ASPPA®
AMERICAN SOCIETY OF PENSION PROFESSIONALS & ACTUARIES
4245 N. Fairfax Drive, Ste 750
Arlington, VA 22203

Comments Submitted by the
American Society of Pension Professionals and Actuaries
to the
Pensions and Retirement Tax Reform Working Group
Committee on Ways and Means

April 15, 2013

The Honorable Pat Tiberi
106 Cannon House Office Building
Washington, DC 20515

The Honorable Ron Kind
1502 Longworth House Office Building
Washington, DC 20515

Dear Representatives Tiberi and Kind,

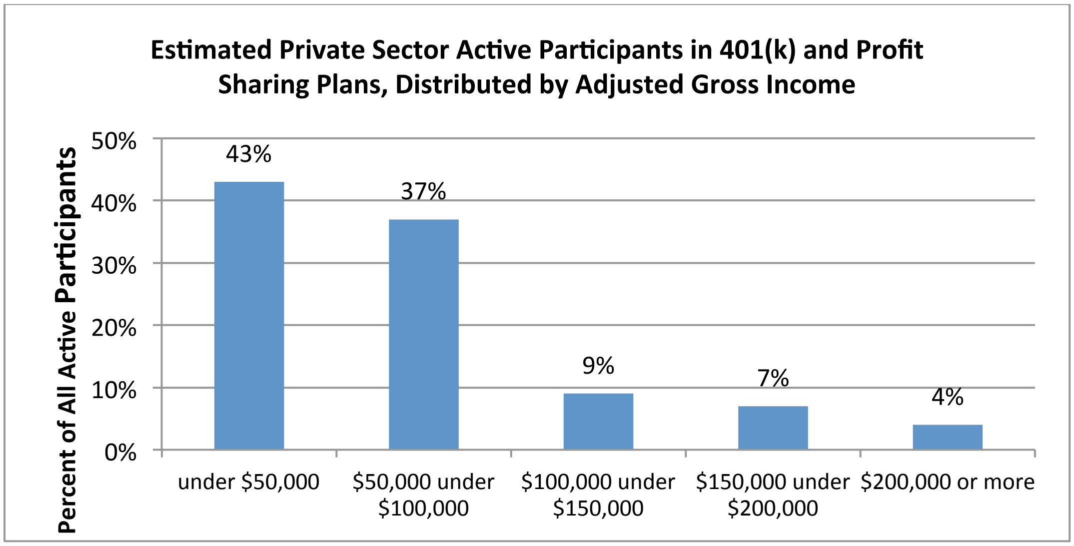
The American Society of Pension Professionals & Actuaries (ASPPA) respectfully submits the following comments to the Tax Reform Working Group on Pensions and Retirement. ASPPA is a national organization of more than 12,000 retirement plan professionals who provide consulting, administrative and investment advisory services for qualified retirement plans covering tens of millions of American workers. ASPPA's membership is diverse but united by a common dedication to the employer-based retirement plan system.

These comments are also submitted on behalf of all of its sister organizations, the ASPPA College of Pension Actuaries (ACOPA), the Council of Independent 401k Recordkeepers (CIKR), the National Association of Plan Advisors (NAPA), and the National Tax Sheltered Accounts Association (NTSAA). ACOPA represents enrolled actuaries who are credentialed members of ASPPA. CIKR is a national organization of independent 401(k) plan service providers. NAPA is an organization of financial advisors serving employers who sponsor retirement plans and participants in those plans. NTSAA's members are those retirement plan professionals focused particularly on the 403(b) and 457(b) plan marketplace.

The Incentives for Workplace Retirement Savings are Unique, Fair and Efficient

401(k) and similar plans primarily benefit middle class families. 80% of participants have adjusted gross income (AGI) of less than \$100,000. 43% of participants have an AGI of less than \$50,000 per year (see Chart 1).

