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FAST Facts

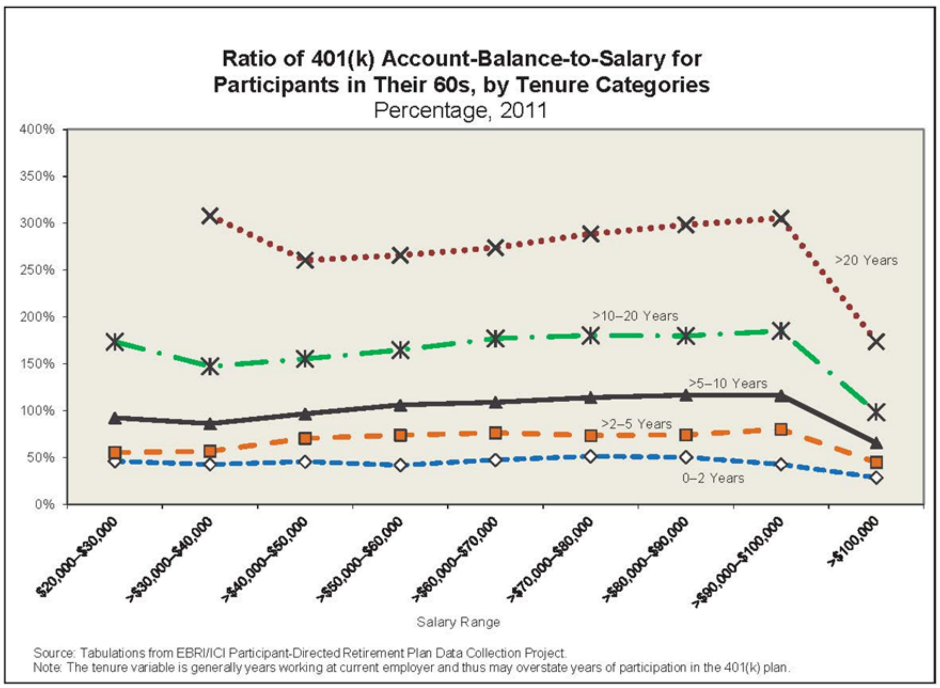
Are 401(k) Tax Preferences Upside Down?

While the current federal tax treatment for 401(k) plans is said by some to disproportionately favor higher-income individuals, research from the nonpartisan Employee Benefit Research Institute (EBRI) provides a broader perspective.

A recent *EBRI Issue Brief* notes that while from a financial economics perspective, those who pay taxes at higher rates are seen as receiving a greater benefit from the deferral of those taxes, actual 401(k) account balances are found to be, in large part, proportionate with compensation levels.

If those so-called "upside-down" tax incentives were the only forces at work, one might expect to find that the higher the individual's salary, the higher the overall account balance would be, not only in absolute terms, but as a multiple of salary.

However, the report notes that a variety of legal boundaries and contribution limits* have, by restricting the contributions made by highly compensated individuals, resulted in a relatively flat multiple of final earnings at retirement across the salary range.



Source: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project.
Note: The tenure variable is generally years working at current employer and thus may overstate years of participation in the 401(k) plan.

In other words, while higher-income individuals have higher account balances, those balances are in rough proportion to their incomes—and not "upside down."

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*Among them the constraints contained in the IRC Secs. 402(g) and 415(c), combined with nondiscrimination requirements for the actual deferral percentage (ADP) and actual compensation percentage (ACP).