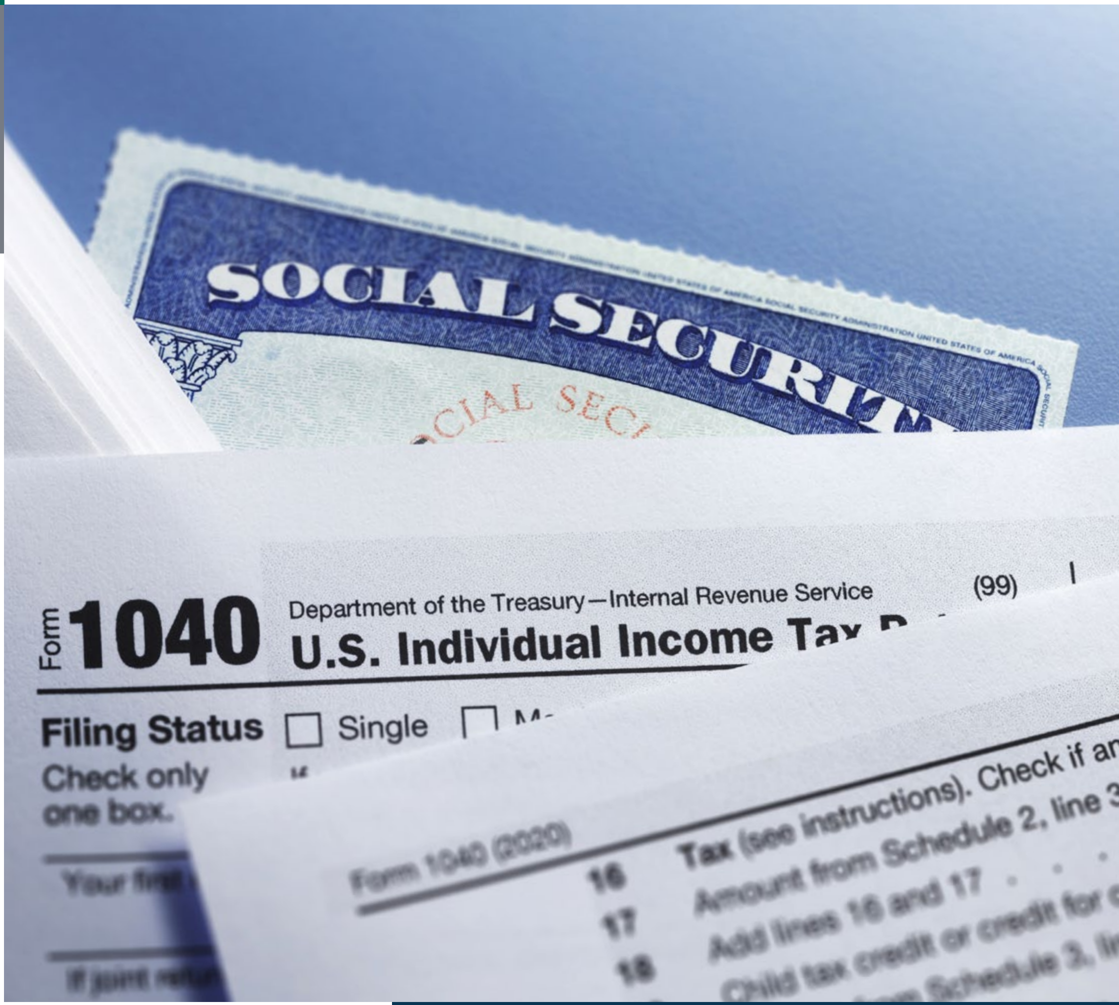
THE MISSING MIDDLE

HOW TAX INCENTIVES FOR RETIREMENT SAVINGS LEAVE MIDDLE-CLASS FAMILIES BEHIND



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EXECUTIVE SUMMARY

Saving for retirement is one of the biggest financial challenges most working Americans will face. While the vast majority will participate in Social Security, most will have less than half of their income replaced by Social Security in retirement. Therefore, many workers also will need to save for retirement through other plans, such as an employer-provided defined benefit pension plan or 401(k) plan, or on their own through an Individual Retirement Account (IRA). Congress has established a number of tax incentives to encourage saving for retirement through these plans. However, due to the structure of the tax code, uneven levels of retirement plan participation, and the growth of income inequality, many of the benefits of these tax incentives accrue to high-income earners.

The middle class is left behind by the retirement savings system in key ways. Social Security replacement rates are too low for middle-class families to maintain their standard of living in retirement, but many middle-class households don't reach the level of income and savings needed to truly benefit from the tax incentives for individual savings. This means the middle class too often is missing out in terms of benefiting from various retirement savings programs.

This report from the National Institute on Retirement Security (NIRS) documents how the current tax incentives fail to promote adequate retirement security for the middle class. It considers the impact of factors including marginal tax rates, retirement plan participation, and income distribution on retirement saving levels. Finally, this research discusses potential solutions that could enhance retirement security for the many working families left behind by existing programs.

The report's key findings are as follows:

- **The current retirement saving structure suffers from a missing middle.** The progressive nature of the Social Security benefit does much to prevent old-age poverty, but the level of income replacement from Social Security falls off far more quickly than private savings function to provide adequate retirement income for middle-class workers.

- **Tax expenditures for various retirement programs are heavily skewed toward high-income earners.** Some of this is due to the design of the tax breaks themselves, but outside factors, such as participation in employer-provided retirement plans and having the financial resources to save for retirement, also play a significant role.

