

Pension and Saving Incentives By the Bushel-Load

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Document date: July 29, 1998
Released online: July 29, 1998

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Over the past three or four decades, Congress and the executive branch have adopted what might be called the bushel-load method to private pension and saving policy. Not a year has gone by in recent memory when they have not fretted over the need to increase saving, in general, or private retirement assets, in particular. The result has been the adoption of an extraordinary array of incentives for individuals and for firms to save for themselves or their employees even while net private saving generally declined and the vast majority of individuals lack significant saving at time of retirement.

Each new Congress has wanted to claim that it did something different from the previous Congresses. To claim some uniqueness, there was an additional temptation to do more than merely modify slightly some existing program, say, by increasing the maximum amount of money eligible for a deduction. Not only were new programs added as a consequence, but with each of them Congress thought up a new and different set of eligibility conditions, penalties for early withdrawal, dollar caps, discrimination rules as applied to employers, deductibility from social security tax, and on and on. Contradictions and inconsistencies multiply upon each other, such as whether the incentives are to apply to retirement only or also to education, health care, housing, and other services.

To show just how messy and complicated this world has become, Harry Conaway, Andrea Barnett, and I put together the following table -- which, even for all its elaborate detail, still simplifies many sources of complexity in order to provide some summary of what has happened in this saving and retirement universe. Nonetheless, [the table](#) speaks for itself. If Congress really wants to simplify laws applying to pensions and saving -- and garner increased returns to savers due to lower administrative cost -- then it must work to reduce the multiple layers of rules and regulations surrounding the offering of so many options.

**Private Pension Plans
Plan Characteristics**

	Plan Characteristics	Individual Accounts				Small Business Plans		
		Non-Qualified Deferred Annuity	Deductible IRA	Traditional nondeductible IRA	Roth IRA	SEP-IRA	Salary Reduction SEP	SIMPLE IRA
	Eligibility	All taxpayers	Taxpayers not in an employer plan, unless earning less than \$35,000 for individuals and \$50,000 for couples (1)	All taxpayers	Taxpayers with earnings less than \$110,000 for individuals and \$180,000 for couples (2)	Employees of all employers	Employees of taxable employers with 25 or fewer employees (3)	Employees of employers without another plan and with under 100 employees
Contribution Limits	Overall Dollar Limit	None	\$2,000 reduced by other IRAs	\$2,000 reduced by other IRAs	\$2,000+reduced by other IRAs (4)	\$30,000 (5)	\$30,000 (5)	NA
	Overall Maximum % of Pay	NA	100%	100%	100%	15%	15%	NA
	Employer Limits	None	NA	NA	NA	Lesser of \$30,000 or 15%	Lesser of \$30,000 or 15%	Matching contribution up to 3% of pay or fixed 2%
	Employee Limits	None	\$2,000	\$2,000 (after-tax)	\$2,000 (after-tax)	NA	\$9,500	\$6,000
	Aggregate Employer Deduction Limits	NA	NA	NA	NA	15% of aggregate compensation for all qualified plans	15% of aggregate compensation for all qualified plans	None
	Exclusion from SS Tax	No	No	No	No	Yes (12)	No for employee contribution	
Distributions	Subject to Early Withdrawal Penalty Tax(6)	No	Yes	Yes	Yes	Yes	Yes	Yes

	Penalty Tax Exceptions (7)	None	Medical expense, 1st home purchase, higher education expense, and health insurance payments for unemployed	Same exceptions as IRA	First time homebuyer (up to \$10,000 limit)	Same exceptions as IRA	Same exceptions as IRA	Penalty is increased to 25% if funds are withdrawn in 1st 2 years
	Conditions for In-service Withdrawal	No Additional Limitations	No Additional Limitations	No Additional Limitations	5-year waiting period	No additional limitations	No additional limitations	No additional limitations
	Loans Available	No	No	No	No	No	No	No
Nondiscrimination	Nondiscrimination rules (8)	None	None	None	None	Uniform percent of pay to all eligible employees	HCEs 125%(9)	Required matching up to 3% or 2% fixed contribution
	Salary Cap for Nondiscrimination testing	NA	NA	NA	NA	\$160,000	\$160,000	\$160,000
	Integrated with Social Security	NA	NA	NA	NA	Yes	No	No
Complicating Factors	Spousal Protection	None	None	None	None	None	None	None
	Vesting	Immediate	Immediate	Immediate	Immediate	Immediate	Immediate	Immediate
	Special Restrictions and Benefits	None	None	None	Based after-tax contributions	Employer does not have to contribute every year	No new plan may be established after 12/31/96	Employees may direct investment after 2 year waiting period

Note: All dollar values are indexed, and the given figures are as of 1997. Sources: Harry Conaway, WILLIAM M. MERCER, and C. Eugene Steuerle and Andrea Barnett, THE URBAN INSTITUTE, 1997. For footnotes see end of second table.

