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Statement

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by

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Statement Summary
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- Today's retirees are at an historic high in cash and non-cash income. Social Security and Medicare have played a significant role in providing this economic security. Employment-based pensions and individual retirement savings have also made a large difference. Social Security (OASDI) paid $227.3 billion in retirement and disability benefits and pension plans paid $244.4 billion in 1989, compared with $1.4 billion and $652 million, respectively, in 1950.

- Pension and individual retirement plans have also had a major impact on capital markets. At the end of 1990, employment-based retirement plans held $2.5 trillion in assets, and individual retirement accounts (IRAs) and Keoghs held an additional $564 billion. This represents more than $3 trillion in patient capital to finance the nation's growth and, over time, the economic security of retirees.

- Government tax and social policy has encouraged the development of these programs, but this support has not been consistent. Changes since 1981 in general, and the Tax Reform Act of 1986 (TRA '86) in particular, significantly reduced voluntary program incentives. The data indicate that, in the absence of some of these changes, there would be more pension coverage today, more individuals with individual retirement savings today, and hundreds of billions of dollars of more assets in retirement plans.

- Under restrictions imposed by TRA '86, 65 percent of all workers aged 21–64 were eligible for a full $2,000 IRA deduction in 1987, and 58 percent are eligible today. By 1995, 52 percent will be eligible.

- TRA '86 restricted IRA deduction eligibility for workers with pensions and incomes over certain thresholds. Workers least likely to remain fully eligible for a $2,000 IRA deduction in 1991 include those with working spouses (45 percent eligible) and those with family incomes in excess of $50,000 (21 percent eligible). Workers with working spouses are disproportionately affected by the restrictions because dual employment increases the likelihood of family pension coverage and higher family income.

- The income thresholds associated with IRA deduction restrictions are not indexed. Therefore, as incomes rise due to inflation or real income gains, the proportion of workers who are eligible declines. While all higher-income workers with pensions are already ineligible for deductible IRAs, an increasing proportion of moderate-income workers are ineligible. The proportion of workers with family incomes between $35,000 and $49,999 (in constant 1991 dollars) who are eligible for a $2,000 IRA deduction fell from 75 percent in 1987 to 55 percent in 1991, and will drop to 43 percent in 1995.

- The Bentsen/Roth bill would improve IRA deduction eligibility for 37 percent of all workers in 1991 and 43 percent of all workers in 1995. While higher-income workers would be most likely to gain eligibility in the near term, many moderate-income workers would also gain. Among workers with incomes in excess of $50,000, 78 percent would gain eligibility in both 1991 and 1995; among those with incomes between $30,000 and $49,999, the proportion gaining eligibility would be 41 percent in 1991 and 54 percent in 1995.

- IRA deduction eligibility does not guarantee that workers will make IRA contributions, nor does ineligibility preclude such contributions. Following TRA '86, IRA participation remained higher at higher income levels. Including both deductible and nondeductible contributions, in 1987, 7 percent of workers with incomes below $30,000 contributed, compared with 14 percent of those with incomes between $30,000 and $49,999, 19 percent of those with incomes between $50,000 and $74,999, and 28 percent of those with incomes over $75,000. IRA deduction eligibility improvements under the Bentsen/Roth bill would be <u>somewhat</u> concentrated among higher-income workers. Actual tax benefits from IRA use arising from the bill would be <u>more</u> concentrated among higher-income workers.

I am pleased to appear before you today to discuss individual retirement account (IRA) deduction eligibility. My name is Dallas Salisbury and I am accompanied by Joseph Piacentini. I am the president of the Employee Benefit Research Institute (EBRI), a nonprofit, nonpartisan, public policy research organization based in Washington, D.C. EBRI has long been committed to the accurate statistical analysis of public policy benefit issues. Through our research, we strive to contribute to the formulation of effective and responsible health, welfare, and retirement policies. In keeping with EBRI's mission of providing objective and impartial analysis, our work does not contain recommendations. Joe is a research associate with EBRI and is responsible for all of our primary analyses of pension and individual retirement account coverage and participation.

