# EBRI ISSUE BRIEF

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## UNIVERSAL IRA's AND DEDUCTIBLE EMPLOYEE CONTRIBUTIONS



The Administration and members of Congress (HR 3849) have set forth proposals for increasing private retirement savings. Such additional private retirement savings will be essential if workers are to offset future effective reductions in Social Security. While these Social Security benefit cutbacks may come over many years - savings build up takes many years.

The Congress has taken action in the past to encourage retirement savings including:

(1) Qualified Plans for tax deferred savings

(2) IRA's for those not covered by employer plans

(3) KEOGH's for the self-employed

(4) SEP's for small employers

The IRA is not available to a worker who for 1 day during the year is an active participant in a tax qualified pension plan. This has denied opportunity for such tax deferred retirement savings to as many as 63% (60 million) of all non-agricultural workers and 74% (43 million) of all full-time, non-agricultural workers between the ages of 25 and 64. These workers are covered by tax qualified plans, or other employer plans. Many, however, due to mobility or part-time work will not receive benefits from these plans.

For most of these workers retirement savings opportunities are needed. For many of them the IRA would represent the best approach; for others deductible employee contributions would be best. HR 3849 provides only for the former.

### "IRA" EXTENSION ARGUMENTS

CON: (1) They have been poorly utilized by low-income groups

(2) They cause a loss of tax revenue

PRO: (1) They provide an opportunity for retirement savings and an incentive to save

(2) They provide a component of retirement savings that is portable

(3) They provide a way for workers who are very mobile to have some retirement savings

(4) They provide a means of retirement savings for those:

- o Who do not participate in their employer's plan for more than a short time
- o Whose employer can afford only a limited plan.

DEDUCTIBLE EMPLOYEE CONTRIBUTIONS

A logical companion to IRA expansion according to many experts, would be a provision allowing employees to deduct contributions made to their employer's plan. This approach is most feasible in cases where plans already allow employee contributions. Research available on utilization of employer sponsored savings programs indicates that very high rates of employee participation can be achieved.

An either-or approach (IRA or contribution to plan) would allow the tax code to remain "neutral". It would not force employees to make a choice between: (1) contributing on a non-deductible basis to an employer plan to receive a possible higher return and (2) contributing on a deductible basis to an IRA to receive a potential lower return. While total tax code "neutrality" would only be achieved if mandatory employer contributions were deductible at the same dollar level. The piece focuses only on voluntary contributions, however.

Two options for expanding individual retirement savings could exists:

First, employers could choose whether or not to allow employees to make contributions to a plan.

Second, the employee could choose whether to contribute to the plan or set up an IRA

Identifiable advantages of this approach include:

(1) The worker has the opportunity to save for retirement on a tax-deferred basis and, when an employer plan is used, to have a broader range and diversity of investments available.

(2) The employer can choose the approach which causes the least confusion, administrative costs, and disruption. Where the employer provides the option overall investment gains should be greatest. And, tax-qualified status can be protected.

(3) The resulting savings would represent <u>long-term</u> savings available to the economy and would help to solve <u>long-term</u> retirement income problems.

(4) A ready means of communicating the availability of the deductions through employers and systematic employer payroll deductions would enable savings in a disciplined manner.

(5) Such a change has the potential of increasing utilization of the present IRA due to heightened consumer knowledge.

By providing additional savings opportunities some pressures will be removed from public programs over the long term.

<u>POTENTIAL UTILIZATION</u>

Research indicates that utilization of such a savings opportunity could be greater than has been the present individual retirement account. This is attributable to the demographic differences outlined in Table I. Low IRA utilization has occurred for a number of reasons, including:

(1) Those now eligible for IRA's are predominately at low income levels: 28% below $5,000 and 37% between $5,000 and $10,000.

(2) Those now eligible for IRA's work predominately for very small employers (79%).

(3) Those now eligible for IRA's are predominately part-time workers (66%).

As a result of these characteristics:

(a) it is very difficult for these persons to save under any circumstances, therefore

(b) public programs now in place provide a very high rate of income replacement for the low income population in retirement.

## TABLE I
## DEMOGRAPHICS FOR IRA POPULATION

| Characteristic | Of Those Now Eligible | Of Those Not Now Eligible |
|---|---|---|
| Under $5,000 | 28% | 7% |
| $5,000 to $10,000 | 37% | 25% |
| Over $10,000 | 35% | 68% |
| Employer Under 25 | 60% | 9% |
| Employer Under 100/Over 25 | 19% | 11% |
| Employer Over 100 | 21% | 80% |
| Full Time | 44% | 75% |
| Under 35 | 49% | 46% |
| Over 35 | 51% | 54% |

Higher utilization of IRA's (and especially deductible employee contributions) is likely among the potential new eligibles due to (1) higher incomes, (2) larger employers, and (3) greater hours worked. Even based upon present utilization rates, however, the annual added contribution to retirement savings could approach 5 billion dollars (Table II) were the allowable maximum $2,000.

## TABLE II
## USE OF IRA's
## Family Adjusted Gross Income

| | 0 to 5,000 | 5,000-10,000 | 10,000-15,000 | 15,000-20,000 | 20,000-50,000 | OVER 50,000 | TOTAL |
|---|---|---|---|---|---|---|---|
| % of Eligible Pop. with IRA's 1/ | .2 | 1.3 | 3.3 | 5.5 | 21.7 | 52.4 | NA |
| Potential new IRA's 2/ (000,000) | 1,800. | 7,020. | 7,840. | 6,875. | 8,400. | 278. | 32,213 |
| Estimate based upon current utilization (000) | 3.6 | 91.26 | 258.72 | 378.13 | 1,822.8 | 145.67 | 2,700.2 |
| Estimated Cont. $1,000 limit | 400 | 600 | 1,000 | 1,000 | 1,000 | 1,000 | NA |
| Estimated Total Cont. | 1.44 | 54.76 | 258.72 | 378.1 | 1,822.8 | 145.67 | 2,661.5 |
| Revenue Loss 3/ (000) | 0 | 3,83 | 38.81 | 51 | 437 | 50.5 | 581.14 |
| Estimated Cont. $2,000 limit | 400 | 600 | 1,000 | 1,500 | 2,000 | 2,000 | NA |
| Estimated Total Cont. | 1.44 | 54.76 | 258.72 | 567.19 | 3,645.6 | 291.34 | 4,819.05 |
| Revenue Loss (000) | 0 | 3,83 | 38.81 | 102.09 | 874.94 | 101.97 | 1,121.64 |

1/ From U.S. Department of the Treasury
2/ Based upon 1979 CPS
3/ Assumes tax rates 0%, 7%, 15%, 18%, 24%, and 35% respectively. These are approximations and actual rates could vary substantially.

CONCLUSION

Recent attention has been given to the fact that the creation of those new retirement savings may not be new real savings, but may only be a shift. There is not extant research available to indicate whether or not this should be a real concern. It should be noted, however, that this likely would increase savings set aside specifically for retirement. Recent research work by public and private organizations indicates that this is a desirable and appropriate national objective. And, it is likely that a portion of this savings, possibly a significant portion, would be new savings.