- **The value of tax incentives for saving is much greater for those at higher income levels,** who face higher marginal tax rates. These incentives are quite weak for much of the middle class. Additionally, those who are able to invest earlier and at higher levels enjoy a greater advantage from the deferral of taxation on investment gains.

- **The tax expenditures for retirement saving, oriented around the defined contribution system, give rise to inequities beyond income and wealth.** Geographic and racial inequities related to retirement are both exacerbated by the tax incentives for saving.

- **Solutions to these inequities should focus on increasing participation in the retirement savings system and ensuring working families also receive adequate incentives to save for retirement.** Some potential solutions could focus on building upon Social Security, either through benefit changes or allowing the program to integrate lifetime income options for savers. Reforming the tax expenditures themselves, by eliminating the deduction-based system and replacing it with a refundable credit is another possibility. Other solutions could focus on increasing access and participation in savings plans, which some states are doing for workers who lack workplace plans, thereby making it easier to participate. Finally, curbing abuses of the existing system would ensure that the significant sums of federal tax revenue that are dedicated to retirement security are directed at generating retirement income.

A BRIEF HISTORY OF RETIREMENT

One hundred years ago, few people in the United States retired. Whether they lived and worked on the farm or in the city, many people worked until they died. If they became too infirm by old age to work, they were either cared for by their families or they lived in destitution. In the case of civil service workers, they often would work into old age, long past the peak of their abilities, because they needed the income from their employment to meet the basic necessities of life.

Beginning in the 1910s and 1920s, several states established pension plans for teachers and general government. These retirement plans helped workers retire when old age prevented them from doing their job and ensured they would not be forced to live in poverty. Old age poverty was common and many looked down upon the elderly for their destitution. Elder poverty was exacerbated by the Great Depression, and one of the early priorities for President Franklin D. Roosevelt's New Deal was to create a system of social security to alleviate old age poverty. The first Social Security check was paid in January 1940, and the system slowly ramped up in the years that followed.

After World War II, the American economy boomed and the middle class boomed with it. As economic growth surged in the post-war period, more state and local governments and private companies established pension plans for their employees. Congress also extended Social Security to more workers. The program initially covered 56 percent of American workers, excluding farm laborers, domestic servants, and employees of federal, state, and local government.[1] Many of these excluded workers were Black and this early exclusion represents a historic example of racial discrimination in government programs. Over time, Congress passed legislation to include more of these workers in the system, and Social Security now covers 96 percent of American workers.[2] The idea of the "golden years" when retirees could travel and visit the grandchildren increasingly became a core part of the post-war American Dream, at least for certain workers in certain sectors of the economy.

While Social Security and defined benefit (DB) pensions were growing and becoming more prevalent, various types of defined contribution (DC) plans were established as well. For some workers, these DC plans were a way to save for retirement in addition to Social Security. For others, these plans were a supplement to both a pension and Social Security. Regardless, these DC plans did not dominate the retirement savings landscape as they do in the private sector today.

Many notions of what retirement should be and how to save for it are rooted in this post-war period. When the middle class was thriving in the thirty year post-war period, the American Dream of a financially secure retirement gained cultural power. For certain workers in certain sectors of the economy, such as union employees at big automobile manufacturing companies, the idea of a well-paying job with a generous company pension and perhaps a supplemental savings plan came to be viewed as the default work arrangement. Many of these jobs could be obtained with a high school diploma and, with them, entry to the growing middle class.

In the late 1970s, however, something fundamental began to shift in the American economy. The gains from economic growth were broadly shared in the thirty year post-war period, raising incomes for those at the bottom and the top. Since 1975, though, economic gains mostly have gone to the top. There has been a marked and noticeable rise in inequality of both income and wealth in the American economy.[3] For a white male without a college degree, real income is lower now than it was in 1975. Median income, full-time, full-year workers generally have experienced little real wage growth during the past forty years, while those at the very top have seen wage growth far surpassing GDP growth.[4]

Economists from the Rand Corporation studied this increase in income inequality from 1975 to 2018, and they did more than just document the increase. They created a counterfactual scenario in which the gains from economic growth were shared as broadly from 1975 to 2018 as they were from 1946 to 1975. If the gains had been shared to the same degree, real income for the bottom 90 percent of workers would have been $2.5 trillion greater.

This period of time in which both income and wealth inequality have increased has coincided with the increasing prevalence of DC plans in the private sector. The Revenue Act of 1978 created 401(k) plans, but these were fairly minor plans until 1981 when the Reagan administration directed the Internal Revenue Service (IRS) to change the legal interpretation of that provision of the tax code to make them more widely available. This change, coupled with other regulatory changes, has led to the gradual decline of defined benefit pensions in certain private sector industries and the widespread dominance of the 401(k) plan and its equivalents.[5] This trend not only shifted the responsibility and risks of retirement onto individuals, but also a significant portion (and often all) of the costs.