Chart 1



Source: Internal Revenue Service (IRS) Statistics of Income Division (SOI)

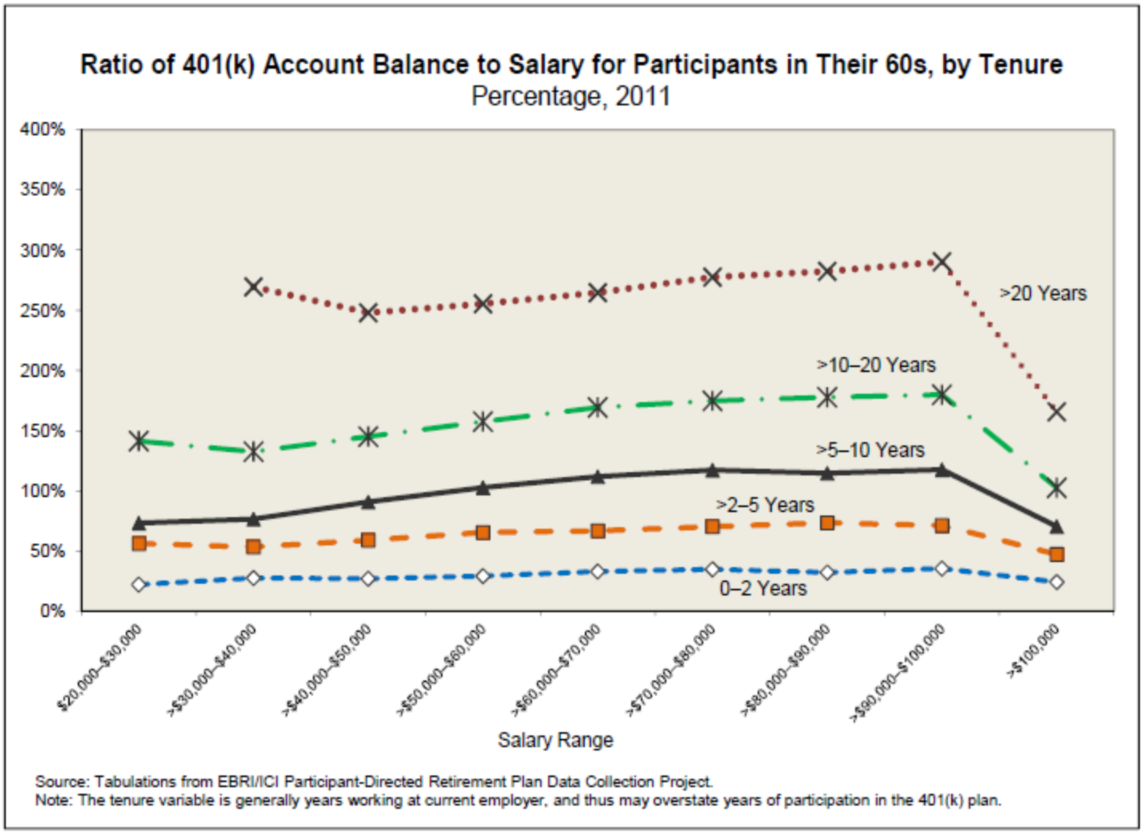
The tax incentives for retirement savings are unique in that the tax incentive is a deferral, not a permanent exclusion. That means every dollar that is excluded from income this year will be included in income in a future year. Unfortunately, that is not reflected in the cash basis measurement of the retirement savings "tax expenditure". In fact, one study shows the current methodology overstates the true present value cost by over 50%[1].

The tax incentive for *employer-sponsored* retirement plans is also unique in that nondiscrimination rules, as well as dollar limits on contributions, and a limit on the amount of compensation that can be included in determining benefits, assure the plans do not discriminate in favor of highly compensated employees. (Imagine having to prove that a majority of employees in your office are taking advantage of the mortgage interest deduction in a proportionate amount based on their compensation in order to claim a deduction for your own mortgage interest.)

The impact of the nondiscrimination rules is shown in Chart 2 below, which shows the ratio of account balance to salary for participants in their 60's with differing years of service with their current employer. As you can see, the ratio is fairly level across the salary range for workers with similar tenure until the ratio drops dramatically at the top income level, presumably due to the impact of the dollar limits on contributions and the limits on the amount of compensation that is allowed to be considered in determining benefits. This shows the current rules clearly produce a very fair result among all income classes.

