

THE ASPPA Journal

ASPPA's Quarterly Journal for Actuaries, Consultants, Administrators and Other Retirement Plan Professionals



WASHINGTON UPDATE

ASPPA Joint Report Highlights Need for Accurate Revenue Estimating for Retirement Savings Proposals

by Teresa T. Bloom, APM

On June 3, 2008, ASPPA, along with ten other organizations, issued a research report ("Report") highlighting the need for more accurate federal budget revenue estimates for proposed legislative changes affecting retirement savings.

The Report, *Revenue Estimates and Retirement Policy: The Need to Consider Present-Value Estimates of Changes in Tax Policy*, concludes that Congress needs to institute a more realistic scoring system when calculating proposed retirement savings legislative changes and their effects on the federal budget.

The Report is the result of a collaborative effort among 11 various organizations (listed at the end of the article) associated with retirement issues, investments and government plans. These organizations strongly support the concept that Congress should explore and institute a more accurate method of calculating legislative revenue estimates for legislative proposals that relate to retirement savings. Over a year and a half period, the organizations worked closely with the two authors of the report, Judy Xanthopoulos, Ph.D., and Mary M. Schmitt, Esq., to develop this



The current revenue scoring system makes the revenue impact of a particular piece of legislation a much more important consideration in the legislative process, often discouraging the enactment of revenue-losing measures that members of Congress would find overly expensive.

comprehensive and concise educational research report. Judy and Mary are both former staff with the Joint Committee on Taxation (the office responsible for producing revenue estimates to members of Congress), and consequently, have many years of experience on this topic.

Overview

The Report explains that for purposes of the federal budget, Congress currently provides revenue estimates for tax legislative proposals on a cash-flow basis using a ten-year budget window. This method works well for tax proposals that provide a current deduction with no subsequent offsetting revenue increase, such as a mortgage interest deduction. However, the use of a cash-flow basis with a ten-year window does not accurately measure the long-term revenue effects of retirement savings proposals—which provide a current-year deduction or exclusion for contributions to a retirement plan and subsequent income inclusion when people start withdrawing amounts for retirement. In effect, these rules result in a significant distortion of the economic costs of retirement savings tax deferrals, ignoring the fact that this money is eventually paid back into the system, and thus inhibiting the enactment of legislative proposals designed to increase retirement benefits for millions of American workers.

The Report concludes that preparing revenue estimates on a present-value approach would allow for a more accurate measurement of the revenue effects. Under a present-value analysis, the revenue estimate for any year would consider the tax exclusion for the contributions, any inside buildup, and the subsequent income exclusion that occurs when the retirement savings is withdrawn. This present-value method would contemplate the income tax collection on retirement savings would ultimately be paid back into the federal budget, which extends way beyond the current ten-year budget window. Accordingly, present-value estimates would more accurately reflect the long-term revenue costs of certain retirement savings proposals.¹

The calculation of federal credit programs, which involve direct federal loans or federal guarantees of private loans, is a precedent for using present-value estimates for federal budget score-keeping purposes. After approximately 20 years of debate about the appropriate way to account for cost of federal credit programs, Congress enacted a change in budgetary accounting that utilizes a present-value calculation so that the costs of these credit programs can be compared to the costs of other federal programs. We are hopeful that Congress will not take 20 years to enact a similar change for retirement savings proposals.

Background

Every piece of legislation reported out of a Congressional committee must provide a revenue score of its potential impact on government revenues and outlays (revenue scoring). Three federal offices prepare these estimates on a regular basis. The Joint Committee on Taxation (JCT) scores a bill's estimated change to federal revenue and distribution of tax burdens, while the Congressional Budget Office (CBO) scores a bill's spending projections and cost estimates. Treasury's Office of Tax Analysis (OTA) provides revenue estimates for the White House and also works with Congress through JCT and CBO. These estimates are very important to policy discussions regarding the impact of proposed tax changes, making it crucial that policymakers receive the most accurate and complete assessment of a tax bill's likely effects.

