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New Research from EBRI:

Tax Reform Proposal Could Clip 401(k) Balances

WASHINGTON—A recent proposal to change the tax preferences for employment-based 401(k) retirement plans could result in an average reduction in 401(k) account balances of between 6–22 percent at Social Security normal retirement age for workers currently ages 26–35, according to new research by the nonpartisan Employee Benefit Research Institute (EBRI).

The response—a combination of plan sponsor reaction and participant response—is strongly tied to plan size, with participants in smaller plans likely to experience deeper average reductions in 401(k) balances, according to EBRI's baseline analysis. For plans with less than $10 million in assets, participant balances at Social Security normal retirement age for workers currently ages 26–35 could decline between 23–40 percent, depending on the size of the plan and income of the participant.

EBRI's report is the first to analyze the response of both private-sector 401(k) plan sponsors and participants to a proposed scenario where the current tax treatment of employer and worker pre-tax contributions would be modified such that workers would have to pay federal taxes on these amounts currently, rather than on a deferred basis (as under current law), and participants would receive an 18 percent government match on all contributions.

"Some analyses of recent proposals to change the tax preferences for employment-based 401(k) retirement programs have assumed status quo in plan design and contribution flows," notes Jack VanDerhei, EBRI research director and author of the report. "Surveys of individual participants suggest, however, that some would decrease or even eliminate their contributions in response to these changes. Additionally, surveys of plan sponsors indicate that many would modify their plan design, or even terminate these plans."

Full results of the study are published in the March *EBRI Notes*, "Modifying the Federal Tax Treatment of 401(k) Plan Contributions: Projected Impact on Participant Account Balances," online at www.ebri.org

In the debate over reducing the federal deficit, a 2011 plan was proposed that would modify the existing tax treatment of both worker and employer 401(k) contributions and introduce a flat-rate refundable tax credit that serves as a federal matching contribution into a retirement savings account.

Until now, there has been no survey data to indicate how both employers and workers would actually react if this proposal became law. However, EBRI was able to use data from a survey by AllianceBernstein of likely employer reactions if the tax-deductible 401(k) contributions were ended, employer contributions were currently included in employees' taxable income, and a federal tax credit was introduced. It also used data from the 2012 Retirement Confidence Survey by EBRI and Mathew Greenwald & Associates, Inc., which asked individual 401(k) participants how they would likely react if such a proposal became law, to quantify the potential financial impact.

Results were calculated using the EBRI-ERF Retirement Security Projection Model® (RSPM) in order to estimate the likely impact of the proposed federal-tax modifications on projected 401(k) balances at retirement age, assuming the modifications took effect immediately.

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