[1] Judy Xanthopoulos and Mary Schmidt, *Retirement Savings and Tax Expenditure Estimates* (April 2012), available at http://www.asppa.org/Main-Menu/govtaffairs/RET2012.aspx

Chart 2

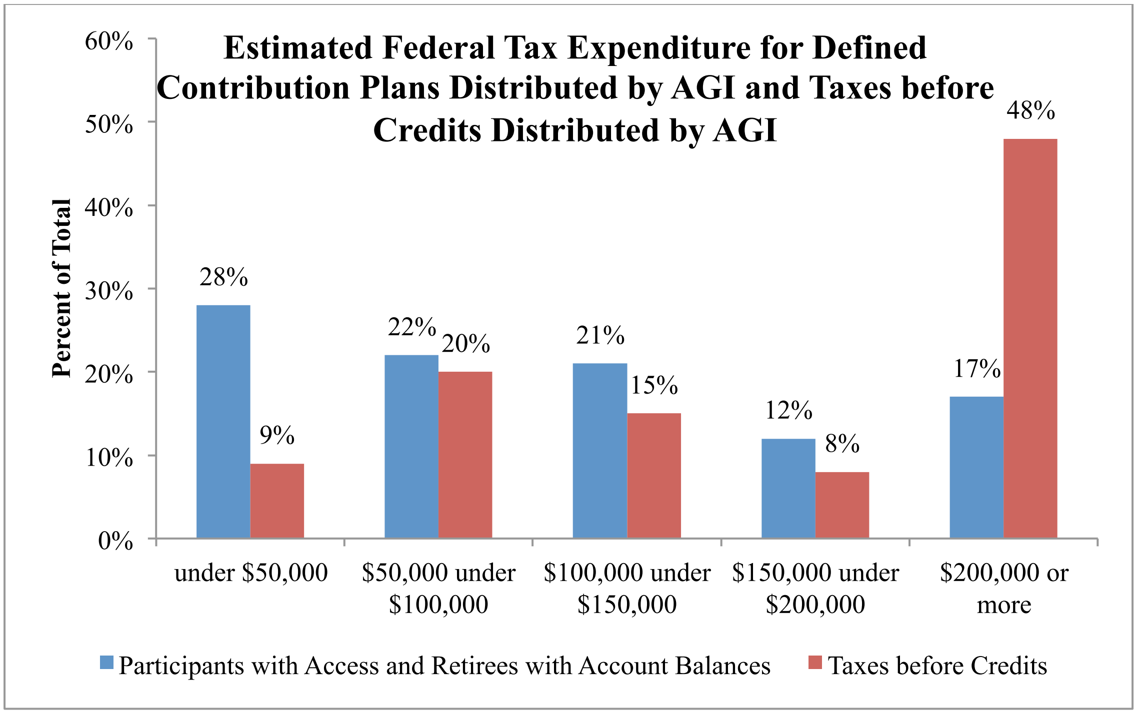


The current tax incentives are also efficient, turning a small business owner's current year deferral into meaningful contributions for rank and file employees. Both the owner and the other employees will be paying taxes later when the money is withdrawn, so the current year's "tax benefit" that is shared with employees through employer contributions is just temporary. This is a very efficient use of a tax incentive.

Unfortunately, the contributions made for non-owner employees are not properly reflected in a traditional analysis of how the benefit of this tax incentive is distributed. A tax benefit equal to the owner's marginal rate multiplied by the owner's contribution is counted as the owner's benefit, even though all or part of that tax savings is used to make contributions for other employees. Logic tells us the other employees' "benefit" is the full amount of the contribution, but the standard analysis would not include the full contribution - only the employee's marginal rate times the contribution. For example, if an employee receives a $3,000 contribution and has no income tax liability for the year, the standard analysis of the distribution of the incentive would show the employee with no benefit at all. A fair analysis of the distribution of the benefit of this tax incentive would reduce the business owner's tax savings by $3,000, and count the $3,000 contribution as a tax benefit for the employee.