JCT provides official revenue estimates for all House and Senate legislation relating to income, estate and gift, excise and payroll taxes (including tax legislation affecting retirement policy). Pursuant to several legislative changes made during the 1970s and 1980s, revenue scoring on all legislation, with the one exception for credit reform proposals, is now confined to a cash-balance basis with a ten-year revenue window.²

JCT estimates can often make or break congressional support for legislation. These estimates are especially important when Congress considers tax legislation, especially if the tax-writing committees are required to adhere to congressionally-mandated budget targets.

Problems with the Ten-year Revenue Window

Confining revenue scoring calculations of retirement savings proposals to a ten-year revenue window ignores the long-term economic effects. This revenue period gives an inaccurate and misleading picture of a bill's budgetary impact, making it impossible for policymakers to adequately consider the full economic effect of certain retirement savings tax incentives that provide for capital accumulation. In particular, the ten-year revenue scoring window fails to take into account the long-term impact of people retiring and paying taxes on their retirement accounts, which results in long-term revenue losses being much lower than what is actually scored. This impact is a crucial element of retirement policy that must be addressed if workers are to continue to have available tax incentives that allow them to adequately save for their retirement.

The current revenue scoring system makes the revenue impact of a particular piece of legislation a much more important consideration

in the legislative process, often discouraging the enactment of revenue-losing measures that members of Congress would find overly expensive. Therefore, many revenue-losing measures (such as a retirement savings proposal) must often be paired with revenue-raising measures. In addition, members of Congress must generally have multiple proposals “scored” for revenue effects in order to find a vehicle that will be acceptable to the relevant congressional committees.

In addition to skewed results, the ten-year horizon creates other problems. By assuming all temporary tax provisions expire as scheduled, and by assuming that obvious problems—such as the alternative minimum tax—will not be addressed, the US budget creates huge incentives for budget gimmicks. For example, a proposal to delay the effective date of a tax provision until year 11 would have significant long-term costs, but cost virtually nothing in the ten-year budget window. Likewise, causing certain tax provisions to expire within a certain time period also skews their long-term budgetary impact.

Present-value Analysis Compared to Cash-flow Analysis

A present-value approach to preparing revenue estimates for retirement savings proposals will allow for a comparison of the overall revenue costs. In particular, a present-value analysis of an increased tax deferral for retirement savings will incorporate the current-year tax deduction or exclusion, the present value of the earnings attributable to the present-year contribution and the present-value of the subsequent income inclusion when people begin to withdraw from their accounts upon retirement. On the other hand, a cash-flow analysis will show significant revenue losses from many retirement savings proposals providing for an increased tax deferral, as the ten-year revenue window will fail to capture the long-term offsets to the revenue losses when people retire and pay back taxes back into the federal budget.

The best way to understand the difference between the two methodologies is to view it in an example. Table 1 in the Report shows the difference in revenue effects of cash-flow estimates and present-value estimates. Under the example, an individual makes a \$1,000 contribution to a deductible retirement plan each year for ten years and then withdraws the account balance ratably during the subsequent ten years. As apparent from the example, the net revenue impact on the federal budget is significantly lower using a present-value analysis versus a cash-flow analysis.

A present-value approach to preparing revenue estimates for retirement savings proposals will allow for a comparison of the overall revenue costs.

Year	Contribution	Cumulative Account Balance	Cash-flow Revenue Effect	Present-value Revenue Effect
1	\$ 1,000	\$ 1,000	<\$ 250>	<\$ 174>
2	\$ 1,000	\$ 2,080	<\$ 270>	<\$ 167>
3	\$ 1,000	\$ 3,246	<\$ 292>	<\$ 161>
4	\$ 1,000	\$ 4,506	<\$ 315>	<\$ 155>
5	\$ 1,000	\$ 5,867	<\$ 340>	<\$ 149>
6	\$ 1,000	\$ 7,336	<\$ 367>	<\$ 143>
7	\$ 1,000	\$ 8,923	<\$ 397>	<\$ 138>
8	\$ 1,000	\$ 10,637	<\$ 428>	<\$ 132>
9	\$ 1,000	\$ 12,488	<\$ 463>	<\$ 127>
10	\$ 1,000	\$ 14,487	<\$ 500>	<\$ 122>
Total Years 1-10			<\$3,622>	<\$1,469>

