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In hunt for revenue, Washington eyes 401(k) tax breaks

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By News Reports

February 27, 2013

Pressure is growing to change incentives for retirement savings as U.S. lawmakers look for revenue, and top earners may pay the price.

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The budget challenges confronting the federal government are leading to scrutiny of tax-advantaged savings accounts such as 401(k)s because they're among the costliest tax breaks. A Brookings Institution report released Tuesday adds to research that recommends curtailing the benefits for top earners to boost U.S. coffers.

"We really need to think hard about whether the dollars we are spending are effective at achieving the goals," says Karen Dynan, co-director of the economic studies program at Washington-based Brookings and author of the report. "Our existing programs are falling short."

The shift from pension plans, which typically guarantee income for life, to tax-deferred 401(k)s has put more responsibility on savers to ensure they don't run out of money in retirement. As the accounts have grown — Americans held \$3.5 trillion in 401(k)s as of September 2012 — they've become a target in deficit-reduction talks because contributions usually are invested and compound on a pretax basis.

The benefits reward higher earners who would save anyway while not providing enough incentive for low and middle-income earners, according to Dynan.

The American Society of Pension Professionals & Actuaries immediately issued a statement objecting to the Brookings report, which it said "would more accurately be described as double taxation" for those affected.

"You won't expand coverage by penalizing small business owners for offering a 401(k) plan," writes ASPPA executive director and CEO Brian H. Graff. "If this proposal went through, a small-business owner in the 39.6% bracket would pay an 11.6% tax on contributions made to the 401(k) plan today, and pay tax again at the full rate when they retire."

The benefit for 401(k)-type plans is the U.S. government's third-largest tax expenditure, behind only the mortgage interest deduction and exclusion of employer contributions for medical insurance. It is estimated to cost about \$429 billion in forgone revenue from 2013 through 2017, according to the administration's latest budget proposal. IRAs will cost about \$100 billion over the five-year period.

Sen. Tom Harkin (D-Iowa), chairman of the Senate Health, Education, Labor and Pensions Committee, plans to introduce legislation this year to require businesses that don't offer a pension or 401(k) plan with a company match to automatically enroll workers in a so-called USA Retirement Fund.

About 68% of workers had access to retirement benefits as of March 2012, according to the Bureau of Labor Statistics.

"The dream of a secure retirement is getting fainter and fainter," Harkin said Feb. 12 in a speech at the Center for American Progress in Washington, D.C. "Savings rates are low and there's no simple way for people to convert their savings into a stream of retirement income they can't outlive."

7 Comments

Posted by: LaborGuyatAECI | February 27, 2013 2:12 PM

Jim Lawson - I don't think I understand your comment. The tax law affecting DB plans back then was a law that mandated minimum funding levels. In other words, it became a requirement to actually have money in the pension fund. Too many funds were underfunded and people were losing their retirements. The law did also allow companies to take money from their funds and use the money for other purposes, but only if the fund was fully funded to begin with. The thing that has killed pension plans is not because the pension rules changed, they were killed because it is too expensive to keep them funded.

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Posted by: Jim Lawson | February 27, 2013 1:43 PM

They are correct that these plans do little to help middle and low income workers. It is definitely time to reverse the Reagan era tax law that killed the traditional pension plan, so that workers may once again have meaningful pensions.

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Posted by: LaborGuyatAECI | February 27, 2013 1:41 PM

msmox - I think I sort of understand your comment, and I agree with much of what you said, however, the current system is set up so that the government will get its money eventually. They get to tax it when people withdraw it. By changing the rules so that they tax it now they will exacerbate the problem of people not planning for retirement. Investment in the markets will shrink significantly, the economy will suffer tremendously, and we will in turn create many more "charity cases". Taxing this retirement incentive is a VERY bad idea.

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Posted by: LaborGuyatAECI | February 27, 2013 1:30 PM

This is a bad idea. The reason 401(k) works is because of the tax protection. Dynan is wrong when she says the tax breaks only help the wealthy. They help every working American who is offered the benefit. Without the tax breaks the plans will die and go away. Then we will have nothing. Social Security is under-funded and going away, companies have all but eliminated DB pension plans, and now there will be no 401(k). Besides losing the retirement benefits, this will crush the economy. People will stop putting hundreds of millions of dollars a year in the markets that are now currently invested because of the existence of 401(k) plans.

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Posted by: jorgan10s | February 27, 2013 1:28 PM

With the growing population moving towards retirement the federal government will see a tremendous increase in tax revenue as dollars are pulled out of these accounts. If the tax deduction disappears is that the unintended consequence would be less dollars put away into retirement accounts.

Those dollars would be taxed as regular income, however it would be tax revenue for today at the expense of future tax income when these individuals retire.

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Posted by: SF23 | February 27, 2013 1:25 PM

When will we be allowed to pay tax on the air we breathe? The government cannot tax us into prosperity.

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Posted by: msmox | February 27, 2013 1:23 PM

How about just making sure everyone is responsible for their own retirement? If you know from the time you are a child that you must save money, you will do it or become a charity case subject to the rules of the charity. It is not the job of government to make sure you have a great life and lots of money. Their job is to ensure you have the opportunity under the protection of law. The Feds refuse to balance their budget, make necessary cuts to programs, eliminate duplicate programs, etc. yet they think they can run your financial life-oh PUH-LEEZ! The more government tries to fix a problem the worse it becomes.

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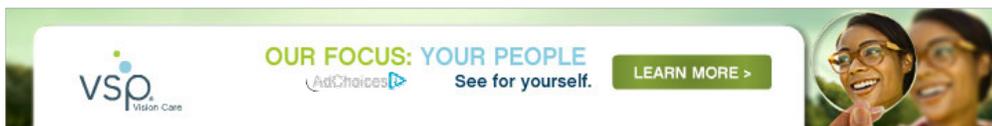
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