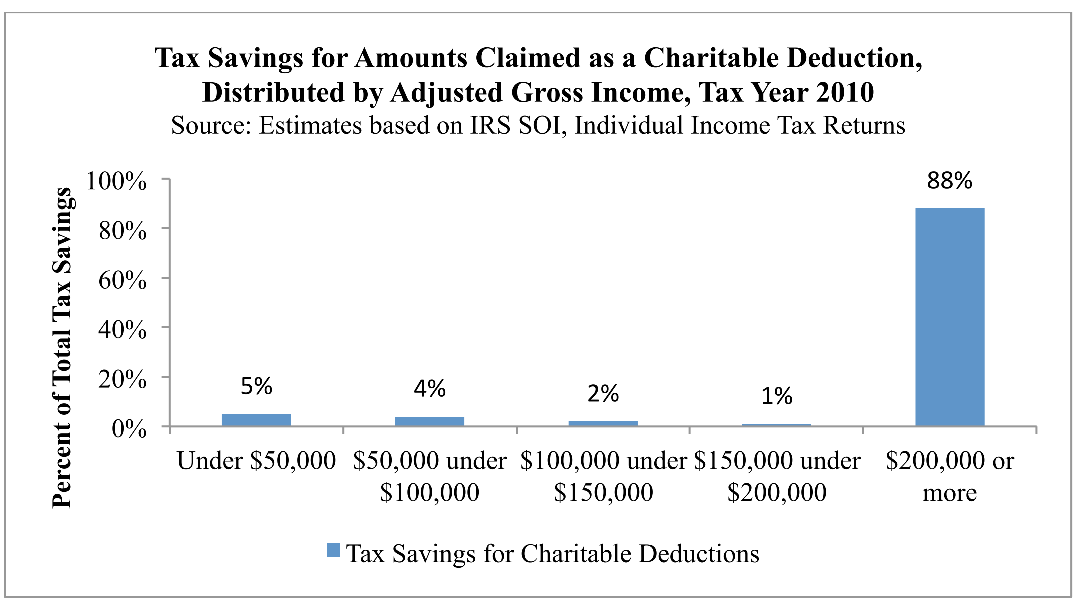
Even though an analysis defining the tax benefit as the marginal rate times deferral overstates the benefit for the business owner and understates it for employees benefitting from the business owner's contributions, the distribution of the tax incentive for defined contribution plans is more progressive than the current progressive tax code. As shown in Chart 3, 71% of the tax benefit goes to households earning less than $150,000. These same households pay only 44% of all income taxes.

Chart 3



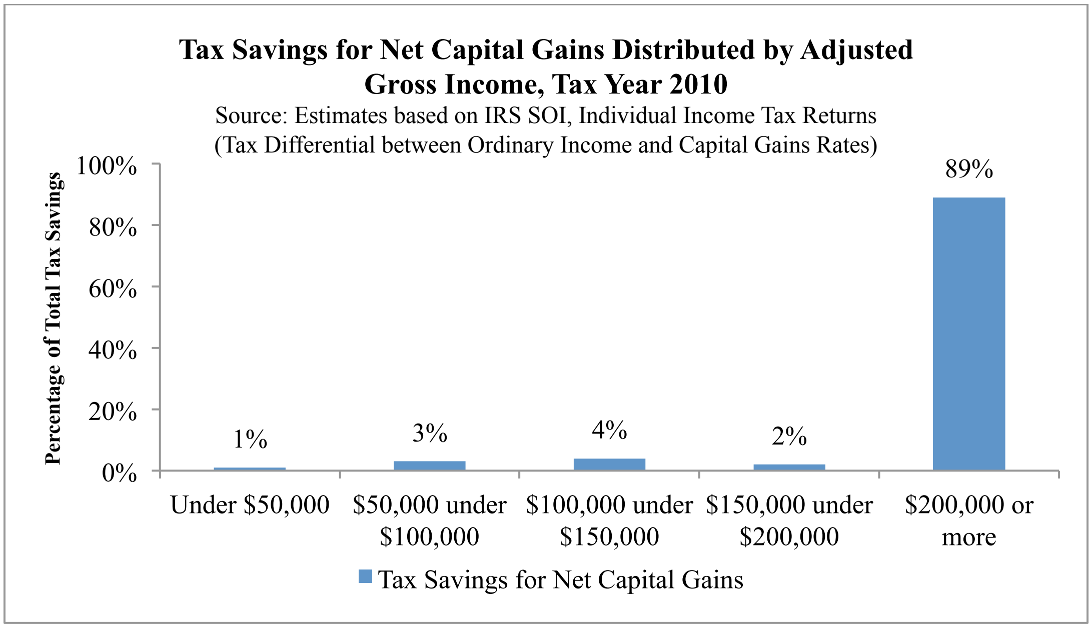
This compares very favorably with the distribution of the tax benefit for charitable contributions (chart 4), where only 11% percent of the benefit goes to families making less than $150,000 per year, and 88% goes to those with adjusted gross income of over $200,000 :