Source: Revenue Estimates and Retirement Policy Research Paper, April 2008

Precedent for Present-value Scoring—Credit Reform and the President’s Budget

Congress has previously addressed the difference between the two methodologies in calculating the costs for federal credit programs, which involves direct federal loans or federal guarantees of private loans. Under prior law, a direct loan was accounted for in the budget as a cash outlay the year the loan was disbursed. However, a loan guarantee where the federal government promised to repay a loan made by a private lender had no impact on the federal budget until a default on the loan occurred and the federal government made cash payments associated with the defaulted loan. The difference in treatment created a significant bias in favor of loan guarantees rather than direct loans, which showed no revenue impact, even though the long-term cost of a direct loan could be much lower.

This experience demonstrates that a pure cash-flow analysis can provide a significant distortion of the overall costs to the federal government. Once Congress made the decision to use a present-value analysis of all the costs attributable to the time credit is extended, policymakers were able to accurately compare the costs of a credit program to other competing credit programs, including loan guarantee programs. We ask that Congress analyze retirement savings proposals in the same way.

The President's budget provides further verification that present-value estimates are more accurate when presenting a list of tax expenditure estimates.³ Under the Congressional Budget Act, JCT is separately required to produce an annual list of tax expenditure estimates.

In particular, the President's annual budget submission provides a cash-value basis of tax expenditures, but *also* provides present-value estimates for certain tax expenditures to show the "true economic cost" of these tax provisions. Interestingly, JCT does not prepare any comparable analysis of their tax expenditures on a present-value basis.

Next Steps

This comprehensive educational research was designed to shed light on the significant threat that any future retirement savings proposals—designed to favor increased retirement savings—would face from the current revenue scoring methodology. The next step is to educate the key members of the House and Senate tax-writing committees (the House Ways and Means Committee and the Senate Finance Committee, respectively). The sponsors of the Report are currently working to schedule both House and Senate Hill briefings later this fall. We will also be requesting individual meetings with key tax-writing committee staff, as well as staff from the JCT.

The sponsors are hopeful that our education efforts will increase the understanding of key policymakers on the resulting economic distortions that occur when scoring retirement savings proposals when the long-term effects on the federal budget are not taken into account. As a consequence, we are optimistic that Congress will ultimately take steps to correct these inaccuracies in revenue estimating procedures, similarly to what they did for federal credit programs. ↗



Judy Xanthopoulos, Ph.D., and Mary M. Schmitt, Esq., prepared the Report. To read and download a printable copy of the publication, visit the ASPPA Web site at www.asppa.org/resources/wash-update.htm.



Teresa T. Bloom, Esq., APM, Chief of Government Affairs, joined ASPPA in September 2004. Prior to working at ASPPA, Teresa was a pension law specialist in the Office of Policy and Research and the Office of Regulations and Interpretations at the DOL's Employee Benefits Security Administration, where she worked on a variety of policy and technical issues relating to Title I of ERISA. Teresa currently serves as a Government Affairs Committee Co-chair. (tbloom@asppa.org)



- 1 The Report notes that when considering potential changes to revenue estimating for retirement plans, those changes should be neutral in relation to defined benefit and defined contribution revenue estimates.
- 2 The Congressional Budget and Impoundment Control Act of 1974, the Economic Recovery Tax Act of 1981 and the Balance Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings).
- 3 We note that a tax expenditure estimate is not the same as a revenue estimate as it does not account for the behavioral effect that might occur if a provision was repealed, whereas a revenue estimate does take into account the behavioral effects.

Sponsors

The following organizations associated with retirement issues, investments and government plans joined together to sponsor the research project:

- The Actuarial Foundation
- American Society of Pension Professionals & Actuaries
- Profit Sharing/401k Council of America
- US Chamber of Commerce
- The ESOP Foundation
- Committee on Investment of Employee Benefit Assets
- National Conference on Public Employee Retirement Systems
- National Association of State Retirement Administrators
- American Benefits Council
- ERISA Industry Committee
- National Association of Manufacturers