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401(k) Employee Contributions Above $2,400, A Possible Rothification Threshold

Over the last week or so, there have been several press and other reports that some tax reform proposals might modify the tax treatment of 401(k) employee contributions to require that 401(k) employee contributions greater than a specified threshold be treated as so-called Roth contributions. In light of this possibility, several members of the Employee Benefit Research Institute (EBRI) and others have asked EBRI to share its most recent information about the distribution of 401(k) employee contributions around the specified threshold, broken out by salary and by age.

This release provides that information. And it provides background on a major study that EBRI has undertaken to assess the projected impact of certain tax reform proposals on retirement income adequacy, using EBRI's Retirement Security Projection Model®.

For more information, please contact info@ebri.org or 202-659-0670.

Specific Proposal

Based on recent press reports, some tax reform packages might include a "mandatory, partial Rothification" proposal that would operate generally as follows:

- 401(k) employee contributions up to $2,400 for a year could be pre-tax or Roth (after-tax) when made, depending on plan design and employee choice,
- 401(k) employee contributions greater than $2,400 would have to be made on a Roth (after-tax) basis, and
- Employee contributions made on a pre-tax basis (and investment returns) would be taxable on subsequent distribution, and employee contributions made on a Roth basis (and investment returns) would, in general, not be taxed on subsequent distribution.

Retirement Income Adequacy Study

For the past several months, EBRI has been working on a major study of the projected impact of certain tax reform changes on retirement income adequacy, using EBRI's Retirement Security Projection Model®.

This study examines the projected impact of mandatory, full Rothification of 401(k) employee contributions, as well as analysis of a "full package" including mandatory, full Rothification plus an enhanced Saver's Credit and an increase in the 402(g)/catch up elective contribution limits on several retirement income adequacy measures. The analysis will consider how the tax changes might affect future employee contributions, plan terminations, pre-retirement distributions, and other behavioral items. And the retirement income adequacy measures will focus on retirement savings shortages and surpluses as well as after-tax balances at retirement ages. In addition, we will examine the impact of these potential changes on assets under management.

We expect to be ready to release the results of the study in an EBRI Policy Forum in early- or mid-November. In addition, in light of the recent reports, EBRI hopes to be able to add to the study the impact of the $2,400 Rothification threshold on retirement income adequacy.

We will broadly share information on the date, time, and location of the Policy Forum once we've made those decisions. If you'd like to receive this info, provide us with your contact information at https://www.surveymonkey.com/r/RetirementIncomeAdequacyPolicyForum.

Who Would be Affected by the $2,400 Threshold

In light of the recent reports, several EBRI members and others have asked EBRI to share its most recent information about the distribution of 401(k) employee contributions around the specified threshold, broken out by wage/income and by age.

Accordingly, we are providing our most-current information on the percentage of 401(k) contributors who would likely be impacted by the $2,400 threshold and the percentage of 401(k) employee contributions that would be above $2,400 and thus subject to mandatory Rothification. We provide this information below with breakouts by salary (Table 1) and age (Table 2). (Note: "401(k) contributors" includes only those individuals who are actually contributing; it does not include individuals who are eligible to contribute but choose not to.)

The information in the tables below are based on runs from the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project incorporating information from millions of administrative records from 401(k) recordkeepers. All contributions are based on year-end 2015 information. Information for individuals with reported salary less than $10,000 is excluded in an attempt to control for those employed by the plan sponsor for only a fraction of the year. Finally, it's important to emphasize that the information set forth below does not directly or indirectly describe the retirement income adequacy impacts of the mandatory, partial Rothification approach using $2,400 as the threshold.

Table 1: Salary Breakouts

Salary range (in $1,000s)	**Percent of those contributing that exceed $2,400**	**Percent of employee contributions that exceed $2,400**	**Average employee contribution**
10-24,999	38%	58%	$ 3,203
25-49,999	32%	51%	$ 2,710
50-74,999	60%	58%	$ 4,197
75-99,999	76%	70%	$ 6,622
100+	87%	80%	$ 11,112

Source: EBRI tabulations from the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project

Table 1 shows that even at the lowest wage levels ($10,000 to $25,000), 38 percent of the 401(k) contributors would be impacted by the $2,400 threshold. This number drops slightly for those with wages of $25,000 to $50,000 but then increases substantially. For those with more than $100,000 in wages, 87 percent would be impacted.

Table 1 also shows the percentage of 2015 contributions that would be impacted by the $2,400 threshold. At the lowest wage levels ($10,000 to $25,000), 58 percent of the contributions from 401(k) contributors would be above $2,400 and thus subject to mandatory Rothification. This number drops slightly for those with wages of $25,000 to $50,000 but then increases substantially. For those with more than $100,000 in wages, 80 percent would be impacted.

Table 2: Age breakouts

Age range	Percent of those contributing that exceed $2,400	Percent of employee contributions that exceed $2,400	Average employee contributions
25-34	43%	53%	$ 3,169
35-44	56%	66%	$ 5,054
45-54	62%	72%	$ 6,488
55-64	64%	75%	$ 7,287

Source: EBRI tabulations from the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project

Table 2 shows that for the youngest 401(k) contributors (ages 25 to 34), 43 percent would be impacted by the $2,400 threshold. This number increases for older participants. For those 55-64, 64 percent would be impacted.

Table 2 also shows the percentage of 2015 contributions that would be impacted by the $2,400 threshold. For the youngest 401(k) contributors (ages 25-34), 53 percent of the contributions would be above $2,400 and thus subject to mandatory Rothification. This number increases for older participants. For those ages 55-64, 75 percent of the contributions would be subject to mandatory Rothification.

Conclusion

The information provided above describes which 2015 401(k) contributors would be affected by a $2,400 Rothification proposal and what portion of their contributions would be above $2,400 and thus subject to mandatory Rothification. Of course, this information does not describe how Rothification - with or without the $2,400 threshold - would impact retirement income adequacy. As noted above, we are examining what the employee and employer behavioral reactions and the retirement income adequacy impacts might be to various tax reform proposals, and we hope to be able to share the results at an EBRI Policy Forum in early- or mid-November.

EBRI's Retirement Security Projection Model® is a microsimulation model that EBRI has used to assess the impact of policy and plan design modifications on US retirement income adequacy since 2003. It includes a detailed accumulation module that simulates, inter alia, the balances of 401(k) participants as well as the IRA balances attributed to 401(k) rollovers. At retirement age, the model simulates 1,000 alternative life paths for each household to include important post-retirement risks such as longevity risk, investment risk and long-term care risk. For links to several of the studies using the model, see: bit.ly/ebri-rspm.