

# ***IRET Congressional Advisory***

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## **EXPANDING IRAS AND PENSIONS: H.R. 1102**

Most Americans have insufficient savings and are relying on an overstressed Social Security System for their retirement needs. The personal saving rate is at an all time low. Only about half of the work force participates in 401(k)-type or other workplace related retirement arrangements. Contribution limits on such plans and on IRAs and limits on benefits payable under defined benefit plans have not been increased since the 1980s or have actually been lowered.

Fortunately, the House of Representatives has passed H.R. 1102, a pension expansion and reform bill. It would expand annual contribution limits on IRAs to \$5,000 and increase limits on other tax deferred pensions. It would reform pension regulations to encourage earlier vesting and easier portability of pensions between jobs. These reforms are long overdue, and would be a big

improvement in the tax system. H.R. 1102 passed the House with overwhelming bipartisan support — a vote of 401 to 25 — on July 18. It now moves to the Senate, which may take up the issue in September.

Specifically, H.R. 1102 would increase yearly allowable contributions to regular and Roth IRAs from \$2,000 in 2000 to \$3,000 in 2001, \$4,000 in 2002, and \$5,000 in 2003. Savers age 50 and above could contribute \$5,000 beginning in 2001. Limits on deferral of employees' salaries in 401(k) and 403(b) plans would rise in stages from \$10,500 in 2000 to \$15,000 in 2005, with workers over 50 allowed an additional \$5,000 a year in "catch up" contributions to make up for years in which they were unable to participate. These limits would be adjusted for inflation thereafter.

Limits on employer contributions to defined contribution plans and limits on annual benefits in defined benefit plans would be increased. Numerous other restrictions would be eased.

Portability of pensions between jobs would be enhanced by allowing rollovers among IRAs, 401(k), 403(b), government section 457, and qualified employer plans. Workers would become vested and eligible for matching employer contributions in 3 years instead of 5. Workers would receive enhanced benefits in section 415 multi-employer plans.

The catch up and portability elements of the bill would be of special interest to women who

*Most Americans have insufficient savings and are relying on an overstressed Social Security System for their retirement needs. The personal saving rate is at an all time low. Only about half of the work force participates in 401(k)-type or other workplace related retirement arrangements... H.R. 4843...[which] the full House of Representatives is expected to vote on it this week...would expand annual contribution limits on IRAs to \$5,000 and increase limits on other tax deferred pensions. It would reform pension regulations to encourage earlier vesting and easier portability of pensions between jobs.*

dropped out of the work force for a time to raise families, and to workers who lost time due to illness or unemployment.

The bill would also streamline regulation of small business pension arrangements and simplify "top heavy" and non-discrimination rules to encourage the provision of pensions by small businesses.

The Treasury Department may object that expanding pension limits costs revenue (estimated at \$52.2 billion over five years), but this is inaccurate and short-sighted. Over time, the savings in retirement accounts compound; as people retire and withdraw their savings, the government gets its deferred taxes back with interest. The saving encouraged by the pension arrangements adds to investment, productivity, employment and wages, which boosts federal revenues from other taxes on income and payroll. Everyone wins.

Pensions should not be viewed as tax "breaks." They are the correct tax treatment for saving, and all saving should get similar treatment. The ordinary income tax hits saving harder than income used for consumption; when we use after-tax income to consume, there is no additional federal tax on most goods and services (except for a few excise taxes), but when we use after-tax income to buy a stock or a bond, there is additional tax on the returns (dividends, interest, corporate earnings, and capital gains) that are the "goods" we purchase with our saving. Pension treatment merely offsets some of these added layers of tax for a portion of our saving, and produces the same level of tax on saving as on consumption. All major tax reform plans, from the flat tax to the national sales tax, contain implicit or explicit IRA treatment for all saving.

In a deductible IRA or 401(k) plan, income saved is tax deferred, growing without tax until it is withdrawn after retirement. The withdrawals are taxed. Under a Roth-style IRA, the income is taxed before it is contributed to the plan, and the earnings and withdrawals are not taxed again. The two approaches are mathematically equivalent if the worker stays in the same tax bracket over time.

Either tax treatment is a great help in building retirement saving. Assume a 7.2% real rate of return (the average real growth rate of the stock market, with dividends reinvested, since 1926), and a hypothetical 20% federal and state tax rate. If a worker can save \$1,000 each year (adjusted for inflation) between age 20 and 65, he or she can accumulate \$349,000 in real dollars for retirement

(before the tax on withdrawals, equal to \$279,000 in a non-taxable Roth IRA). That is enough to buy an annuity paying a real \$27,000 a year for life after taxes and inflation. To get the same results without IRA treatment, a worker would have to save \$1,730 a year (adjusted for inflation).

It is important to begin saving early to give compound interest time to work. If a worker waits until age 30 to

begin contributing to a pension, the annual saving requirement for that same annuity would jump to \$2,094; waiting until age 40, it would jump to \$4,609 a year; at age 50, \$11,500, even with the benefits of tax deferral. Without IRA or pension treatment, the required saving rates would be almost 50% higher, a nearly impossible goal for most households.

These numbers lead to two conclusions. First, we must reform the pension system to encourage more businesses to offer pensions to cover more employees, which would help people to start to

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save earlier. Second, millions of older Americans who have not yet done much saving will have to set aside several thousands of dollars a year for retirement, well above current IRA limits. H.R. 1102 will go a long way toward addressing

these problems if the Senate concurs and the President agrees to sign it into law.

Stephen J. Entin  
President and Executive Director