

Retirement Savings & Tax Expenditure Estimates

Retirement Savings Are Deferrals Not Expenditures ***How Congressional Budget Calculations Could Kill 401(k) Plans***

- Each year the staffs of the Congressional Joint Committee on Taxation (JCT) and the Treasury Department's Office of Tax Analysis (OTA) publish estimates of Federal tax expenditures.¹ Policymakers subject tax expenditures to special scrutiny, particularly when they are exploring options to increase Federal revenues, so these tax expenditure estimates generate considerable attention with each publication. Policymakers use tax expenditure estimates to identify special tax benefits in the Federal income tax system and to identify possible sources of increased revenues, often targeting the largest tax expenditure as possible sources of revenue raising proposals. (page 4)
- The current method for calculating tax expenditure estimates for retirement savings contributions measures the *difference between current taxes deferred and revenues received from prior-year tax deferrals*. This cash-flow measure is appropriate for deductions or exclusions from income where the tax benefit occurs in the year of the deduction, but it overstates the value of retirement savings provisions in absolute terms, *and distorts the size of the retirement saving tax expenditures relative to other tax expenditures*. (page 9)
- Retirement tax expenditures differ from most other types of tax exemptions as they reflect the deferral of tax rather than avoidance of tax. Retirement savings provisions create two tax benefits—the primary benefit of tax-exempt earnings on retirement savings and a secondary benefit when taxpayers face lower marginal tax rates when taxpayers withdraw retirement savings than the tax rates they faced when contributing to retirement savings.
- To measure the correct value of the tax expenditure for retirement savings in a way that makes these provisions directly comparable to other tax expenditures, one should measure the present value of the tax benefits attributable to the current-year retirement saving contributions. This benefit for tax expenditure purposes is the sum of (1) the present value of the tax benefit on future earnings plus (2) the present value of the tax benefit of deferral on the current year contributions.
- Measuring retirement savings provisions on a present-value basis would help policymakers *understand the lifetime tax benefits occurring with respect to retirement savings contributions and would allow an “apples to apples” comparison with tax expenditures such as current deductions and credits* Measuring retirement savings provisions on a present-value basis for tax expenditure purposes would help policymakers to understand the lifetime tax benefits occurring with respect to “activity undertaken” in the current year. (Page 11)
- Tax expenditure estimates for retirement savings provisions should be prepared on a present-value basis. The one-year present-value tax expenditure estimates are 34 percent lower than the JCT one-year estimates and 54 percent lower than the Treasury one-year estimates. Similarly, the one-year present-value tax expenditure estimates are lower than the Treasury one-year present-value estimates by approximately 77 percent.² In addition, the present-value tax expenditure estimates of contributions made in the first five years are 55 percent lower than the JCT five-year estimates and 75 percent lower than the Treasury five-year estimates. (Tables 1 & 2 pg. 7-8; Table 4 page 13)

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The American Society of Pension Professionals & Actuaries (ASPPA) is a national organization of more than 7,500 retirement plan and benefits professionals that serves as the educator, voice, and advocate for the employer-based retirement system. ASPPA members are administrators, actuaries, advisors, attorneys, accountants, and other financial services professionals who provide consulting and administrative services for qualified retirement plans. www.asppa.org

¹ The JCT submits a report containing these estimates to the House Committees on Ways and Means and Budget and the Senate Committees on Finance and Budget. The OTA includes estimates of tax expenditures in the President's annual budget submission to the Congress.

² Present value estimates are very sensitive to assumptions about contribution and withdrawal patterns, discount rates, and assets earnings rates.