

# Key Elements of the U.S. Tax System

TAXES AND RETIREMENT SAVINGS

## What are defined contribution retirement plans?

**Q. What are defined contribution retirement plans?**

**A. Think savings accounts with tax benefits—and a lot of rules.**

Tax-deferred defined contribution plans include the familiar 401(k) plans, similar 403(b) plans for nonprofit employees, 457(b) plans for state and local government employees, and the federal government's Thrift Savings Plan.

### PARTICIPATION

Less than 40 percent of workers contributed to a defined-contribution plan in 2016. Workers' participation in defined contribution plans generally increases with age and income. About three-quarters of workers earning \$100,000 or more made contributions (table 1).

### CONTRIBUTIONS AND WITHDRAWALS

Contributions to defined contribution plans are tax deferred, meaning that neither the employer nor the employee pays tax on initial contributions or accumulating plan earnings. However, employees pay tax when they withdraw funds. The major exception is Roth-type defined-contribution plans. With Roth plans, account holders pay taxes when contributions are made rather than when contributions are withdrawn.

Early withdrawals (before age 59½) from defined-contribution plans incur penalties (in addition to the regular tax on withdrawals), except in limited circumstances such as disability or very large medical expenses.

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TABLE 1

Participation in Defined Contribution  
(401(k) type) Plans  
Tax year 2016



	Number of taxpayers with elective contributions	Share of wage-income taxpayers with elective contributions
All	55,897,000	39%
<b>Wage income</b>		
Under \$20,000	4,874,000	11%
\$20,000–\$50,000	21,274,000	40%
\$50,000–\$100,000	20,070,000	63%
\$100,000–\$200,000	7,374,000	75%
Above \$200,000	2,306,000	81%
<b>Age</b>		
Under 35	15,585,000	29%
35–45	12,743,000	45%
45–55	13,735,000	48%
55–75	13,646,000	44%
Above 75	188,000	14%
<b>Filer type</b>		
Joint returns	32,251,000	48%
One wage earner	8,005,000	43%
Two wage earners	24,246,000	49%
Nonjoint returns	23,646,000	31%

**Source:** Internal Revenue Service, *SOI Tax Stats—Individual Information Return Form W2 Statistics: Tables 3.A., 3.C, and 3.D, Tax Year 2016, September 2019.*

## BALANCES

According to data from investment company Vanguard, the average defined contribution account balance was just over \$92,000 in 2018, while the median balance was just over \$22,000. The median balance was higher by income, age (up to age 65), and job tenure. The median account balance for those age 55-65 was just under \$62,000 in 2018. The median account balance was about \$27,000 for men and just under \$18,000 for women (table 2).

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TABLE 2

### Defined Contribution Account Balances for Vanguard Plans 2018



	Average	Median
All	\$92,148	\$22,217
<b>Income</b>		
Under \$15,000	\$15,843	\$1,376
\$15,000–\$30,000	\$10,283	\$2,678
\$30,000–\$50,000	\$22,679	\$6,909
\$50,000–\$75,000	\$54,588	\$21,359
\$75,000–\$100,000	\$92,596	\$41,507
\$100,000–\$150,000	\$137,058	\$61,635
Above \$150,000	\$193,130	\$76,448
Terminated	\$98,130	\$25,197
<b>Age</b>		
Under 25	\$4,236	\$1,427
25–35	\$21,970	\$8,126
35–45	\$61,238	\$22,123
45–55	\$115,497	\$40,243
55–65	\$171,623	\$61,739
Above 65	\$192,877	\$58,035
<b>Gender</b>		
Male	\$106,796	\$27,030
Female	\$72,451	\$17,620
<b>Job tenure (years)</b>		
Under 1	\$10,696	\$2,236
2–3	\$25,050	\$9,638
4–6	\$45,931	\$21,823
7–9	\$74,722	\$38,215
Above 10	\$188,078	\$90,109

**Source:** The Vanguard Group, Inc. *How America Saves 2019*. Figure 52. Account balances by participant demographics, 2018. June 2019.

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### RISKS

Defined benefit plans offer employees a contractually assured annuity at retirement. In contrast, under a defined contribution plan, an employee owns an account in which balances depend on the size of past contributions and on the investment returns those contributions accumulate. The employee bears the risk of underperforming assets and the possibility of outliving the income generated. But employees can manage these risks at retirement by using the assets in their plans to purchase annuities from insurance companies.

*Updated May 2020*

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### Data Sources

Internal Revenue Service. *SOI Tax Stats—Individual Information Return Form W-2 Statistics*. Tax Year 2016. Tables 3A, 3C, and 3D.

The Vanguard Group, Inc. *How America Saves 2019*. Figure 52. Account balances by participant demographics, 2018. June 2019.

### Further Reading

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