Tax Reform Working Groups

Each of the 11 groups will review current law in their designated issue areas and then identify, research and compile feedback related to the topic of the working group. The working groups will be responsible for compiling feedback on their designated topic from: (1) stakeholders, (2) academics and think tanks, (3) practitioners, (4) the general public and (5) colleagues in the House of Representatives. Once the work of those groups has been completed, the Joint Committee on Taxation (JCT) will prepare a report for the full Committee that describes current law in each issue area and only summarizes these submissions and other information gathered by the Committee Members.

Public comments will be accepted through Monday, April 15, 2013. Those comments will be included in the final JCT report, which will be delivered to the Ways and Means Committee on Monday, May 6, 2013. The process for submitting comments is below.

- Any person(s) and/or organization(s) wishing to submit comments can email tax.reform@mail.house.gov.
- In the subject line of the email, please indicate "Comments: (name of) Tax Reform Working Group" (note: be sure to specify the name of the working group in the subject line - e.g., Energy Tax Reform Working Group).
- Attach your submission as a Word document.
- In addition to the Word document attachment, please include in the body of the email a contact name, physical address, phone number and email address.
- For questions, or if you encounter technical problems, please call (202) 225-3625 or (202) 225-1721.

Pensions/Retirement	Pat Tiberi (R-OH)	Ron Kind (D-WI)

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April 15, 2013

House Ways and Means Committee
Tax Reform Working Groups
Pensions/Retirement

Dear Representatives Tiberi and Kind:

Thank you for soliciting input as you pursue comprehensive tax reform. The Asset Building Program at the New America Foundation is dedicated to incubating and promoting innovative public policies to enable low- and middle-income families in the United States to accumulate savings, access wealth-building financial services, develop financial capability, and build and protect productive assets across the life course. Our comments outline the deficiencies of the current retirement savings system, identify a framework for reform, and propose options for corrective action. Please consider these comments as you assess the state of the tax code and develop future directions for tax policy.

Our perspective is informed by a simple yet powerful finding: **The ability to accumulate and access savings is a fundamental determinant of economic security for many families, especially those with low incomes and limited resources.** This is because savings can buffer a family against unexpected events or financial shocks and allow them to invest in ways that may improve their future. In this manner, savings provides a foundation for economic mobility.

Increasing retirement security is an important savings objective but it is just one of many. Families have a hierarchy of saving needs, including being able to respond to emergencies and make strategic investments that can pay off over a lifetime. Failure to support this diversity of needs may unintentionally serve as a barrier to increased saving. In addition to the benefits derived from the resources themselves, the act of saving has been linked to myriad socially desirable outcomes.

Policies within the U.S. tax code have the explicit purpose of increasing personal savings. In fact, by awarding tax preferences to deposits to certain accounts, public policy shapes the marketplace of savings products. In the 1970s, Congress created Individual Retirement Accounts (IRAs), the first 401(k) plans and subsequently has expanded the tax-saving benefits associated with participation. In the mid-1990s, similar tax advantages were offered to those savings for education and health care needs, first with Medical Savings Accounts and Coverdell Education Savings Accounts, then with Health Savings Accounts and Qualified Tuition Programs (also known as 529 Plans). With favorable tax treatment of deposits, a significant amount of resources are at stake through foregone revenue. The federal government will devote over $177 billion in FY 2014 to incentivize contributions to promote saving for retirement alone.

The scale of these resources reflects a large public commitment to promoting saving but the structure of the policies undermines this investment. There are several key questions to consider. Do policies work to promote net new savings? Are the families which would benefit from increased saving eligible for support? Do the current tax rules promote clear policy objectives? Unfortunately, the answer to each of these questions is a qualified “no.” The prevailing method of incentivizing saving is with tax deductions and preferences which primarily benefit households with higher incomes, diverting resources from the households for whom an incentive to save would most likely generate new savings.

Additionally, the very complexity of the rules governing tax-favored saving accounts and defining "qualified expenses" creates administrative costs, compliance burdens, and confusion among recipients that undermine the effectiveness of the policy. **As a result, our current tax policies to support saving are flawed and in need of reform to improve the reach and impact of federal resources.** Tax reform should respond by creating policies that promote increased saving, reach families that would benefit from this activity, and avoid conferring a windfall on people who are simply taking advantage of a tax sheltering opportunity.

Savings and Retirement Security Objectives

As a country, we are no longer relying on defined-benefit pensions to provide for retirement security. Yet the rise of defined-contribution (DC) plans over the last thirty years has not put us on a course for success. Our current approach is failing to cover anything more than a bare majority of workers, leaving most Americans unprepared for their retirement, doing little to create new savings, delivering greater benefits to those with the least need for support, and being undermined by a lack of flexible non-retirement savings.