Chart 4



And for the distribution of the capital gains tax preference (chart 5), only 8 percent of the tax preference goes to families making less than $150,000 per year, and 89% goes to those with adjusted gross income of over $200,000 :

Chart 5



Proposals to cap the incentives for retirement savings – whether the $20,000/20% of pay illustrative option in Simpson Bowles, the $3 million cap in the President's 2014 budget, the 28% cap on the current year's tax benefit, or proposals to convert the current incentive into a uniform refundable credit, ignore the unique nature of the retirement savings incentive. First, it is a deferral, and revenue gained in the current window in large part represents revenue lost in a future period. Second, reducing the incentives for small business owners and decision makers makes the nondiscrimination rules for employer-sponsored retirement plans less effective. When the business owner no longer cares about the plan, his or her employees at best lose out on employer contributions, and at worst no longer have a plan at work. The short term gain in revenue from reducing the incentive becomes a long term loss for retirement savings of lower and middle income workers.

Employer Contributions as "Compensation"

Employer contributions to employer-based retirement plans are appropriately considered to be "compensation" because the contributions are provided for services performed by the plan participant. However, some economists and proponents of various modifications to the current system often state, or implicitly assume, that total compensation does not vary with whether or not employer-provided retirement benefits are provided – that compensation just moves from one bucket to the other.

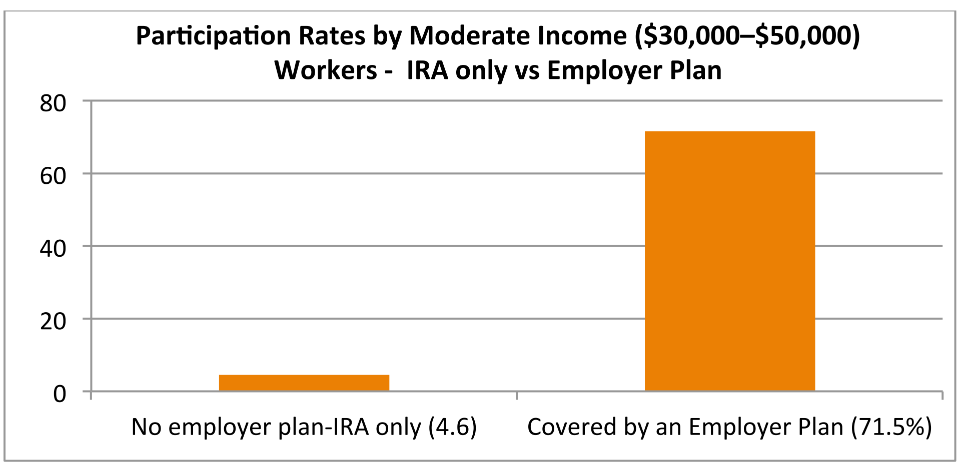
This concept may appear to be true in a collective bargaining context (although for individuals it is not – cents per hour for defined benefit plan costs rarely if ever reflect the value of accruing benefits), and it may be true for an economy at the macro level over an extended period of time, but it definitely is *not* true for individuals covered by an employer-sponsored plan. The worker whose matching contribution was cut during the economic down turn lost compensation while the match was suspended. When the match is restored, total compensation increased. Employees of a small business owner who decides to set up a retirement plan, and uses tax savings to pay for required contributions for employees, receive additional deferred compensation as a result of the combination of tax incentive and nondiscrimination rules. A recent study confirms there is in fact additional compensation per dollar of contribution, especially at lower income levels.[2] This is a strong argument for including the additional "compensation" amount, not just the contribution multiplied by the marginal rate, in an analysis of benefit of the existing tax incentives. If that were to be done, the benefit illustrated in Chart 3 would shift substantially toward the under $50,000 income group, many of whom are not currently paying income taxes but do receive benefits from the plan due to the nondiscrimination rules.