Private Pension Plans Plan Characteristics

		Defined Contribution Plans						Defined Benefit
	Plan Characteristics	Eligible 457 Plans	403(b)	401(k)	Profit Sharing	Employee Stock Ownership Plan	Money Purchase	Defined Benefit
	Eligibility	Employees of state and local government and tax-exempt organizations	Employees of tax- exempt organizations and public schools	All employees except state and local governments	Employees of any employer	Employees of taxable employers	Employees of any employer	Employees of any employer
Contribution Limits	Overall Dollar Limit	\$7500 (\$15,000 limit for last 3 years before retirement as catch-up allowance) Reduced by contributions to 403(b), SEP and 401(k) plans	\$30,000 (5)	\$30,000 (5)	\$30,000 (5)	\$30,000 (increased to \$60,000 if not more than 1/3 of employer contributions are allocated to HCEs)	\$30,000 (5)	Benefit limit= \$125,000
	Overall Maximum % of Pay	33.33%	25%	25%	25%	25%	25%	Benefit limit = 100% *except for state and local government
	Employer Limits	Lesser of \$7500 or 33 1/3% reduced by employee contribution	Exclusion allowance = 20% of pay times years of service reduced by employer annuity purchase	Lesser of \$30,000 or 25% reduced by employee contribution	Lesser of \$30,000 or 25% reduced by employee contribution	Lesser of \$30,000 or 25% reduced by employee contribution	Lesser of \$30,000 or 25% reduced by employee contribution	Normal cost for the year plus amortization over 10 years or 150% of current liability (10)

	Employee Limits	Lesser of \$7500 or 33 1/3%/ reduced by employer contribution	\$9500 (plus catch-up allowance if more than 15 years of service)	\$9,500	Only after-tax if not 401(k) plan - subject to overall limits	Only after-tax if not 401(k) plan - subject to overall limits	Not typically allowed	Subject to DC limits
	Aggregate Employer Deduction Limits	NA	NA	15% of taxable compensation	15% of taxable compensation	25% of taxable compensation for leveraged (15% - nonleveraged) plus deductions on ESOP dividends	Based on funding requirement	Based on funding requirement (11)
	Exclusion from SS Tax	Yes	No	No for employee contributions	Yes (12)	Yes (12)	Yes (12)	Yes
Distributions	Subject to Early Withdrawal Penalty Tax(6)	No	Yes	Yes	Yes	Yes	Yes	Yes
	Penalty Tax Exceptions (7)	None	None	None	None	None	None	None
	Conditions for In-Service Withdrawl	Unforeseeable emergency (14)	Financial Hardship (13)	Financial Hardship (13)	Minimum 2 year holding period for each contribution	Depends on set-up	Not allowed	Not Allowed
	Loans Available	Yes	Yes	Yes	Yes	None	No	No
Nondiscrimination	Nondiscrimination rules (8)	Can favor HCEs	ACP for matching funds, general test for nonelective deferrals, and uniform availability for elective deferrals. (16)	\$160,000	General Rule (15)	General Rule (15)	General Rule (15)	General Rule (15)
	Salary Cap for Nondiscrimination testing	NA	\$160,000	\$160,000	\$160,000	\$160,000	\$160,000	\$160,000
	Integrated with Social Security	NA	Yes	No	Yes	Yes	No	Yes
Complicating Factors	Spousal Protection	None	None	Death benefit (17)	Death benefit (17)	Death benefit (17)	Survival Annuity, Consent and Death Benefit	Survival Annuity, Consent and Death Benefit
	Vesting	Deferred	Immediate	Employer Contributions are deferred, and elective contributions are vested immediately	Deferred	Deferred	Deferred	Deferred
	Special Restrictions and Benefits	Unfunded plan. All assets part of employer's general assets and subject to creditors until distribution. Must be held in trust after 1/1/99 for public sector. May also be a DB plan.	May also be structured as a DB plan	SIMPLE 401(k) follow same regulations except they follow SIMPLE IRA rules for eligibility, employer and employee contribution limits, and vesting	None	* 100% Employer Securities Allowed. * Required opportunity for divesture at 55. * Put option and voting rights	Minimum funding required in full each year	* Pension Benefit Guaranty Corporation premium of \$19 per employee. *Special rules for Multi-employer plans

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This table does not include education IRAs because they are not properly viewed as retirement vehicles.

1)IRA phase-out schedule: currently \$25,000 to \$35,000 for individuals and \$40,000 to \$50,000 for married couples filing together. These phase-outs are scheduled to increase to \$50,000 to \$60,000 for individuals and \$80,000 to \$100,000 for joint filers by 2007 with incremental increases starting in 1998. There are also special limits for non-working spouses.

2)The phase-out schedule for Roth IRAs is \$95,000-110,000 for individuals and \$150,000-160,000 for married couples filing jointly.

3)Public sector employees and employees of tax-exempt organizations are not allowed to make elective deferrals into a SEP.

4)Deposit limits for contributions to Roth IRAs actually have a greater value than traditional IRAs because it is an after tax contribution.

Other Publications by the Authors

- [C. Eugene Steuerle](#)

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