Taxes Will Be Cut But Not Reformed

By Kerry Pechter *Wed, Oct 25, 2017*

'The odds of tax reform coming out of this conference are zero percent,' said former Treasury official Mark Iwry at the academic forum of the Defined Contribution Institutional Investments Association last week in New York. 'The odds of tax cuts are considerably higher.'

As a Treasury official in the Obama administration, Mark Iwry kept his personal opinions largely to himself. The most authoritative of public speakers about auto-IRAs and longevity annuities, he was also the most careful. No one broached the topic of retirement security with more circumspection and deliberation.

But since last January he has been out of government (he's a non-resident scholar at the Brookings Institute), and as a private citizen he's free to loosen up a bit. Iwry can even let a few wry barbs fly, which he did as a panelist at the Defined Contribution Institutional Investment Association's (DCIIA) academic forum in New York last week.

"Every four years or so the nation and the federal government go through the first year of a new administration. I've seen a few from the inside and I've been struck by the fact that during the first year, the upper reaches of the administration are populated by two personality types: Those who came to run the world and those who want to save it—that is, save it from those who want to run it.

"I used to think that gridlock was a bad thing," he said drily. "Now, regarding Richard Thaler, whose recent award of the Nobel Prize [for behavioral economics] was well-deserved, and regarding the topic of irrationality in government and human behavior, when you look at the current situation, it's good that Richard did his work years ago when it was a novel concept. The notion that irrationality is a fundamental fact of life seems less novel today than previously."

Iwry (right) turned to the topic of tax reform, which DCIIA members are concerned about. They worry that legislators will try to pay for tax reductions for corporations and the wealthy by reducing the cap on tax-deferred contributions to defined contributions plans (currently $18,000 for individuals and $54,000 for certain executives, with an additional $6,000 allowed for those over age 50) to as low as $2,400. Taxable contributions above the cap would go into a Roth 401(k), to be withdrawn tax-free in retirement. (Roth owners can withdraw principal penalty-free at any time and can withdraw gains penalty-free after at least a five-year holding period.)

Iwry expects little besides tax cuts from Congress this fall. "The odds of tax *reform* coming out of this [legislative] conference are zero percent," he said. "The odds of tax *cuts* are considerably higher.

Broadening the tax base, eliminating the special tax breaks and complexity in the code, making the rates lower in a paid-for and progressive way—the odds of that happening are virtually nil. The odds of largely *un*paid for tax cuts that threaten to increase the deficit—and lead to calls for cuts to critical programs that help the people who are most likely to stop saving or reduce saving if Rothification happens—those look like likely consequences, assuming that some of the cuts will be paid for.

"It looks like full Rothification is off the table. It's too extreme and too politically suboptimal. Partial Rothification also seems highly unlikely. That's if legislation is done at all. I put the odds of that as low for this year. There's pressure to do something before the end of the year. But it's an awfully tall order to get this done in what is now a matter of weeks."

Conventional wisdom says that major legislation tends not to occur in even-numbered years, Iwry pointed out, when all 454 members of the House of Representatives and about one-third of U.S. Senators are up for reëlection. But he doesn't expect tax cut fever to disappear.

"The appetite that has been whipped up for tax cuts for people who are high in the income ladder and for estate tax repeal is unlikely to be sated by continuing promises. So we will get tax cuts sooner or later and Roth will be likely part of it," he said. "My concern is that [Former House Ways and Means Committee Chairman] Dave Camp's proposal from several years ago represents one end of the possibilities, not a likely middle."

The Camp proposal called for capping tax-deferred contributions at $9,000 and allowing an additional $9,000 in Roth contributions. "The [Republicans] would like to be able to argue that the average employee wont be affected by the changes. That's unlikely to be the case, but there is a talking point to be had by putting the peg at the median level of contributions and set the level at something in the $2,000s… a little south of $3,000," Iwry said.

"I don't think that would be justified, but that would be a way to find a peg," he added. "Later they might get word from the leadership that 'We need $500 billion in revenue,'" he added. "Then a week later that 'We need $550 billion.' The night before the vote, they could hear, 'We're looking for $600 billion in new revenue,' and that will be the number that ultimately determines the cutoff point. It's reverse-engineered."

"That brings me to the 'grand bargain' possibility. The Democrats' leverage to get a grand bargain or a full tax package is iffy. It could turn out that there is no grand bargain," Iwry said.

As for Rothification, it may merely be a “negative shiny object,” he explained, meant to distract the public from a greater danger to the promotion retirement savings: the Republican proposal to lower the tax rate on “pass-through” entities, such as partnerships and S corporations, to 25%. Owners of small business could reduce their taxes by converting to pass-throughs instead of sponsoring 401(k) plans. “The impact on [retirement] plan formation could be affected by a reduction in taxes for pass-through entities. That could be a real problem. It might be worse than Rothification.”