◆ Introduction

Today's retirees are at an historic high in cash and non-cash income. Social Security and Medicare have played a significant role in providing this economic security. Employment-based pensions and individual retirement savings have also made a large difference. Social Security paid $227.3 billion in retirement benefits and pension plans paid $244.4 billion in 1989, compared with $1.4 billion and $652 million, respectively, in 1950.

Americans like retirement. So much, in fact, that they told the EBRI/Gallup poll that, on average, they would love to retire by age 61. In recent years, as a result of retirement savings, individuals have been able to retire earlier. Americans like the programs that have made retirement possible, but they are concerned about the future.

Americans like Medicare. But 71 perccent tell the EBRI/Gallup poll that they believe Medicare will provide a lower level of benefits when they retire than it does today. Over one-half would willingly pay higher payroll taxes tomorrow to secure the program. They have reason to be concerned. The program is projected to move to negative cash flow in 1996 and run out of investment earnings in 2001. To maintain benefit levels, the program will grow from 2 percent of GNP in 1990 to 6 percent in 2060. Far more Americans believe that employers will provide health insurance in retirement than is the case. Seventy-three percent believe employers should be required to provide health insurance in retirement. In the future, Americans will need to increase savings for retirement to retire when they want to and in order to afford health care expenses in retirement.

Americans like Social Security. But 42 percent of poll respondents not currently retired do not think the system will pay them a benefit when they retire; 44 percent of those aged 18–34 and 45 percent of those aged 35–54 do not think the system would pay them a benefit. One-half oppose payroll tax reductions, particularly (64 percent) if it would mean an increase in other taxes. **The vast majority say employers and the government should do more to encourage them to save and to make it possible for them to save. And, that if this were done, they would save.**

Employers and individuals have saved a great deal. Pension and individual retirement plans have, as a result, had a major impact on capital markets. At the end of 1990, employment-based retirement plans held $2.5 trillion in assets and individual retirement accounts and Keoghs held an additional $564 billion. This represents more than $3 trillion in patient capital to finance the nation's growth and, over time, the economic security of retirees.

Government tax and social policy has encouraged the development of these programs, but this support has not been consistent. Changes since 1981 in general, and the Tax Reform Act of 1986 (TRA '86) in particular, significantly reduced incentives. The data indicate that, in the absence of some of these changes, there would be more pension coverage today, more individuals with individual retirement savings today, and hundreds of billions of dollars of more assets in retirement plans.

Under restrictions imposed beginning in 1987 by TRA '86, 63 percent of all workers aged 21–64 were eligible for a full $2,000 IRA deduction in 1987, and 58 percent are eligible today. By 1995, 52 percent will be eligible.

The Bentsen/Roth Super IRA proposal would extend eligibility for deductible contributions to IRAs to all workers. TRA '86 restricted that eligibility for workers with pensions and incomes over certain thresholds, beginning in 1987. This testimony quantifies the extent of IRA deduction eligibility under current law for workers today and in the near future. It documents the use of deductible and nondeductible IRAs following TRA '86. Finally, it examines the proportion of workers in different income groups and family types that would gain IRA deduction eligibility under this provision of the Bentsen/Roth bill.

◆ Background

With the enactment of the Employee Retirement Income Security Act of 1974 (ERISA), Congress established IRAs, effective in 1975, to provide workers without employer-sponsored pensions an opportunity to save for retirement on a tax-deferred basis. In general, ERISA allowed workers without pensions to contribute the lesser of $1,500 (unindexed) or 15 percent of earnings annually to an IRA on a tax-deductible basis. As ERISA originally provided, investment earnings on IRA contributions are also tax deferred, and IRA withdrawals in retirement are taxable. IRA eligibility restrictions were basically unchanged from 1975 through 1981. In 1975, 1.2 million taxpayers claimed $1.4 billion in IRA deductions, according to the Internal Revenue Service (IRS). By 1981, 3.4 million taxpayers claimed $4.8 billion in IRA deductions (chart 1).

