participants are more likely to prefer employee workshops or one-on-one consultations. With this in mind, Pam called on policymakers to give plan sponsors and administrators flexibility so providers can reach different people at different points in their lives and in the manner most suitable to the participant.

Read Pamela's Presentation