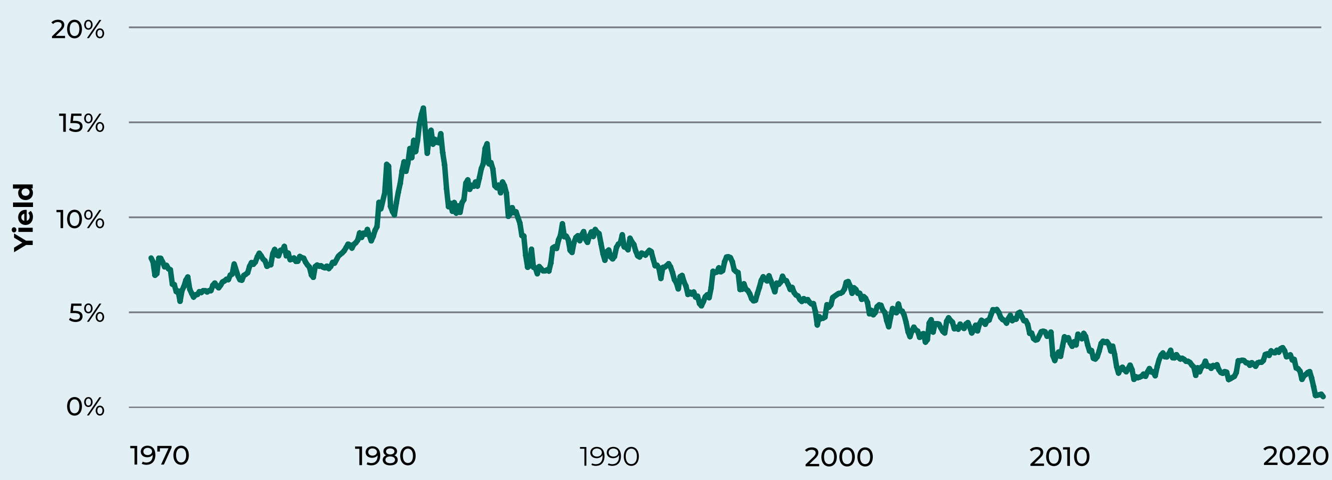
THE MISSING MIDDLE CLASS

The middle class, which constitutes slightly more than half of American households, has borne the brunt of this cost shift. Retirement researchers have consistently found median (50th percentile) retirement savings for American workers and households to be too low. Some researchers optimistically point to average savings, but this data point causes the savings of those with extraordinary wealth to obscure the retirement savings challenge facing the middle class. It is clear that there are many people approaching retirement with a Social Security benefit that will replace less than half of their income, meager savings, and who are less likely to be accruing a pension benefit than middle-class workers in the past.

Paradoxically, the current retirement systems seem to prioritize both reducing elder poverty and serving the interests of those who have high incomes and wealth. Forty years ago, saving for retirement through a 401(k) offered more benefits for a typical middle-class worker. However, recent changes to the tax code, the economy, and life expectancy have made saving for a secure retirement through a 401(k) more challenging for middle-class families. The economy and the tax code have changed dramatically since the early 1980s when 401(k)s began their rise to dominance. For one thing, top marginal income tax rates are much lower now than 40 years ago, so there is generally less advantage to be gained by lowering taxable income through contributions to a 401(k) or other retirement plan.[7] Second, the standard deduction on federal income tax returns is much larger now, thanks to the Tax Cuts and Jobs Act. In addition, those who are married and filing jointly need household income above $109,000 in 2022 to move beyond the 12 percent marginal tax bracket, given that the standard deduction is $25,900 and the first $83,550 of taxable income is taxed at 12 percent or less. Thus, the 'tax match' available through retirement savings is only 12 percent or less for many middle-class families, which is a weak illiquidity premium offer for locking up money for decades.

There also have been structural changes in the economy. Interest rates are much lower now than in the early 1980s **(Figure 1)**. At that time, interest rates were in the double digits, so someone saving for retirement could invest in a fairly simple mix of relatively safe assets, like Treasury bonds, and earn a sizeable return (even if those high interest rates had harmful effects in other areas of life beyond retirement saving). Now that interest rates are at historically low levels, investors must either take more risk or plan for lower returns in their investments by saving more.[8] Given that 401(k) tax incentives operate in two ways – the contributions are made pre-tax and taxes on investment gains are deferred for long periods of time – the tax benefits relating to investment returns may be less in a market with lower returns.[9] This means the immediate income deductibility of contributions represents a greater portion of 401(k) retirement tax incentives for middle-class families.

Figure 1: Corporate Bond Yield



Taken together, these changes mean that a typical middle-class family receives a smaller tax benefit through saving for retirement in a tax-advantaged plan like a 401(k) than a similar family forty years ago while also expecting to need more resources for a secure retirement.[10] Saving for retirement remains a good idea, but tax changes have changed the arithmetic regarding retirement savings. It is true many employers offer some sort of contribution match that impacts this value proposition, but participation in employer plans is spotty at the income levels where the tax benefits are weakest. So it's a question as to whether a middle-class family today is receiving a strong incentive to save for retirement through the tax code.