The Economic Recovery Tax Act of 1981 (ERTA) extended eligibility for deductible IRA contributions to all workers, including those with employer-sponsored pension plans, and raised the deduction limit to the lesser of $2,000 (unindexed) or 100 percent of earnings. ERTA became effective in 1982. At this time, banks and other investment services vendors began to market IRA products aggressively. IRA deduction eligibility remained nearly universal among workers from 1982 to 1986, with restrictions only for workers earning less than $2,000 annually. In 1982, the number of taxpayers claiming an IRA deduction increased to 12.0 million, and the total amount deducted reached $28.3 billion. In 1985, IRA deductions peaked at $38.2 billion from 16.2 million taxpayers (chart 1).

Effective in 1987, TRA '86 restricted IRA deductions for taxpayers with employer-sponsored qualified retirement plan coverage and income over certain unindexed thresholds. Specifically, the maximum allowed IRA deduction—$2,000 per worker—is phased out evenly for single workers with adjusted gross incomes (AGIs) between $25,000–$35,000 and for married couples filing jointly with AGIs between $40,000–$50,000. These restrictions apply to joint filers if either spouse is covered by a pension. (Married individuals filing separately are not affected by their spouses' pension coverage. However, if they are covered by a pension plan, their IRA deduction eligibility is phased out between AGIs of $0 and $10,000.) Workers who are not eligible for the full IRA deduction are permitted to make nondeductible contributions. Combined deductible and nondeductible contributions generally must not exceed the lesser of $2,000 (unindexed) or 100 percent of earnings.

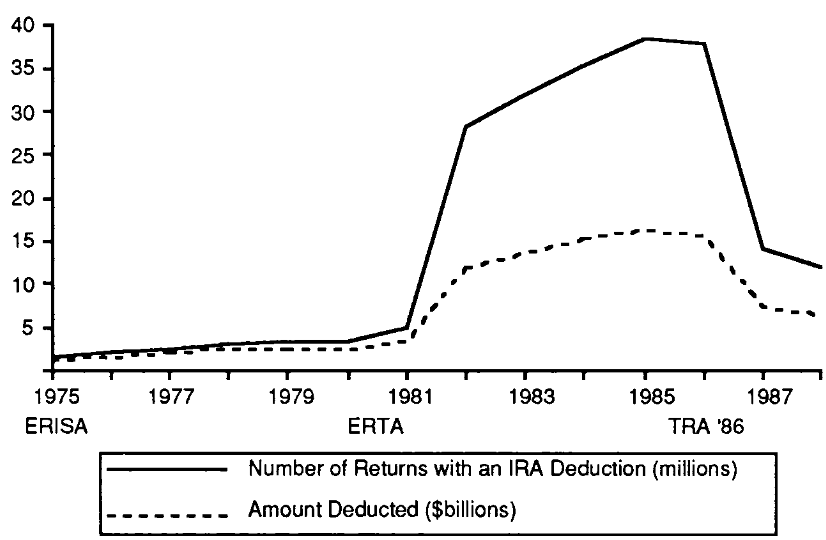
Primarily as a result of TRA '86, use of the IRA deduction fell sharply. In 1987, 7.3 million taxpayers claimed $14.1 billion in IRA deductions; in 1988, 6.4 million taxpayers claimed $11.9 billion (chart 1).

◆ Current IRA Deduction Eligibility

New EBRI research quantifies changes in workers' IRA deduction eligibility resulting from the TRA '86 restrictions for different income groups and family types. The research also measures IRA use by both eligible and ineligible workers.

