
Debate continues over capping 401(k) tax break at 28%

By Editor Test Thu, Feb 28, 2013

Under the "28% cap" proposal, someone in the 39.6% marginal tax bracket could reduce his federal income taxes by a maximum of \$14,000 on a deferral of \$50,000 into a 401(k) plan, rather than the potential \$19,800 tax savings under current law.

The executive director/CEO of the American Society of Pension Professionals & Actuaries (ASPPA), Brian H. Graff, issued a statement rebutting a recent suggestion from a Brookings Institution scholar that the federal budget deficit could be reduced by \$40 billion over 10 years by reducing the maximum tax break on retirement plan contributions at 28%.

The suggestion was made by the Brookings Institution Karen Dynan in her essay, ["Proposal 6: Better Ways to Promote Saving Through the Tax System,"](#) which was part of a report from Brookings' Hamilton Project, "15 Ways to Rethink the Federal Budget." Her proposal has been favored by the Obama Administration.

There's been a rising chorus of academic and governmental voices suggesting that at least part of the annual "expenditure" on retirement plan tax deferral (estimated at \$50 billion to \$70 billion by the Center for Retirement Research at Boston College) is wasted because it offers incentives to wealthy people who would save even without the incentive.

Under the "28% cap" proposal, a small business owner in the 39.6% marginal tax bracket would reduce his federal income taxes by a maximum of \$14,000 on a maximum deferral of \$50,000 into a 401(k) plan, rather than the potential \$19,800 tax savings under current law.

Only adjusted gross income over \$400,000 for single filers (\$425,000 for heads of households and \$450,000 for couples filing jointly) is taxed at the highest marginal rate, and only about one percent of Americans earn that much. But many of them, some would argue, are business owners who base their decision to sponsor or not sponsor a retirement plan on the size of the tax benefit to themselves.

ASPPA CEO Brian H. Graff is in that camp. He has publicly maintained that incentivizing savings isn't the only benefit of the tax break for high earners. It also incentivizes high-earning small business owners to sponsor a retirement plan in the first place, he has argued. Reduce their benefit, and they'll shut down their plan or never start one in the first place. In his latest prepared statement on the topic, Graff said:

"Brookings Hamilton Project has proposed placing a 28% cap on the 'rate at which deductions and exclusions related to retirement saving reduce a taxpayer's income tax liability.' Because the tax incentive for retirement savings is a deferral, not a permanent exclusion, the proposal would more accurately be described as double taxation of contributions to retirement savings plans for anyone with a marginal tax rate of over 28%.

You won't expand coverage by penalizing small business owners for offering a 401(k) plan. Retirees already pay ordinary income tax on distributions from retirement savings plans. 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 Hamilton Project paper acknowledges that individuals subject to this double taxation may decide to put their savings somewhere other than in the 401(k) plan. What it fails to acknowledge is when that double-taxed person is a small business owner and it no longer makes sense for the owner to have a 401(k) plan, that owner probably won't offer a 401(k) plan to the employees, either.

ASPPA strongly supports expanding coverage through proposals such as automatic enrollment IRAs. But we think those proposals should be a step up for workers who have no access to workplace retirement savings. Not a step down for workers that had a 401(k) plan before their employer got hit with a double tax on their own 401(k) contributions. "

Dynan's proposal includes the following recommendations:

- Cap the rate at which deductions and exclusions related to retirement saving reduce a taxpayer's income tax liability at 28%
- Increase the tax credit that small businesses can take for startup pension plan expenses.
- Establish an automatic IRA program.
- make the saver's credit refundable and easier to understand
- Remove obstacles to firms establishing expanded savings platforms that would allow employees to save for both retirement and nonretirement purposes.