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Issue Brief

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KEY POINTS

- While the final *Tax Cuts and Jobs Act* did not change the taxation of retirement savings, it has raised the profile of retirement security in America.
- Many tax provisions affecting retirement plans and savings do not actually increase or decrease tax revenue over the long run.
- When considering changes to retirement provisions in the tax code, the impact on retirement security should be assessed.
- Among the factors to consider include the impact on participation rates, availability of plans, savings rates, retention of savings, and overall retirement security.

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The Role of Tax Policy in Promoting Retirement Security

U.S. policymakers have sought for many years to use tax incentives to drive changes to retirement policies. While reductions in 401(k) pre-tax limits were not part of tax reform legislation that recently became law, the discussion leading up to the release of the *Tax Cuts and Jobs Act*[1] has highlighted the question of the role that tax incentives play in the federal government's approach to encourage employers to offer and employees to participate in retirement programs. The debate about changing the taxation of retirement savings has raised the profile of retirement security in America.

Over the past decade, tax considerations have motivated Congress to adopt several pieces of legislation that may have reduced the amount of money that employers have set aside to support retirement benefits. For example, the *Moving Ahead for Progress in the 21st Century Act* (MAP-21)[2] allowed employees to reduce funding of pension plans with a goal of increasing government tax revenue to offset the cost of other priorities.

Tax policy can play an integral role in helping Americans attain a secure retirement. Without a thorough review of the impact on employees' retirement security, changes to tax laws that affect retirement security provisions for the sake of raising tax revenue may negatively impact the finances of our country and the security of our citizens.

1 Pub. L. No. 115-97.
2 Pub. L. No. 112-141, 126 Stat. 405.

Now or Later

Many tax provisions affecting retirement plans and savings do not actually increase or decrease tax revenues when considered over the long run. Most of the retirement program tax exemptions are simply tax deferrals. For example, eligible 401(k) plan contributions are currently exempt from taxation, but those contributions, plus investment earnings on those contributions, are fully taxable at distribution. In contrast, Roth 401(k) plan contributions do not benefit from current tax deductibility, but all investment earnings as well as contributions are tax-free when withdrawn in a qualified distribution from the plan. Proposals to change 401(k) contributions to the "Roth option" are often motivated by a desire to increase near-term tax revenue.

While reducing tax deductions in the near term would ostensibly generate revenue within the congressional ten-year budget window, this would be accompanied by an offsetting reduction in the tax revenue received in later years. The impact of such future revenue losses should be considered on a longer-term basis to fully capture the true budget effect of the change. A similar concept applies to other tax-driven policy changes affecting retirement plans. In the case of legislation that required or permitted employers to reduce contributions to their pension plans, it does not eliminate the need to fund them in the future. If employers do not fund them, the results may become a burden on the Pension Benefit Guaranty Corporation (PBGC) or participants themselves if their benefits are non-guaranteed. Greater strain on the PBGC's resources could lead to higher premium requirements which could provide another reason for employers to discontinue their defined benefit plans.

Key Considerations for Americans' Retirement Security

When considering any changes to retirement provisions in the tax code, the impact of the proposed changes on retirement security should be assessed. The factors that could be considered in this analysis include the following:

Overall participation—Will the change be expected to increase or reduce the number of participants who are covered by plans?

Prevalence of employer-sponsored retirement plans—Will the change be expected to increase or reduce the number of employers that sponsor plans?

Employer contributions—Will the change be expected to increase or reduce the level of contributions made by employers to retirement plans?

Employee contributions—Will the change be expected to increase or reduce the level of contributions made to plans by employees?

Leakage—Will the change be expected to increase or reduce the level of leakage where employees leave plans and take distributions?

Low and middle-income workers—Will the change be expected to ultimately improve or worsen individuals' retirement security, especially for low and middle-income workers?

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The answers to these questions can help clarify how changes in tax policy impact overall retirement security for Americans, including the potential impact on social insurance programs and the long-term sustainability of such changes (e.g., the need for additional future tax revenue could potentially lead to pressures for changes in later years, which could impact retirement security).

Retirement Policy

The U.S. does not have a formalized, cohesive and integrated retirement policy specifically designed to address issues of retirement security. This has the potential to leave many retirees with insufficient retirement assets or provide for retirement security in an inefficient manner from the perspective of both the retiree and society at large. Retirement security is a multi-faceted issue with many drivers and influencers. Changes to tax policy affecting retirement programs should not be considered in a vacuum. As changes to retirement-related tax provisions are considered in the future, it is critical that the revenue implications of any proposal that directly or indirectly impacts retirement security be assessed over a long-term period and reviewed for whether the resulting effect is likely to increase or decrease retirement security for American retirees.

Retirement security is a critical issue for the United States. This issue is likely to gain increasing attention, and a recent publication by the U.S. Government Accountability Office (GAO)[3] has called for a comprehensive study of our nation's retirement system. We look forward to participating in that effort.

3 U.S. Government Accountability Office, "The Nation's Retirement System: A comprehensive re-evaluation is needed to better promote future retirement security," October 2017. (Accessed Dec. 28, 2017.)