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Estimates of a Proposal to Establish Guaranteed Retirement Accounts, Financed by Reduced Limits on Current Law Contributions to Defined Contribution Retirement Saving Plans

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The Tax Policy Center (TPC) prepared revenue and distributional estimates of a proposal to replace the current tax benefits for defined contribution (DC) qualified retirement plans with a new Guaranteed Retirement Account (GRA). TPC estimates that the proposal would reduce federal income and payroll tax receipts by \$292 billion between fiscal years 2018 and 2027 and increase the number of tax units either making employee contributions or receiving employer contributions on their behalf in 2018.

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OVERVIEW

At the request of Teresa Ghilarducci of the New School for Social Research, the Tax Policy Center (TPC) prepared revenue and distributional estimates of a proposal (the GRA proposal) to replace the current tax benefits for defined contribution (DC) qualified retirement plans with a new Guaranteed Retirement Account (GRA). Under the GRA proposal, all employers and employees would be required to contribute 1.5 percent of earnings to a new Guaranteed Retirement Account, up to a maximum of \$3,750 (\$7,500 for the combined worker-employer) per year. Employees would receive a 100 percent credit for their first \$600 of contributions. Amounts contributed by employees in excess of \$600 would be deductible up to the maximum of contribution of \$3,750 and earnings would accrue tax-free within the accounts. Withdrawals from the accounts at retirement would be taxable as ordinary income.

DETAILS OF PROPOSAL AND ESTIMATING ASSUMPTIONS

1. Every worker and their employer will each contribute 1.5 percent of every paycheck to the worker's portable retirement saving account – called the Guaranteed Retirement Account (“GRA”), up to a maximum of \$3,750 each (or \$7,500 total) per year. Workers will maintain ownership of the GRA over their career, automatically contributing until they retire, which TPC assumed will occur at age 65 for workers younger than 65. For workers 65 and over, TPC assumed they would retire after one additional year of employment.
2. For low-income workers, the employer contribution will be a minimum of 15 cents per hour, even if that is more than 1.5 percent of wages, up to \$300. To model this proposal using data available on the TPC micro-simulation model, TPC assumed the proposal required employers to contribute 1.5 percent of earnings (as stated in 1. above) unless earnings are less than \$20,000, in which case the employer would contribute the minimum of \$300 or 2 percent of earnings.
3. Every individual saver will get a refundable tax credit to offset their mandatory GRA contribution, up to a maximum of \$600 per person per year. The tax credit will apply only to employee contributions.
4. Employer contributions to current DC plans will continue to be exempt from income tax and payroll tax and amounts from their contributions will accrue tax-free and will be taxable upon distribution. Reductions in employer contribution levels will be prohibited.

In preparing our estimates, TPC assumed that employers would continue to contribute more than the 1.5 percent minimum if they were already making contributions to existing DC plans in excess of that level.

5. People in current defined benefit (DB) plans may also contribute 1.5 percent of their pay up to \$3,750 and be eligible for the \$600 credit, but there will be no employer match.

In estimating this provision, TPC made the following assumptions:

- Employees with a DB who are currently making employer-sponsored DC plans or Individual Retirement Accounts (IRAs) under current law would contribute the same amounts under the proposal. The first \$3,750 of these contributions would receive the same credit and deduction benefits as other GRA contributions. Contributions in excess of \$3,750 would receive deferred annuity treatment, as discussed in #12 below.
- Employees with a DB plan only who currently do not contribute to either a DC plan or an IRA would not contribute to a GRA.

6. Individuals who contribute less than \$600 will not be able to claim the full \$600 tax credit. For instance, for a saver earning \$30,000 a year, 1.5 percent of earnings amounts to \$450. This saver would have the cost of her contribution fully offset by a \$450 tax credit, but \$150 of potential credits would be unclaimed.
7. Any worker whose 1.5 percent of earnings contribution adds up to more than \$600 will be able to deduct the additional mandatory contribution from their taxes up to \$3,150, reflecting the maximum mandatory contribution of \$3,750.
8. The proposal will only affect contributions to employer-sponsored DC retirement plans and IRAs that are made after the effective date. Earnings on prior-year contributions within existing 401(k) plans, 403(b) plans, other employer-sponsored retirement plans, and IRAs will continue to accrue tax-free.
9. Because the deduction cap is 1.5 percent of earnings up to \$250,000, the highest-income Americans will be entitled to a smaller tax deferment than under the current system—even as the vast majority of Americans receive greater benefits. Many higher earners would continue to contribute more than 1.5 percent of earnings to their plans, but they would not be able to deduct contributions in excess of the maximum amount. This feature reduces the cost of the GRA compared to current law. The maximum credit plus deduction under the plan will be \$3,750 under the GRA

compared to a maximum deduction of \$18,000 to 401(k) plans (\$24,000 for a person over age 50) under current law.

- Employees who currently contribute more than \$3,750 to a tax-preferred account would receive deferred annuity treatment (see #12) on contributions in excess of \$3,750.

