ebri.org
Employee Benefit
Research Institute

News from EBRI

1100 13th St. NW • Suite 878 • Washington, DC 20005
(202) 659-0670 • www.ebri.org • Fax: (202) 775-6312

For Immediate Release: March 30, 2011
Contact: Tracey Young, EBRI (media relations), 202/775-6329, young@ebri.org
Jack VanDerhei, EBRI (author of report), 202/775-6327, vanderhei@ebri.org

New Research from EBRI:

Modifying the Exclusion of Employee Contributions to Retirement Savings Plans From Taxable Income: Survey Evidence on Likely Impact on Retirement Savings

WASHINGTON—If Congress were to modify the exclusion of employee contributions to retirement savings plans from taxable income, who would most likely cut back on their savings: lower-income workers, or those with higher income?

Although conventional wisdom is that upper-income workers would be most affected, new findings by the nonpartisan Employee Benefit Research Institute (EBRI) suggest that lower-income workers are far more likely to say they would reduce their contributions if the tax exclusion for employee contributions for retirement savings plans were lowered or eliminated.

Results from EBRI's just-released 2011 Retirement Confidence Survey (RCS) show that more than three-quarters of full-time workers with household income of $15,000 to $25,000 say that having the ability to deduct their contributions to retirement savings plans is "very important." More than half (56 percent) of full-time workers currently saving for retirement say they would reduce the amount they save if they were no longer able to deduct retirement savings plan contributions from taxable income.

By comparison, only 22 percent of full-time workers currently saving for retirement with household incomes of $100,000 or more say they would save less if the tax treatment of their retirement savings plan were reduced or eliminated.

The reactions become even starker as saving amounts grow, EBRI found: 71 percent of those with less than $1,000 in savings said they would reduce the amount saved if they were no longer allowed to deduct their contributions, compared with about 13 percent of those with $500,000 or more.

"Our research suggests that that some proposals to modify the exclusion of employee contributions for retirement savings plans from taxable income may have unintended consequences," said Jack VanDerhei, EBRI research director and author of the report. "Instead of reducing the contribution levels of those with larger taxable incomes (and hence higher marginal tax rates), the RCS results indicate that workers with low levels of household income would be most likely to cut their contribution—in some cases completely."

Those found to be most likely to reduce their contributions to retirement savings plans were individuals who work for small private organizations as well as those with relatively low educational levels.

((more))

Full results of the report are in the March 2011 EBRI *Notes*, "The Impact of Modifying the Exclusion of Employee Contributions for Retirement Savings Plans from Taxable Income: Results from the 2011 Retirement Confidence Survey," online at www.ebri.org

In recent years, proposals have surfaced to reform the 401(k) system based on the assumption that higher-income individuals receive more tax-related benefits from these programs than do individuals in lower marginal tax brackets (as well as those who may pay no federal income taxes in a particular year). Some of these proposals have included modifications of the current federal income taxation treatment that excludes some or all of the contributions employees make to tax-qualified defined contribution plans.

From a strictly financial perspective, VanDerhei said, it is logical to assume that the lower-income individuals (those most likely to pay no or low marginal tax rates and therefore have a smaller financial incentive to deduct retirement savings contributions from taxable income) would be least likely to rate the exclusion of employee contributions for retirement savings plans from taxable income as "very important."

However, the RCS data show that those in the household income category of $15,000 to $25,000 actually have the largest percentage of respondents classifying the tax deductibility of contributions as very important. While higher-income workers would be the most likely to be negatively affected by a proposal to cut or eliminate the exclusion of employee contributions for retirement savings plans from taxable income, VanDerhei noted that behavioral economics has shown that workers' reaction in similar situations are often at odds with what would have been logically predicted.

The EBRI analysis notes that determining the overall tax advantage of making before-tax contributions to a 401(k) plan involves the prediction of several factors, including amounts and timing of contributions, marginal tax rates during the accumulation and decumulation periods, rates of return, and withdrawal behavior during the decumulation period.

Among the report's other findings:

Results by savings level: Of the full-time workers who are currently saving for retirement who report that they currently have less than $1,000, 71.3 percent indicate they would reduce the amount saved. This value declines to 38.8 percent for those with savings of $1,000 to less than $10,000.

Results by education level: Approximately 32.2 percent of high school graduates indicate they would reduce savings, whereas only 22.1 percent of those with a graduate or professional degree have a similar response.

EBRI is a private, nonprofit research institute based in Washington, DC, that focuses on health, savings, retirement, and economic security issues. EBRI does not lobby and does not take policy positions.

###