



Why Employer-Provided Retirement Plans Work

Americans Save at Work

401(k) and similar plans have been very successful in getting workers to save for retirement. A report recently issued by the Congressional Research Service showed that in 2007, over 75% of eligible workers whose employer sponsored a defined contribution plan participated in that plan.

This success extends to low to moderate income workers that are appropriately the focus of efforts to extend coverage. Data prepared by the Employee Benefit Research Institute (EBRI) updated to 2010 shows that over 70% of workers earning from \$30,000 to \$50,000 participated in employer-sponsored plans when a plan was available, whereas less than 5% of those without an employer plan contributed to an IRA.

Tax Incentives Are Effective

- Since we have a progressive tax system, an exclusion from income for individuals in higher tax brackets will always result in a higher rate of *tax* savings than for individuals in a lower tax bracket. However, the current tax incentives for retirement savings are actually more progressive than current tax rates. A comparison of the portion of estimated tax expenditures for *defined contribution* plans to federal income taxes paid shows that participants with income under \$50,000 per year pay only about 8% of income taxes, but receive about 30% of the defined contribution plan tax benefit. Those earning under \$100,000 pay about 26% of income taxes, but receive about 62% of the tax benefit from defined contribution retirement plan savings incentives.
- One reason the tax benefits for defined contribution plans are more heavily weighted toward lower income groups than the tax burden is that tax incentives for qualified retirement plans are coupled with coverage and nondiscrimination rules designed to assure contributions made to those plans do not discriminate in favor of highly compensated employees. This system of carrots (tax deferral) and sticks (nondiscrimination rules) has resulted in significant benefits for lower income workers.
- Many covered workers who pay no income tax, and so have no current tax benefit, still benefit from the current tax structure. For example, many small business owners make a “safe harbor” contribution of 3% of pay for all employees in the 401(k) plan so that the owner can make the maximum elective deferral into the plan (currently \$16,500 per year). While the owner gets an exclusion for the \$16,500 this year (and pays taxes on it in a later year), the worker gets 3% of pay deposited in the plan *in addition* to the worker’s personal contributions. This employer contribution is a very real benefit for the lower-paid worker.

Tax Deferral *Not* Tax Exemption

Retirement savings are not included in current income while savings is accumulating, but will be *subject to income tax* when workers retire and start withdrawing benefits. This makes the tax incentive for retirement savings different than other tax breaks, such as the exclusion for health coverage or the deduction for mortgage interest, which are *exemptions* – not *deferrals*. Since retirement contributions and earnings excluded from income this year will be taxable in a future year, tax-deferred retirement savings is not only an investment in a comfortable retirement for future retirees; it is savings toward future tax revenue.

Expanded Coverage Should be Next Focus

The message is clear – employer-based retirement savings works. The challenge is to extend work-place savings opportunities to more workers. ASPPA supports proposals, such as automatic IRA programs, that will expand coverage and encourage employers to “step up” to qualified retirement plans such as 401(k) plans. We look forward to working with Congress to improve retirement security for American workers.