To Increase Retirement and Financial Security, Expand Workplace Savings

ASPPA shares the Committee's goals of simplicity, fairness, efficiency, and increased retirement and financial security. The current tax incentives for employer-based retirement programs have been very efficient at promoting retirement security for millions of working Americans. If increasing retirement and financial security is the goal, increasing the availability of workplace savings is clearly the way to get there:

- Over 70% of workers earning from $30,000-$50,000 will participate in a plan at work, but less than 5% will save through an IRA on their own.

Chart 6



Source: Employee Benefit Research Institute (2010) estimate using 2008 Panel of SIPP (Covered by an Employer Plan) and EBRI estimate (Not Covered by an Employer Plan-IRA only).

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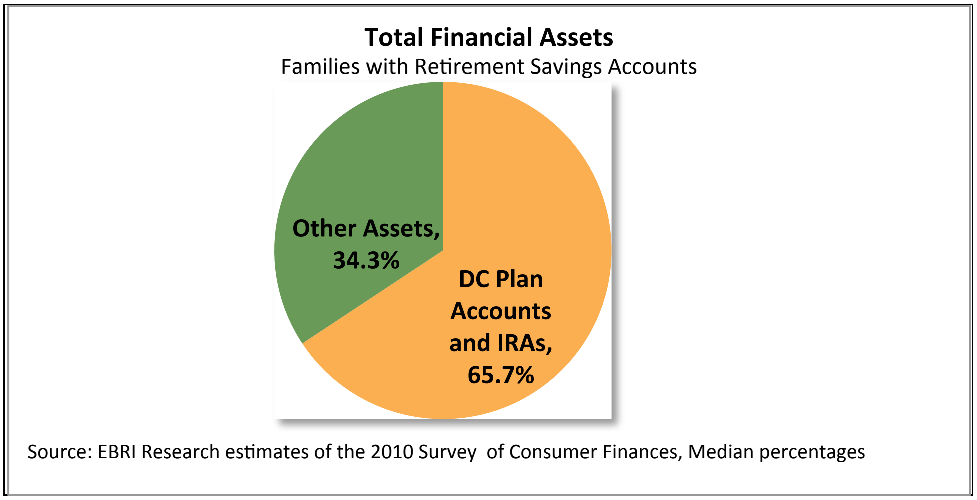
[2] Eric Toder and Karen Smith, "***Do Low-Income Workers Benefit From 401(K) Plans***?"(September 2011)*, available at* *http://crr.bc.edu/wp-content/uploads/2011/10/wp_2011-14_508-1.pdf*

- Among households making their first mutual fund purchase in 2005 or later, 74% bought the fund through an employer-sponsored retirement plan.
- For families with a retirement savings account, the median percentage of the families total financial assets held in these accounts is 65.7%, up from 59.6% in 2004.

Chart 7



Access to a retirement plan at work is the key to successfully preparing for retirement. Consequently, modifications to the current incentives considered by the Committee should be evaluated based on whether or not the changes will encourage more businesses to sponsor retirement plans for their employees.