Under pre-TRA '86 law, 95 percent of all workers aged 21–64 would have been eligible for a $2,000 IRA deduction in 1987. As a result of TRA '86, 65 percent were eligible in 1987, and 58 percent are eligible today. By 1995, 52 percent will be eligible. Looking at the data another way, at 1991 income levels, 35 percent of those who contributed to an IRA in 1982

Chart 1
Use of the IRA Deduction Responds to Eligibility Law



Source: Internal Revenue Service.

retain full eligibility, compared with 64 percent of those who did not participate. If TRA '86 was intended to stop those who were deducting IRA contributions from doing do, Census Bureau data indicate it was very effective.

Higher-income workers are more likely to be covered by employer-sponsored plans and to have AGIs above the TRA '86 thresholds and therefore are less likely to be eligible for the full IRA deduction. Just 21 percent of workers aged 21–64 with AGIs of $50,000 or more are currently eligible for a $2,000 deduction, compared with 55 percent of workers with AGIs between $30,000 and $49,999 and 86 percent of workers with AGIs less than $30,000.

Because the TRA '86 income thresholds are not indexed for inflation or income growth, between 1987 and 1991 the proportion of lower- and middle-income workers who were eligible declined, while the proportion of higher-income workers who were eligible remained nearly the same. This trend is expected to continue through 1995. Among workers with AGIs of less than $30,000 (in constant 1991 dollars), the proportion eligible for a $2,000 deduction declined from 90 percent in 1987 to 86 percent in 1991; it is expected to fall to 83 percent in 1995. Workers with AGIs of $30,000–$49,999 are facing the sharpest decline in eligibility, from 75 percent in 1987 to 55 percent in 1991 to an estimated 43 percent in 1995. Among workers with higher AGIs, between 20 percent and 22 percent remained eligible from 1987 to 1991, and the number is expected to remain in that range through 1995.

Two-earner couples have been disproportionately affected by the TRA '86 IRA deduction restrictions, in part because the presence of two workers increases the likelihood of coverage under an employer-sponsored pension plan. Moreover, many two-earner couples' combined earnings and other income already exceeds the TRA '86 thresholds. Given expected inflation and income growth, more two-earner couples will become ineligible in the near future as more of their incomes surpass these thresholds. Among all workers whose spouses also work, the proportion eligible for the full IRA deduction declined from 53 percent in 1987 to 45 percent in 1991; it is expected to drop to 38 percent in 1995 (table 1).

One other issue at the center of legislation and regulation in the 1980s was non-discrimination, that is, the desire to have individuals at all income levels participate in programs. TRA '86 also had an interesting impact on this objective, according to analysis of the statistics of income from the Internal Revenue Service (IRS). In 1986, the proportion of all returns by income category with an IRA deduction ranged from a high of 67 percent of those with incomes of $75,000 or higher to a low of 7 percent for those with incomes below $30,000. With TRA '86 in effect, 1987 returns showed a high of 15 percent for those earning between $30,000 and $49,999 and a low of 5 percent for those earning below $30,000. For those at $75,000 or higher, the rate dropped to 10 percent.

Table 1

Percentage of Civilian Workers Aged 21–64 by Eligibility for IRA Deduction

	Eligibility Under TRA '86 IRA			Eligibility Under Bentsen/Roth IRA			Percentage Distribution of All Workers
	Full	Partial	None	Full	Partial	None	
1987							
All Workers	65%	16%	20%	95%	4%	2%	100%
Family Type							
Single	76	14	10	94	5	2	36
Married, sole worker	74	10	16	97	2	1	17
Married, spouse works	53	18	28	95	4	2	48
Family Pension Status							
Pension	45	22	33	97	2	1	57
No pension	91	6	3	91	6	3	43
Family Income (1991$)							
Less than $30,000	90	7	3	91	7	3	41
$30,000-$49,999	75	20	6	97	2	1	29
$50,000-$74,999	20	34	45	98	1	1	20
$75,000 or more	22	a	78	98	1	a	10
Age							
Under 35	74	14	12	94	4	2	42
35-54	56	17	26	96	3	1	46
55 or older	64	14	22	94	4	2	11
1991 (Projected)							
All Workers	58%	15%	27%	94%	5%	1%	100%
Family Type							
Single	74	15	11	94	6	a	37
Married, sole worker	69	11	20	97	3	1	11
Married, spouse works	45	16	39	94	5	1	53
Family Pension Status							
Pension	31	21	49	97	3	a	55
No pension	91	8	1	91	8	1	45
Family Income (1991$)							
Less than $30,000	86	13	1	90	9	1	43
$30,000-$49,999	55	35	10	96	3	a	27
$50,000-$74,999	21	1	78	98	2	a	18
$75,000 or more	21	1	78	98	2	1	12
Age							
Under 35	69	15	16	94	6	a	43
35-54	48	15	37	95	4	1	46
55 or older	54	15	13	92	6	1	11

