
Taxes deferred aren't taxes denied: ASPPA

By Editor Test Tue, May 31, 2011

In their attacks on retirement savings incentives, 'budget hawks' don't appear to realize that 401(k) participants and others pay the deferred taxes after they retire, albeit sometimes at a lower tax rate.

The verbal battle over “tax expenditures” is heating up.

ASPPA (American Society of Pension Professionals & Actuaries) now claims that recent proposals to eliminate tax deferral on contributions to and build-up in 401(k) plan accounts are based on “faulty math.”

The real cost of tax deferral is actually 55% to 75% lower than claimed by Congressional budget hawks, ASPPA says in a new report, [“Retirement Savings and Tax Expenditure Estimates.”](#) If so, the proposed cuts won't save as much as projected and may even jeopardize the future of 401(k)s and other tax-favored savings programs.

According to ASPPA, , the Congressional Joint Committee on Taxation (JCT) and the Treasury Department's Office of Tax Analysis (OTA) both use current cash-flow analysis when estimating the cost of the tax deferral.

But the 10-year timeframe used in their cash-flow analysis doesn't recognize the fact that 401(k) participants and others eventually pay the deferred taxes after they retire, albeit sometimes at a lower tax rate. Thus tax deferral differs from tax credits or deductions, such as those for medical expenses or mortgage interest, which are never repaid.

Using present-value analysis, which economists typically use for long-term analysis, economist Judy Xanthopoulos and tax attorney Mary M. Schmitt have calculated that present-value estimates of the five-year cost of retirement savings tax expenditure are 55% lower than those of the JCT and 75% lower than those of the OTA.

“The short-term window used in Washington budget scoring overstates the cost of retirement savings incentives - and therefore the savings that would result from slashing these incentives,” said Brian H. Graff, ASPPA's executive director and CEO. He added that “If we reduce the incentives for workers to save through these plans, we will send millions of low- to moderate-income workers into retirement with little savings.”

The JCT and OTA numbers are commonly used in proposals for reducing the federal budget deficit. The National Commission on Fiscal Responsibility and Reform (the Simpson-Bowles commission) used them when it proposed a cap of \$20,000 a year (or 20% of income, if less) on the amount of money people could contribute to tax-deferred retirement accounts. U.S. Senator Pete Domenici and former Director of the Office of Management and Budget Alice Rivlin made a similar proposal.