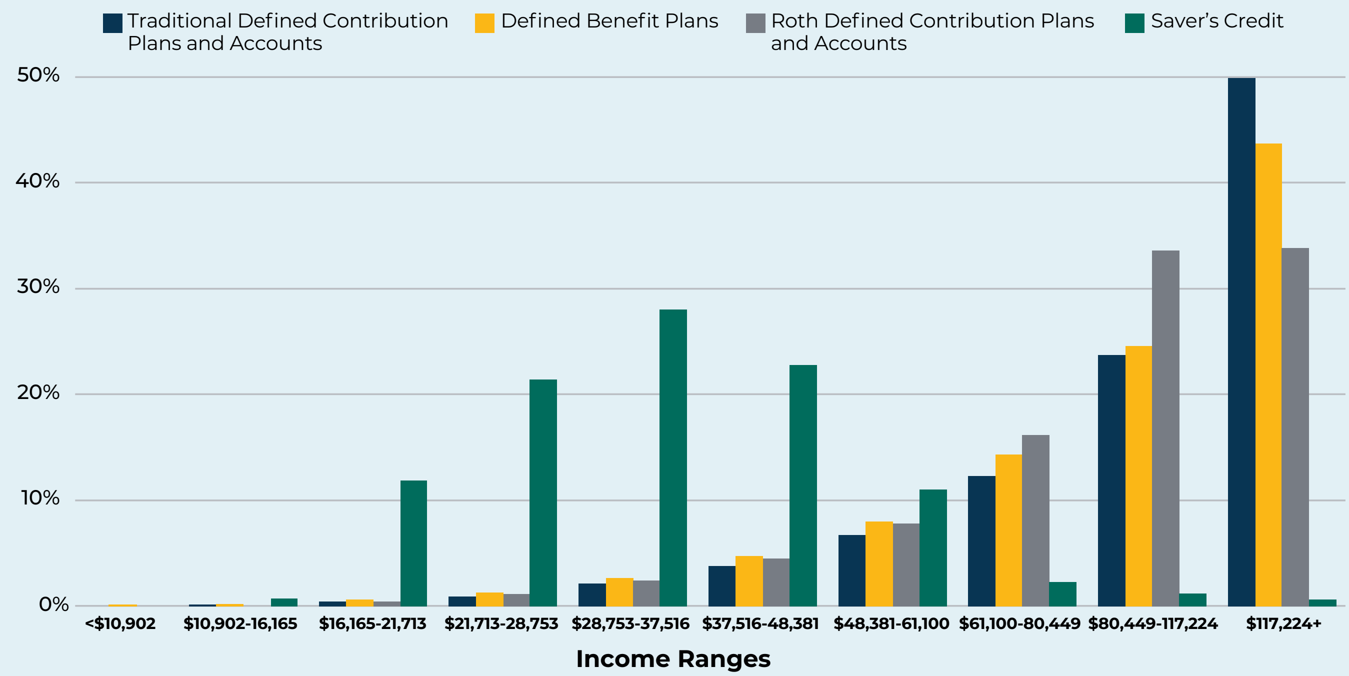
This missing middle is characterized by a Social Security benefit that replaces less than half of pay, spotty access to employer plans, meager tax benefits, and major life costs–such as college, health care, and child care–that make consistent saving seem out of reach.

There is an argument that because of Social Security's progressive benefit structure and capped benefit amount, high-income earners need to save more for retirement through private means because they will receive a smaller replacement ratio via Social Security than low-income earners. While this is true, as one moves up the income scale, the generosity of the Social Security benefit erodes far more quickly than the point at which the utilization of private savings plans and tax incentives begins to generate adequate retirement income. This leaves a gaping hole into which much of the middle class falls.

Lower income workers and service sector workers, who often overlap, largely are left out of the retirement savings system and, therefore, are not able to enjoy the tax breaks and employer matches available to those who do contribute to a retirement plan. The share of the present value of retirement tax benefits always rises with income **(Figure 2)**. Those at the top of the income spectrum, who face the highest marginal tax rates, always will benefit the most from tax deductions in a system with a progressive tax structure.

Figure 2 displays the share of the present value of tax benefits for retirement savings by income decile.[11] More than half of the present value of tax benefits for DC plans and IRAs accrues to those in the top ten percent by income. A significant percentage of the present value of DB pension plans also accrues to those in the top 10 percent. In fact, the top 30 percent of workers by income receive 89 percent of the present value of DC plans & IRAs, and 83 percent of the present value of DB plans.

Figure 2: Share of Retirement Tax Expenditures by Income Deciles and Program (2017)



* Data from Distribution of Selected Tax Expenditures, Treasury Department and authors' calculations. Deciles are based upon cash income adjusted for family size, as follows: "Families are placed into deciles based on cash income adjusted for family size, by dividing income by the square root of family size."

TAX EXPENDITURES

Tax expenditures are a common tool used by the federal government to promote public policy goals. Tax expenditures function as a form of spending through the tax code. Rather than allocating money for a specific purpose through the regular budgeting process, Congress often will spend through the tax code by creating a tax expenditure that diverts revenue away from the federal government. But unlike the annual appropriations process, once Congress creates a tax expenditure, it remains in the tax code in perpetuity, or at least until modified by Congress. Tax expenditures typically are used for good purposes: encouraging Americans to buy health insurance, own their own home, give to charitable causes, or save for retirement. As history has shown, though, tax expenditures can be diverted from their original purpose to serve the interests of a smaller segment of the taxpaying public.

It's not just a question of whether the benefit of a tax expenditure is diverted from its original purpose. The design of a tax expenditure can be less effective from the outset if it does not take into account who pays taxes, which tax bracket they fall in, and whether or not tax breaks can incentivize behaviors from certain segments of the population.

Take retirement savings. A tax incentive for retirement savings structured as a deduction offers no immediate tax benefit if someone does not owe taxes.[12] Tax deductions work by reducing a taxpayer's federal income tax liability. This can be done either by reducing the amount of income subject to taxation or by offsetting some portion of taxes owed. If a taxpayer starts off by owing little or no taxes, then an incentive to reduce taxable income does not help this person.