(continued on next page)

	Full	Partial	None	Full	Partial	None	Percentage Distribution of All Workers
1995 (Projected)							
All Workers	52%	12%	36%	95%	4%	1%	100%
Family Type							
Single	69	14	17	95	5	a	37
Married, sole worker	61	10	28	97	2	1	11
Married, spouse works	38	12	50	95	4	1	53
Family Pension Status							
Pension	19	17	64	97	2	a	55
No pension	92	7	1	92	7	1	45
Family Income (1991$)							
Less than $30,000	83	16	1	91	8	1	43
$30,000-$49,999	43	22	35	97	3	a	27
$50,000-$74,999	22	1	78	98	2	a	18
$75,000 or more	21	1	79	98	1	a	12
Age							
Under 35	63	13	23	94	5	a	43
35-54	42	11	47	96	3	1	46
55 or older	49	13	38	93	6	1	11

Source: EBRI estimates and projections based on Census Bureau data and Social Security Administration assumptions.
[a]Less than 0.5 percent.

◆ Conclusion: Effect of IRA Deduction Eligibility Extension

Legislation introduced in March by Senators Lloyd Bentsen and William Roth would extend IRA deduction eligibility to all workers. This provision would increase the proportion of all workers who are currently eligible for a $2,000 IRA deduction from 58 percent to 94 percent (table 2). It would improve IRA deduction eligibility for 37 percent of all workers in 1991 and for 43 percent of all workers in 1995.

Eligibility gains would be greatest among high-income workers. Seventy-eight percent of workers with AGIs of $50,000 or more would enjoy improved eligibility under this provision in both 1991 and 1995. Because the TRA '86 thresholds are not indexed, the proportion of moderate-income workers whose eligibility would improve is expected to increase. Among workers with AGIs between $30,000–$49,999, eligibility would improve for 41 percent in 1991 and for 54 percent in 1995. Among workers with working spouses, eligibility would increase for 50 percent in 1991 and for 58 percent in 1995 (table 3).

IRA deduction eligibility does not guarantee that workers will make IRA contributions. Most eligible workers do not contribute, and some ineligible workers make nondeductible contributions. Among workers who were fully eligible for the IRA deduction in 1987, IRA contributions were more common among workers in higher-income families. Likewise among ineligible families, nondeductible contributions were most common at higher income levels. These patterns suggest that increased IRA deduction eligibility under repeal of the TRA '86 restrictions would be disproportionately concentrated among high-income families, and actual tax benefits flowing from the repeal might be even more concentrated.

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Table 2

Changes in IRA Deduction Eligiblity Resulting from Bentsen/Roth, Civilian Workers Aged 21–24

