I'll Let You Work Out the Details

By Editor Test *Thu, Apr 11, 2013*

Is it really true that if you cap a small business owner's tax-deferred retirement accounts at $3 million, he or she will stop offering a plan at all? Sounds like blackmail.

Brian Graff, the executive director of the American Society of Pension Professionals and Actuaries, is a smart and candid guy. He commented on *Forbes*' website yesterday about the Obama budget proposal to block people with more than about $3 million in their combined IRAs and defined contribution accounts from adding any more to the accounts.

Graff explained, as he always explains when people talk about limiting contributions to 401(k) accounts, that the policy would backfire, because small business owners would react by shutting down their company's plan altogether.

"When a small business owner reaches the $3 million limit, they're going to shut the plan down," Graff said. "They don't like being told they don't get anything out of a plan."

That explanation bothers me. I can see the pragmatism behind it. But I find it profoundly cynical. If it's true—and I'm not so sure that it is— I think it would be reprehensible for anyone to take that attitude. It smacks of blackmail. Why have a public policy that depends on people who have contempt for public policy?

To find out what other people were thinking about the Obama proposal, I checked out the 401(k) Group on LinkedIn, where somebody opened a discussion on the $3 million cap idea. "Government interference," someone called it. A "success tax," someone else said. Another person suggested impeachment, calling Obama a "Marxist pig." (And LinkedIn is the *high-toned* social network.) Another contributor contested the whole notion of income taxes at all.

Whence springs this well of sympathy for the ultra-wealthy? Am I the only one who doesn't have over $1 million in my retirement accounts? If the tax-deferred system is so intrusive, if it does so little for the average joe, and if ERISA and the tax code are so complicated, why not call the whole thing off? Who needs to carry a huge burden of deferred taxes into retirement, anyway?

I mentioned cynicism above. The level of cynicism in the retirement industry about the average participant is startling. And sadly, it's justified. Participants don't contribute enough. They do not read their statements or their disclosures. They do not rebalance annually.

But can you blame them? They have little job security, no representation when plan decisions are made, and often even no matching contribution from their employer. They believe that the investment game is rigged. And they're right.

Here's a simple solution. Along with offering a defined contribution plan, every employer should contribute

10% of each employee's pay into the employee's plan account. The employees will take home 10% less, but that's OK, because they won't miss what they never had. Some companies already do this.

Once the money is in the plan, they can't take it out, except to roll it into another qualified account. At retirement, they use a certain percentage of their savings to buy a deferred income annuity fund that pays an income if and when they reach age 85. In return, they can distribute the rest of their qualified savings tax-free.

A win-win, right? I'll let you work out the details.