Additionally, if a taxpayer is not saving, then a tax break offers no benefit even if they have a tax liability. Roughly half of Americans do not participate in a retirement savings plan through their employer, and this means they are far less likely to save. Retirement plan access is a major hurdle for retirement savings generally, but it compounds the inequality that is exacerbated by retirement tax expenditures because high-income earners are more likely to participate in a retirement savings plan through their employer.

Table 1: List of Federal Retirement Tax Expenditures

- **Partial Exclusion of Social Security Benefits**
- **Net exclusion of pension contributions and earnings:**
    - Defined benefit plans
    - Defined contribution plans
    - Individual Retirement Accounts (IRAs)
    - Self-Employed Plans
- **Saver's Credit**

UNDERSTANDING RETIREMENT TAX INCENTIVES AND COSTS

The Internal Revenue Service (IRS) recognizes a broad array of types of retirement plans.[13] These can be grouped into several broad categories: DB plans, DC plans, Individual Retirement Accounts (IRAs), and self-employed plans. The category of DB pension plans includes single and multiemployer plans in the private sector, as well as state and local government plans. It also includes cash balance plans.[14] DC plans include 401(k) plans, as well as 403(b) and 457 plans. IRAs are either traditional or Roth with tax differences being the main distinction between the two. Contributions to traditional IRAs are made pretax, but withdrawals are taxed as income in retirement, whereas contributions to Roth IRAs are made after tax, but the withdrawals -and the growth in investments- are not taxed. Finally, self-employed plans are those such as Simplified Employee Pension (SEP) plans, SIMPLE IRAs, and other plans self-employed workers can establish to save for their own retirements.

Each category of retirement plans receives different tax treatments and has different tax expenditures targeted toward them. The tax expenditure for employer-sponsored DC plans is the fourth largest tax expenditure of the federal government. More than $1.3 trillion will be spent on this expenditure alone during the next 10 year budget window of the federal government. It is clear that significant sums of money are spent to incentivize Americans to save for retirement.

Much of the retirement industry is oriented around saving in 401(k) plans and IRAs. When experts speak of closing the access gap, they typically mean increasing the number of employer-sponsored DC plans accessible to working people. When states have stepped up to fill this gap, they have mostly done so by establishing automatic IRA programs. Policymakers in Washington have proposed a national program that would enable private employers to offer their workers a 401(k) plan sponsored by the federal government. Recent innovations like multiple-employer plans (MEPs) and pooled employer plans (PEPs) are just further examples of increasing access to DC plans to close the retirement savings access gap.

Most tax incentives for retirement savings offered by the federal government are similarly oriented around individual savings. As noted above, these tax incentives represent a substantial use of federal resources. Adding up the cost of all federal tax expenditures for retirement savings totals $2.9 trillion over 10 years starting in fiscal year 2021, although even this is only an estimate because the federal government does not track the actual amount of tax revenue lost to retirement tax expenditures.[15]

The tax incentives that exist to promote DB pension plans are substantial as well, but employers typically have paid for the majority of these plan costs, particularly in the private sector. Thus, these tax incentives are less likely to have the effect of reducing tax bills for individuals participating in the plan and largely are used to reduce employer taxes. In the public sector, it is much more common for DB pension plan participants to contribute to their pensions and be able to claim a tax deduction, though there is less wage inequality within public employment, as EPI notes:

Public-sector earnings are less unequal than private-sector earnings, with more workers clustered in the middle of the earnings distribution and fewer workers with very low or very high earnings.[16]

This means the distributional impacts of the retirement tax incentives for public sector DB pension plans are less pronounced. The benefits of DB pension plans also are not contingent on voluntary participation, since participation is often mandatory, nor on rate of return because all plan participants benefit from the same rate of return on the plan's investments. The tax benefits from DC plans reflect the length of the investment horizon, the rate of return the investor is able to achieve, and changes in marginal tax rates between beginning to save and taking disbursements in retirement.

As noted above, many working Americans are not participating in an employer-sponsored retirement savings plan. There has been a persistent access gap in which roughly half of working Americans at any given time don't participate in an employer-sponsored plan. There is no tax benefit to be gained if one does not have a plan in the first place, and even for those who are participating, if their income is too low, the immediate tax savings are meager. There are real efforts underway at both the state and federal level to close this access gap, but any discussion of the effectiveness of retirement tax incentives needs to begin by recognizing that many are excluded from these benefits because they do not have a retirement plan at work.

Many people could open an IRA at their financial institution and save on their own, but few do so, and there are well-established behavioral hurdles that prevent them from saving on their own. About 1-in-20 households do not even hold a bank account.[17] And workers are 15 times more likely to participate in a retirement savings plan if offered a plan through their employer. Traditional IRAs mostly contain rollovers from 401(k)s and other DC plans, whereas most of the money in Roth IRAs comes from contributions.[18]

According to the Investment Company Institute, as of December 31, 2021, there was $13.9 trillion in IRAs in the U.S., larger than any other type of retirement plan.[19] The ownership of IRAs is skewed heavily toward the top. Those who have the resources and the know-how to open an IRA and take advantage of it also are those who are likely to be well-compensated and have the disposable income to save. Furthermore, because traditional IRAs mostly contain rollovers from DC plans, they reflect the fact that high-income individuals save the most in 401(k)s and eventually roll over those savings into IRAs when they change jobs or other life events necessitate a rollover. It is noteworthy that early in the COVID-19 pandemic when Congress acted to make loans and withdrawals from retirement plans easier, relatively few took advantage of this. This likely is explained by the fact that those who were experiencing job losses, reduced hours, and other economic shocks were those least likely to have a retirement plan, while those who had sufficient savings in a retirement plan were not experiencing significant economic shocks.