	Percent of All Workers	Eligibility Increases Percent Gaining	Eligibility Increases Percent of All Gainers	Eligibility Unchanged Percent Unchanged	Eligibility Unchanged Percent of All Unchanged
			1991 (Projected)		
All Workers	100%	37%	100%	63%	100%
Family Type					
Single	37	20	21	80	46
Married, sole worker	11	28	8	72	12
Married, spouse works	48	50	72	50	42
Family Pension Status					
Pension	55	67	100	33	28
No pension	45	0	0	100	72
Family Income (1991$)					
Less than $30,000	43	4	5	96	65
$30,000-$49,999	27	41	30	59	25
$50,000-$74,999	18	78	39	22	6
$75,000 or more	12	78	26	22	4
Age					
Under 35	43	25	29	75	51
35-54	46	47	59	53	38
55 or older	11	38	12	62	11
			1995 (Projected)		
All Workers	100%	43%	100%	57%	100%
Family Type					
Single	37	25	22	75	49
Married, sole worker	11	36	9	64	12
Married, spouse works	53	58	70	42	39
Family Pension Status					
Pension	55	79	100	21	20
No pension	45	0	0	100	80
Family Income (1991$)					
Less than $30,000	40	8	7	92	66
$30,000-$49,999	26	54	33	46	21
$50,000-$74,999	19	78	34	22	8
$75,000 or more	14	78	25	22	5
Age					
Under 35	43	31	31	69	52
35-54	46	54	57	46	37
55 or older	11	45	12	55	11

Source: EBRI estimates and projections based on Census Bureau data and Social Security Administration assumptions.

Table 3

IRA Sue Rates: Percentage of Civilian Workers Aged 21–24 Contributing to an IRA in 1987

	All workers	IRA deduction eligibility Full	Partial	None
All Workers	13%	12%	13%	19%
Family Type				
Single10	9	13	16	
Married, sole worker	17	15	22	22
Married, spouse works	15	13	12	20
Family Pension Status				
Pension	15	12	16	20
No pension	11	12	3	a
Family Income (1991$)				
Less than $30,000	7	7	4	a
$30,000-$49,999	14	14	16	14
$50,000-$74,999	19	26	15	17
$75,000 or more	28	38	a	25
Age				
Under 35	7	6	8	12
35-54 16	14	13	20	
55 or older	28	27	33	28

Source: EBRI estimates and projections based on Census Bureau data and Social Security Administration assumptions.
[a]Sample too small to provide reliable estimate.

Appendix

All estimates of IRA deduction eligibility and IRA use contained in the tables provided with this testimony are based on U.S. Census Bureau Current Population Survey (CPS) data. Estimates for 1987 are based on 1987 income and pension data contained in the March 1988 CPS income supplement and 1987 IRA data contained in the May 1988 CPS employee benefit supplement. Estimates for 1991 and 1995 are based on 1989 income and pension data contained in the March 1990 CPS income supplement. Income and earnings are projected forward from 1989 to 1991 and 1995 based on Social Security II-B intermediate assumptions on growth in average covered wages. AGI is assumed to equal the reported total personal income of individuals or the combined reported total personal incomes of married couples. Workers' earnings are assumed to equal their reported total income from all employment during the base year.

Because CPS data do not provide for a reasonable determination of tax filing status, all married couples are presumed to file jointly. The effect of this limitaion on the estimates is probably very small due to the small number of married couples who file separately. IRS reports that in 1987 no more than 3 percent of married couples filed separately. However, some married workers—particularly those with employer-sponsored plan coverage only through their spouses—could gain IRA eligibility by filing separately. A separate set of EBRI estimates suggests that, if all married workers chose their filing status to maximize the combined IRA deduction available to themselves and their spouses, the proportion of all workers eligible for a full IRA deduction in 1991 would be 63 percent rather than the 58 percent reported above. However, under this approach, 16 percent of married couples would file separately in order to improve their IRA deduction eligibility—a proportion far larger than the 3 percent reported by IRS. Moreover, many of the couples who actually file separately may not improve their IRA deduction eligibility by doing so. For these reasons, assuming that all married couples file jointly should provide reasonable estimates of IRA deduction eligibility.

Some workers would remain eligible for less than the full IRA deduction under the Bentsen/Roth proposal because they do not report enough earnings to qualify for the full deduction.

In the preceding analysis, "improved" eligibility status refers to a change from partial eligibility to full eligibility or from no eligibility to partial or full eligibility. Increases in partial eligibility are not included.

All estimates are restricted to workers aged 21–64. Estimates for 1991 and 1995 hold pension coverage and work force demographics constant at 1989 levels.