Proposals for Expanding Coverage

Because it is clear that the most effective way to expand retirement savings is to make payroll deduction savings available to most workers, ASPPA has been supportive of "auto-IRA" proposals that would require employers that do not sponsor another type of plan to make automatic payroll deduction IRAs available to their employees. We believe Representative Neal's auto-IRA proposal strikes a good balance – excluding very small employers and new businesses from the obligation, and offering a modest credit to defray any start up expenses.

ASPPA opposes proposals to expand coverage that include mandatory employer contributions. Employers already contribute to Social Security, and small business can ill afford another required contribution. However, we do not believe asking an employer to withhold and forward payroll deduction savings is a burden. The modest credit in the Neal proposal will more than compensate for the initial effort, and frankly, there is no way to significantly expand coverage other than requiring employers to make payroll deduction retirement savings available.

The Committee should also consider requiring employers to permit permanent part-time workers to contribute to existing employer-sponsored plans. ERISA determined that employer-sponsored plans should not be required to cover employees that never work more than 1000 hours per year. As a result, many workers are denied access to their employer's 401(k) plan because they work less than 1000 hours per year. If the requirement to include permanent part-time employees were limited to elective deferrals, not matching or other employer contributions, the burden on employers would be modest, but many workers would immediately have access to a plan at work. (Top heavy rules that penalize small employers who might otherwise allow employees who work less than1000 hours per year to contribute to 401(k) plans through payroll deduction also should be changed.)

Other proposals, usually geared toward small business, might lead to a marginal improvement in coverage. Multiple employer plans (MEPs) could be a good alternative for some employers, but are not likely to make significant inroads on expanding coverage without an accompanying requirement for small business to offer retirement savings at work. Similarly, ASPPA supports providing a "deferral-only" safe harbor to encourage employers to offer workplace savings arrangements, or to continue their existing arrangements during economically challenging times. However, such a safe harbor should be available to both single and multiple-employer 401(k) plan arrangements to ensure parity in the marketplace.

ASPPA supports an improved Saver's Credit because it will help lower-paid workers be able to afford to save. If the credit were deposited to retirement savings accounts instead of refunded to the saver, it should also help supplement savings. However, an improved Saver's Credit would not in and of itself make a significant impact on coverage without increased availability of workplace savings.

Improving Adequacy

One of the challenges faced in analyzing the adequacy of retirement savings is that the usual method of measuring savings is based on average or median 401(k) accounts or IRA accounts. Since many individuals have retirement savings held in more than one account, these measurements understate total retirement savings. However, there is broad agreement that participants need to save more. There are three steps to improving adequacy:

- Make workplace savings more broadly available, such as by enacting an auto-IRA program. Improve the Saver's Credit to assist workers of low to moderate income with saving.

- Improve the default contribution rates. Instead of 3%, automatic enrollment should begin at 5% or 6%, and auto-escalation should be permitted to continue until elective deferrals reach 15%.

- Minimize leakage. The proposals included in the SEAL Act are a good start – allowing more time to rollover loan balances when employment is terminated, and eliminating the suspension of contributions after a hardship withdrawal. Another important step would be to permit, but not require, IRAs to accept rollovers of loan account balances.

Simplification

A discussion of simplification often leads to talk of "consolidation". Consolidating all types of defined contribution plans into one type of plan would not be simplification. It would disrupt savings, and force state and local governments and nonprofits to modify their retirement savings plans and procedures. Improved retirement security, and meaningful simplification, will be accomplished through thoughtful modifications to the existing structure, without wasting resources on cosmetic overhauls that produce more change than gain.

ASPPA looks forward to working with this work group and the Committee to simplify the rules and regulations surrounding retirement savings incentives, and to help American workers, especially small business owners and their employees, take advantage of workplace savings. A number of specific suggestions were outlined in our testimony for the April 17, 2012 Ways and Means Committee hearing on Tax Reform and Tax-Favored Accounts. Those suggestions and others are discussed in the attached "Proposals to Enhance the Private Retirement Plan System" developed by our Government Affairs Committee.

Thank you for this opportunity to participate in this important effort.

Sincerely,

Brian H. Graff, Esq., APM
ASPPA Executive Director/CEO

Judy A. Miller, MSPA
ASPPA Director of Retirement Policy