The current tax incentive structure is not an accident. It is the outcome of a series of legislative and regulatory decisions made over the course of decades. Some have described the 401(k) as an "accident of history." They mean this in the sense that, when originally created, it was not intended to be the dominant retirement savings vehicle. But even in its original incarnation, the 401(k) was a tax-advantaged savings vehicle for high-income earners to shelter their wealth from taxation. This foreshadowed the future development of the tax incentives for retirement savings, which seem to disproportionately serve the interests of high-income earners, rather than low-income and middle-class earners, who are less likely to save and at greater risk of falling behind in retirement.

WHAT DRIVES THE ALLOCATION OF TAX BENEFITS?

HOW SAVINGS-BASED TAX EXPENDITURES ARE ALLOCATED THROUGH TAX DEDUCTIONS

The federal income tax code consists of seven tax brackets **(Table 2)**. Each dollar of income that falls within a certain bracket is taxed at the rate for that bracket, not at the rate for income in brackets above or below. For example, a married couple filing a joint tax return with household taxable income of $75,000 in 2022 would pay no taxes on the first $25,900 of income due to the standard deduction. Then, they would pay 10 percent on the next $20,550 of income and 12 percent tax on the remaining $28,550 of income. This pattern continues up the tax brackets such that a married couple with $700,000 of taxable income would have income that falls into all seven brackets **(see Table 3)**. This division into brackets reflects the progressivity of the tax code, but also drives the rewards for retirement saving given that the tax benefits of saving are based upon reducing taxable income.

Looking at the immediate tax benefits available to retirement savers as a tax-match, the top marginal rate drives the value of contributing to a 401(k), IRA, or other tax-deferred retirement account.

> Given there are penalties to withdrawing money before retirement–with a few exceptions–it is reasonable to think of the tax-match as the illiquidity premium that savers receive for committing resources towards retirement.

For those with higher incomes, it is clear that a 24 to 37 percent tax-match provides a significant incentive to save for retirement. But, it's not as clear that a tax match of zero, 10 percent, or 12 percent is a great tradeoff for savers with less income, particularly if it means locking up those dollars for multiple decades.

Along with the growing inequality of incomes, this is part of the reason why so much of these tax benefits accure to those with high incomes. The system is built upon the progressive federal income tax system, which inherently offers a greater benefit by reducing taxable income at higher marginal tax rates. The skewness of these benefits towards those at the top offsets some of the progressivity of the income tax system's fundamental design and contributes to significant annual revenue loss for the federal government.

Table 2: Federal Income Tax Brackets (2022)

MARRIED FILING JOINTLY		SINGLE FILERS	
Tax Rate	Taxable Income Bracket	Tax Rate	Taxable Income Bracket
10%	$0 to $20,550	10%	$0 to $10,275
12%	$20,551 to $83,550	12%	$10,276 to $41,775
22%	$83,551 to $178,150	22%	$41,776 to $89,075
24%	$178,151 to $340,100	24%	$89,076 to $170,050
32%	$340,101 to $431,900	32%	$170,051 to $215,950
35%	$431,901 to $647,850	35%	$215,951 to $539,900
37%	$647,851 or more	37%	$539,901 or more

Table 3: Marginal Tax Rates for Married Filing Jointly (2022)

Marginal Tax Rate/Savings Match	Standard Deduction	Household Income Taxed at Each Marginal Rate	Income Level to Reach Each Marginal Tax Bracket	Tax Deferral per $100 Saved at each Top Marginal Rate
0%	$25,900	First $25,900 not taxable	N/A	N/A
10%	$25,900	$25,901-$46,450	$25,901	$10
12%	$25,900	$46,451-$109,450	$46,451	$12
22%	$25,900	$109,451-$204,050	$109,451	$22
24%	$25,900	$204,051-$366,000	$204,051	$24
32%	$25,900	$366,001-$457,800	$366,001	$32
35%	$25,900	$457,801-$673,750	$457,801	$35
37%	$25,900	$673,751+	$673,751	$37

Table 4: Illustration of Marginal vs. Effective Tax Rates

FOR A FAMILY MAKING $130,000 AND TAKING THE STANDARD DEDUCTION:

Income Bands	Marginal Tax Rates	Income Taxed at Each Rate	Taxes Owed
First $25,900 income	0%	$25,900	$0
$25,901-$46,450	10%	20,550	2,055
$46,451-$109,450	12%	63,000	7,560
$109,451-$130,000	22%	20,550	4,521
Total		$130,000	$14,136
Effective Tax Rate (Taxes / Income):			10.9%
Marginal Tax Rate (Rate on the next dollar of income):			22%

* Tax Savings in year contribution is made to 401(k) or IRA are based on Marginal Tax Rate, as contributions reduce taxable income. In this case, it would reduce the dollars taxed at the 22% marginal rate.