10. The GRA employer contributions will be deductible for income and payroll tax purposes as all employer compensation costs are now.
11. At retirement, the balance of the GRA will be automatically converted into a lifelong annuity for the worker and his or her spouse, payable by the Federal government using the existing Social Security payment system. The annuity payments will be taxed as ordinary income.
12. People can contribute added voluntary amounts to their GRAs up to the existing 401(k)/IRA limits (\$18,000/\$5,500 for people below 50 and \$24,000/\$6,500 for people over 50), but any such voluntary amounts over the mandatory minimum (i.e., 1.5 percent of earnings up to \$3,750) will not be deductible, but will instead be subject to deferred annuity treatment. The investment returns on these voluntary contributions will also accumulate tax deferred and will be rolled into the annuity at retirement.
 - We assume that taxpayers would continue to save at the same current-law pre-tax amount under the GRA system.
 - A fraction of the post-retirement payouts will be taxable. We set the fraction such that payouts come out in proportion to contributions and account earnings, with the amounts attributable to contributions (or principal) tax-free and the amounts attributable to earnings taxable.
13. At retirement, the worker could opt to pull out 25% of the minimum GRA plus all voluntary amounts as a lump sum instead of converting those sums into an annuity. The accumulated earnings portion of such distributions would be taxable as ordinary income.
14. Self-employed individuals, participants in partnerships, and shared economy workers without traditional employers would contribute the whole 3 percent mandatory minimum amount themselves. Half would be deemed to be from them as employee and half from them as employer. They would be eligible for the same \$600 tax credit against the employee half. Both the employer half and first \$3,150 of the employee half would be deductible for tax purposes. There would be no new deductible

contributions to existing qualified retirement plans for the self-employed, but amounts within those plans will continue to accrue tax-free. Self-employed people who contribute more than \$7,500, but up to the limits for Keogh and simplified employee plans, would get deferred annuity treatment for contributions in excess of \$7,500.

15. The current law Retirement Savings Contributions Credit will be repealed.
16. The proposal is effective for new contributions beginning on 1/1/2018.
17. The maximum credit amounts and dollar contribution limits stated above are for 2016. They are indexed to changes in the consumer price index after 2016.

REVENUE ESTIMATES

TPC estimates that the proposal would reduce federal income and payroll tax receipts by \$292 billion between fiscal years 2018 and 2027 ([Table T17-0195](#)). The proposal would increase the number of tax units either making employee contributions or receiving employer contributions on their behalf in 2018 from 66 million under current law to 136 million under the proposal – an increase of 70 million tax units contributing to retirement accounts.

The revenue loss consists of several pieces:

- The combination of the new credit and higher deductible employer contributions, partially offset by lower current year deductible employee contributions to retirement accounts, reduces income tax receipts by \$198 billion and payroll tax receipts by \$69 billion over 10 years.
- Excise tax receipts increase very slightly (less than \$1 billion over 10 years), reflecting the net effect of increases in Adjusted Gross Income on the individual mandate penalty under the Affordable Care Act.
- Changes in contributions in prior years reduce income tax receipts by \$27 billion between fiscal year 2018 and 2027. This reflects the loss in revenue due to the increase over time in the share of income from private savings that accrues tax-free within qualified retirement plans, partially offset by a gain in revenue from increased taxable withdrawals from these accounts. The annual revenue loss due to prior year contributions is initially very small, but increases rapidly over time from under \$1 billion per year in fiscal years 2018 through 2020 to \$6 billion in fiscal year 2027. This is because the net revenue effects from contributions made in prior years in 2019 would come from changes in

retirement savings contributions in 2018 only, while the revenue effect in 2020 would come from changes in retirement savings contributions in 2018 and 2019, and so on.

The proposal could be made revenue neutral over the 10-year budget window by reducing the credit amount to \$207 ([Table 17-0196](#)). With a \$207 credit, federal income tax receipts from current year contributions increase by \$111 billion over 10 years, payroll tax receipts decrease by \$69 billion, and receipts from prior year contributions decrease by \$43 billion. The GRA proposal with a \$207 credit reduces net receipts towards the end of the budget window because of the rapid growth in the revenue loss from prior year contributions.

DISTRIBUTIONAL ESTIMATES

The GRA proposal reduces tax burdens on low-income tax units and increases taxes on high-income units. TPC calculates tax burdens from changes in the treatment of retirement saving plans as the change in the lifetime present value of after-tax income from the combination of new credits and the opportunity to accrue more or less income within tax-free retirement saving accounts. TPC estimates, when ranking tax units by level of expanded cash income, the GRA proposal with a \$600 credit would on average increase the present value of after-tax income from tax year 2018 contributions for tax units with expanded cash income below \$200,000 and reduce after-tax income for tax units with expanded cash income above \$200,000 ([Table 17-0197](#)). The tax units with the largest tax increase as a share of after-tax income are those with incomes between \$200,000 and \$1,000,000.

When ranking tax units by expanded cash income percentile, the proposal raises after-tax income on average for tax units in the bottom 90 percent of the income distribution and increases after-tax income for units in the top 10 percent ([Table 17-0198](#)). The tax units with the largest tax increase as a share of after-tax income are those in the 90-99th percentiles of the income distribution.

With the credit reduced to \$207, the average change in tax burden across the entire population is close to zero, with lower income tax units seeing a reduction in tax burden and high-income units seeing a tax burden increase. When tax units are ranked by level of expanded cash income, groups with income less than \$100,000 receive on average a tax cut, and groups with income over \$100,000 face increased tax burdens ([Table 17-0199](#)). When tax units are ranked by expanded cash income percentile, groups in the bottom four quintiles received a cut in tax burdens and those in the top quintile see their tax burden increased ([Table 17-0200](#)).



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