The nation's retirement shortcomings are rooted in a lack of access to coverage through the employer-based system. Only 58 percent of full-time workers ages 25-64 were employed by an employer who sponsored a plan in 2010. Fewer workers still, only 42 percent of all private sector employees in this age range in 2010, actually participated in a plan. This low figure reflects a disturbing trend over the past several decades, as the participation rate has fallen from 50 percent in 1979 to 42 percent today. Furthermore, these troubling statistics become more staggering when viewed by race and income level. Participation is significantly greater among covered White workers (55 percent) than among Black (48 percent) or Hispanic workers (32 percent). Access is also notably tilted toward higher income employees, as 73 percent of workers in the top quartile had access to an employer sponsored plan in 2008, while only 38 percent of workers in the lowest quartile were covered. While automatic enrollment has become increasingly popular, lack of participation is still a defining feature of the retirement system. Roughly one-third of all workers will accumulate no individual retirement savings and will rely totally on Social Security for their retirement.

Even workers who do participate in a tax advantaged, DC plan are not saving enough to support themselves in retirement. In 2010, the median household retirement account balance for workers between the ages of 55-64 was $120,000. Three-quarters of near retirees (ages 50 to 64) have annual incomes below $52,201, with an average total retirement account balance of $26,395. Sixty percent of low-income households are at risk of failing short to being able to meet their already modest standards of living during their retirement years. Furthermore, many families do not have a clear sense of their retirement security needs or savings targets.

The tax incentive for retirement saving is upside down and inefficient. Eighty percent of the retirement benefits delivered through the tax code accrue to the wealthiest quintile of Americans, leaving the bottom 80 percent of Americans just 20 percent of the benefits. The greater benefit of these plan structures persists for wealthier Americans even when you consider the taxation of qualified withdrawals in the retirement years. In addition, new research published by the Center for Retirement Research suggests that only 15 percent of the population actively responds to changes in retirement subsidization through the tax code. The other 85 percent tend to continue the behavior that preceded changes in the policy. This “active” 15 percent has a strong correlation to the highest income members of society. We should strongly consider whether our desired policy is one that delivers greater benefits to wealthier individuals and one that meets the needs of the minority of “active” savers or the large majority of “passive” savers.

Lack of support for building flexible use savings undermines the impact of the substantial investments made to support retirement savings. Since every family’s circumstance is different, so too are their savings needs, which can range both in time horizon and purpose. Current federal policy favors longer-term, targeted purposes, such as saving for retirement, leaving a void in policy supports for households whose savings needs are more immediate. Unrestricted savings are a necessary precursor to successfully saving for longer-term goals over time by allowing families to satisfy their short-term consumption needs, establish a buffer against financial shocks, and develop experience saving. More than 40 percent of households lack sufficient savings to live at the poverty line for three months if they lose their income. This lack of unrestricted savings also undermines the retirement savings system. Financial services firm HelloWallet released a report in January 2013 that found that more than 25 percent of households with a 401(k) “breached” their retirement savings to meet non-retirement purposes. These penalized withdrawals are estimated to amount to more than $70 billion annually. The firm reported that meeting basic needs was the largest cause of withdrawals, a need that could be prevented by the development of better systems for developing emergency savings.

Framework for Reform

In weighing changes to the nation’s tax code, the Committee should consider its central role in creating the infrastructure to support savings, for both retirement security and other vital purposes. We believe that tax reform is an opportunity to improve our savings infrastructure and emerge with a system that supports savings in a way that is accessible, sufficient, fair, and flexible. If tax policies resulted in substantially higher overall savings, they might serve a public purpose, such as increased capital formation, but instead they create a large direct cost in foregone federal revenue. Perhaps worse, they violate what should be a first order priority of any public policy: avoid subsidizing behavior that will occur anyway. **The twin principles of fairness and inclusion can serve as a foundation for considering ways to reform account ownership and the delivery of savings incentives to more effectively target low- and moderate-income households.** To overcome obstacles to savings for these families, policy must create savings products and vehicles that are accessible and coherent as well as incentives that are meaningful and effective. .