Table 5: Illustration of Immediate Tax Benefits for Families at Various Income Levels

	Family A	Family B	Family C	Family D
Wages	$25,000	$50,000	$150,000	$500,000
Contribution Rate	3%	6%	12%	8.2%*
Contribution	$750	$3,000	$18,000	$41,000*
Marginal Tax Rate	0%	12%	22%	35%
Tax Savings	$0	$360	$3,960	$14,350
Savings as % of Income	0%	0.72%	2.64%	2.87%

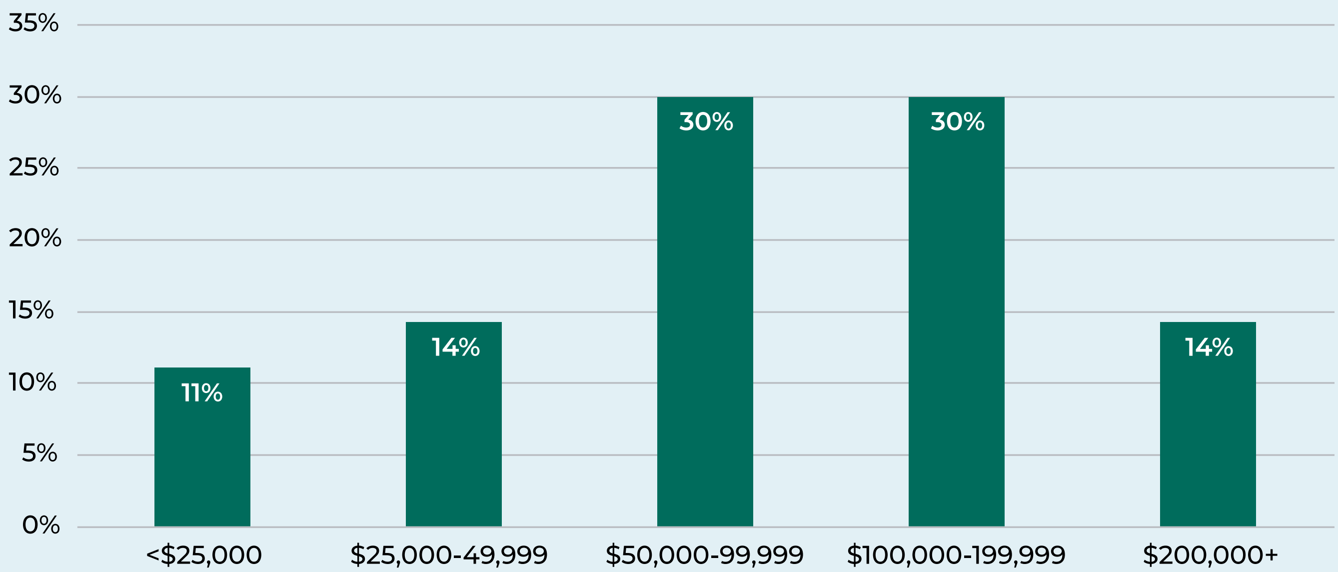
*Pre-tax contributions capped at $20,500 in 2022, but those over 50 are allowed to contribute an additional $6,500 in catch up contributions. Family D represents a two-income couple where both are maxing out their 401k contributions, but not making catch-up contributions. After age 50, total contributions could reach $54,000 which would push tax savings to $18,900.

A Look at Married Tax Filers who File Jointly

Given recent changes to the tax code, such as the increase in the size of the standard deduction, it is significant that more than half of U.S. households filing jointly as married had Adjusted Gross Income (AGI) of $100,000 or less, which would make their top marginal tax rate 12 percent or less (based upon the standard deduction of $25,900 and the need to have taxable income of $83,551 or more to reach the third tax bracket). And, it is noteworthy that roughly 90 percent of tax filers now take the standard deduction, instead of itemizing.[20]

In 2019, there were nearly 55 million tax returns filed as married, filing jointly, with each return representing two or more people in each household. To understand how workers are impacted by these incentives, it is important to see how many people fall into the various marginal tax brackets. **Figure 3** shows the percentage of people reporting AGI at various income levels, along with the top marginal tax rate that would be in place for most people assuming they take the standard deduction. Though, it is worth pointing out that those with large itemized deductions could report lower taxable income.

Figure 3: Married Tax Filers by Adjusted Gross Income



*Data from IRS Statistics of Income, Table 1.2. All Returns: Adjusted Gross Income, Deductions, and Tax Items, by Size of Adjusted Gross Income and by Filing Status, Tax Year 2019 (Filing Year 2020)

Table 6: Impact of AGI on Marginal Tax Rate, Married Filing Jointly

AGI Grouping	Number of Filers	% of Joint Filings	Most Common Marginal Tax Rate
<$25,000	6,064,381	11%	0%
$25,000-49,999	7,806,934	14%	10%
$50,000-99,999	16,623,033	30%	12%
$100,000-199,999	16,693,362	30%	22%
$200,000+	7,608,405	14%	24%

By looking at the distribution of AGI in this manner, we can see that 55 percent of married tax filings are reporting AGI of $100,000 or less–meaning that roughly 55 percent of these households would receive tax savings of 12 percent or less of contributions in the tax year the contributions are made.

Given that it was not possible to separate out today's retirees, these figures may be distorted to some degree by including retirees who may not be in a savings phase of life. However, the fact remains that the immediate savings-based tax incentives available to families reporting AGI under $100,000 are somewhat meager. For example, if a family earning $70,000 contributed 10 percent of their pay to a 401(k), the tax savings would be $840–or 1.2 percent of their income.

