NATIONAL CENTER FOR POLICY ANALYSIS

Congressional Brief: Retirement Accounts

Private retirement accounts include employer-sponsored 401(k)s and 403(b)s, and privately-purchased plans like Individual Retirement Accounts (IRAs). Today, about 88 million people participate in one of these defined-contribution plans, with total assets of more than $4.5 trillion.

Key Facts about 401(k)s

- Nearly 80 percent of full-time workers have access to a 401(k) or other employer-sponsored retirement plan. On average, employees are saving an average of nearly 7 percent of their salary in these plans.
- About 20 percent of workers with access to a 401(k) plan do not contribute.
- The maximum allowable contribution to a 401(k) of 403(b) in 2015 is $18,000.
- The Pension Protection Act of 2006 made it easier for workers to prepare for retirement by allowing (but not forcing) employers to offer:
    - *Automatic Enrollment*. New employees are automatically part of an employer's plan and must opt out if they don't want to participate.
    - *Automatic Escalation of Contributions.* Unless they opt out, employees' contributions will automatically rise to equal 3 percent of compensation by the end of the first year, 4 percent in year two, 5 percent in year three and 6 percent thereafter.
    - *Matching Contributions.* An employer must match the first 1 percent of compensation the employee contributes dollar-for-dollar, and 50 cents for each additional dollar up to 6 percent of compensation (for a total of 3.5 percent), or contribute at least 3 percent of compensation to the account of every participating employee, regardless of the employee's contribution. The employer's contributions must fully vest after the employee completes two years of service.
    - *Diversified Investment Options.* The law also encourages employers to offer at least three different investment options — other than employer stock — that are diversified and have different levels of risk.

Key Facts about IRAs

Some workers do not have access to a 401(k) plan because they work for an employer that does not offer one. Thus, an IRA is one of the best ways to save when one doesn't have access to an employer-sponsored plan.

- **Income Restrictions for Traditional IRAs**: The tax deductibility of IRA contributions phases out for people with moderate or higher incomes who are participating in an employer's qualified retirement plan:
    - IRA contributions are fully deductible for singles with an adjusted gross income (AGI) up to $61,000 and couples who are married filing jointly with an AGI up to $98,000.
    - However, the deductibility of contributions phases out at incomes above these levels; singles with an AGI of $71,000 or more — and couples who are married filing jointly with an AGI of $118,000 or more — get no deduction for contributions to traditional IRAs.
- **Different Retirement Savings Rules for Working vs. Not Working**. Unlike employer-sponsored 401(k)s,

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IRAs have lower contributions limits and some income limits.

- IRA participants (both tax-advantaged and Roth IRAs) can contribute up to $5,500 a year ($6,500 if age 50 or older).

Key Facts about Roth Accounts

Traditional retirement savings vehicles, such as 401(k)s and IRAs, are tax-deferred accounts. They allow people to invest pretax dollars, but taxes must be paid on the investment and accumulated earnings at the time of withdrawal. By contrast, deposits to Roth IRAs or Roth 401(k)s are made with after-tax dollars and withdrawals are tax-free. Since 2010, all taxpayers, regardless of income, have been able to convert their regular IRAs into Roth IRAs.

- Taxpayers who file as a single with an adjusted gross income more than $131,000 cannot contribute to a Roth IRA, and cannot make the full contribution ($5,500, or $6,500 if age 50 or older) if their adjusted gross income is $116,000 to $131,000.
- Taxpayers who are married filing jointly cannot contribute to a Roth IRA if their adjusted gross income is greater than $193,000, and can only make a partial contribution if their income is $183,000 to $193,000.

The New MyRA Accounts

The Obama administration directed the Treasury Department to establish a program of individual retirement savings accounts known as "MyRAs" beginning January 2015. MyRA accounts allow workers to save via payroll deductions

- The minimum requirement to open a MyRA is $25 and monthly contributions can be as little as $7 a month; the maximum annual contribution level to a MyRA is the same as a Roth IRA — $5,500 for 2015.
- The MyRA account is portable, since it is tied to the individual, not his or her employer; thus, account holders who change jobs need not bother with "rollover" paperwork.
- Fees charged for maintenance of the account are paid by the Treasury, not the account holder.

Singles earning up to $129,000 a year and married couples earning up to $191,000 a year (filing jointly) are eligible to contribute to a MyRA account. MyRAs will most likely appeal to young and low-to-middle-income savers, the most likely to have small amounts to save.

But the MyRA has several significant drawbacks:

- Because it is only invested in government debt (bonds), it is not the wisest choice for workers who have decades before retirement.
- The MyRA is only available to workers whose employers are set up to make automatic payroll deductions.
- The MyRA account is limited to 30 years or a $15,000 balance, at which time the account must be rolled over into a private IRA

NCPA Policy Recommendations

- **Additional 401(k) Reforms.** Longer lifespans — and the need to draw from retirement savings for more years — increase the risk of outliving one's retirement savings. Encouraging 401(k) plans to offer a lifetime annuity as the default payout option at retirement would go a long way toward addressing this potential problem. A lifetime annuity is a financial contract with an insurance company; in exchange for a lump-sum payment — for example, the savings accumulated in a 401(k) — the insurance company guarantees regular payments for as long as the beneficiary lives.

- **Expand Individual Retirement Accounts (IRAs)**. Current tax law penalizes those who do not have employer-sponsored savings plans. For example, participants in an employer-sponsored 401(k) plan can contribute up to $18,000 annually, while nonparticipants can contribute only $5,500 to a tax-advantaged IRA. This policy is particularly harmful to early retirees. We need a level playing field that treats all savers equally.

- **Create Universal Roth IRAs**. Given the effects of the Social Security benefits tax and the expectation of higher tax rates in the future, Roth taxation makes sense for many younger taxpayers. Simplify and unify the many retirement savings vehicles by creating universal Roth IRAs.