Savings vehicles should be accessible to people up and down the income scale. Accessible vehicles will be designed to facilitate participation of all potential savers, especially those in the workforce with lower incomes. Accordingly, ideal platforms for connecting workers with retirement accounts are those with sufficient scale to reach the plurality of potential participants. Employers are uniquely positioned to enroll workers into a retirement savings plan and deliver deposits through payroll deductions. Accordingly, setting more employers to offer access to savings plans through the workplace should be a primary policy objective. Policy can also employ inertia to its advantage by setting defaults that are likely to increase positive outcomes. For example, recent policy changes have made it easier for employers to automatically enroll employees in their savings plans while allowing workers to opt-out if they choose to go to the effort. This approach has increased participation rates among workers at all income levels. Other features associated with automatic enrollment that can make savings more productive include escalating contribution amounts over time. Workers with multiple employers and uneven work histories are least likely to own a retirement account. Public policy should be seeking out means to link all households to saving opportunities. A promising means to do this is through the tax filing process. Embedding into the tax form the option to open an account and then elect to divert a portion of the refund into the account could provide a platform of scale to accessible to most workers to fill a gap in the employer-based system.

Accounts should be designed coherently so they reduce the complexity associated with the current set of tax-favored savings accounts and plans. The proliferation of federally-sanction savings accounts and plans has created confusion among potential savers, diluting the effectiveness of the saving incentives. Rules should be simplified and the number of special accounts consolidated in ways that allow consumers to save for multiple purposes. This might entail creating one class of accounts that are only for retirement and another that can be used for multiple purposes, such as education, homeownership, or other life contingencies.

To be meaningful, incentives must have value to most Americans, even when they have low incomes and low tax liabilities. Regardless of whether tax subsidies for higher-income households are reduced, if benefits are available to some they should be available to all, especially those who are most likely to accrue new savings. This means benefits must have value to households even when they have low or no tax liabilities. To cover nearly half of Americans who will not benefit from an up-front tax deduction, we suggest a system that directly matches deposits in designated accounts after households have made and reported contributions. This direct match approach could easily be facilitated through the tax filing process.

Specific Proposals

The Asset Building Program at the New America Foundation supports a set of policy reforms, which can be achieved through the tax reform process, to address the shortcomings in our saving infrastructure. Each of the options described below offers a way to satisfy the need to provide accessible accounts and meaningful incentives through a large-scale platform.

Establish a Universal 401(k) system. To ensure that all workers, regardless of their employment status or work history, are enrolled into a retirement savings plan, policy should support a Universal 401(k) system. This policy would be modeled on the components of the current employer-based 401(k) system that have demonstrated success while making modifications to achieve broad coverage and motivate participant deposits. Specifically, a worker-based, Universal 401(k) would include: (1) a single, portable account that provides coverage for part-time, contract, temporary, or other workers who change jobs frequently; (2) a new flat, refundable tax credit of 30 percent for savings by all workers; and (3) government matching contributions for the initial savings of lower- and middle-income families. To facilitate deposits in Universal 401(k)s, automatic payroll deductions would be offered by employers. A "clearinghouse" could be set up to create "default" accounts for workers with very low incomes who might initially have minimal account balances, or who were otherwise unable to navigate the process of setting up and managing a private account. A full description of this approach is available in "Facing Up To the Retirement Savings Deficit," published in October 2011.

Create a Financial Security Credit. The scale and existing infrastructure provided by the tax filing process presents an attractive alternative method of building retirement security, particularly among those workers who are most disadvantaged by the employer-based system. By also providing a direct match incentive and support for saving for multiple purposes, including emergencies, this policy would have the added benefit of shoring up the near-term savings households need to make saving for retirement realistic and sustainable. A Financial

Security Credit would support low- and moderate-income individuals and families who choose to invest in their economic future by saving at tax time by: (1) allowing households without a preexisting account to open one directly on their federal income tax form, extending the opportunity to save to those with little or no previous savings experience; (2) supporting a variety of restricted savings products designed to meet a range of savings needs, including IRAs, 401(k)s, 529 College Savings Plans, Coverdell Education Accounts, U.S. Savings Bonds and certificates of deposit. (3) matching every dollar that low- and moderate-income tax-filers deposit in a designated savings product with an additional dollar from the federal government, up to a $500 annual maximum; (4) depositing the credit directly to the designated account rather than returning it in the form of a refund to help build sufficient balances. A full description of this approach is available in "The Financial Security Credit," published in September 2012.

Other proposals might also be considered to advance the principles of fairness and inclusive. These include the President's Auto-IRA proposal and reform of the Saver's Credit to make it refundable. However, this is an opportunity for our policymakers to be more ambitious. This Congress should seize the moment to pursue tax reform on a large scale in ways that would provide similar opportunities to all Americans and create meaningful opportunities for all to save and build financial security.

Sincerely,

Reid Cramer
Director, Asset Building Program
New America Foundation