Single Tax Filers

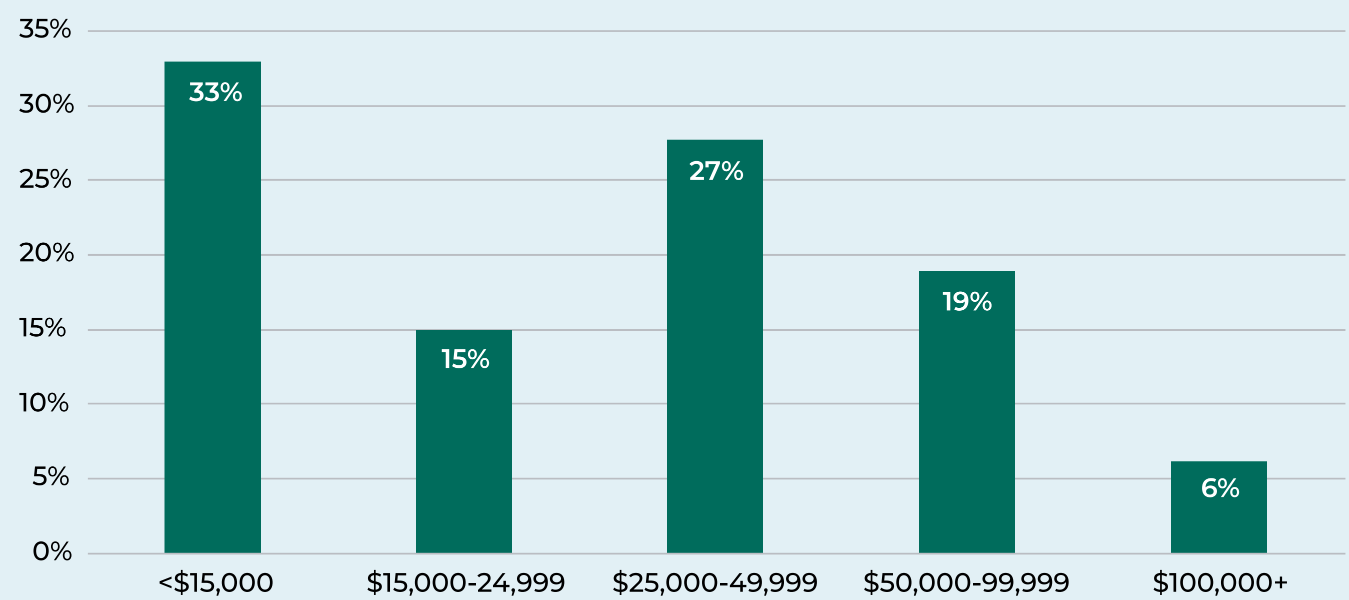
There were another 77.6 million tax filers in 2019 who filed single returns. To have a top marginal rate that exceeds 12 percent on the next dollar of income in 2022, one would need to reach $54,726 in income (standard deduction of $12,950, plus taxable income of $41,776). However, in 2019 (the most recent data available), three-quarters of single tax filers had AGI of $50,000 or less **(Figure 4)**.

Savings Versus Deferral of Taxation

The tax savings one realizes by contributing to a 401(k) or IRA generally are seen as a deferral of taxation to a date far in the future, but the assumption that this will be cost neutral in terms of tax revenues relies upon a shaky foundation. First, it is highly likely tax rates will continue to change, as they have on an almost constant basis in the past. Second, it is assumed that retirement assets that get passed onto heirs will be taxed. However, considering the erosion of the estate tax -- in terms of who pays the tax and the "stepped-up basis" used in calculating the tax -- as well as the current efforts to increase, or possibly even eliminate, the age for Required Minimum Distributions (RMDs), it seems far from certain that these retirement assets will be taxed in future years, at least at current tax rates. In other words, the deferral of taxation could morph into a serious discount on or even elimination of taxation in future decades when assets are passed on to heirs.

In addition to deferring taxation for many decades, the other major aspect of these tax-advantaged savings plans is the disproportionate benefit that accrues to those who have had the largest investment gains during the deferral period. In most situations, this will be people who can contribute a lot, start contributing early in their careers, and invest more aggressively for longer periods. Those who are unable to start saving early will miss out on the benefits of the deferral of taxation on investment gains that are enjoyed by those who hold investments for long periods of time. Furthermore, those able to tolerate risky investments stand to reap a greater benefit, both on the investment and tax fronts, than those who might invest more conservatively due to their lower levels of savings.

Figure 4: Single Tax Filers by Adjusted Gross Income



*Data from IRS Statistics of Income, Table 1.2. All Returns: Adjusted Gross Income, Deductions, and Tax Items, by Size of Adjusted Gross Income and by Filing Status, Tax Year 2019 (Filing Year 2020)

Table 7: Marginal Tax Rates for Single Filers (2022)

Marginal Tax Rate/Savings Match	Standard Deduction	Household Income Taxed at Each Marginal Rate	Income Level to Reach Each Marginal Tax Bracket	Tax Deferral per $100 Saved at each Top Marginal Rate
0%	$12,950	First $12,950 not taxable	N/A	N/A
10%	$12,950	$12,951-$23,225	$12,951	$10
12%	$12,950	$23,226-$54,725	$23,226	$12
22%	$12,950	$54,726-$102,025	$54,726	$22
24%	$12,950	$102,026-$183,000	$102,026	$24
32%	$12,950	$183,001-$228,900	$183,001	$32
35%	$12,950	$228,901-$552,850	$228,901	$35
37%	$12,950	$552,851+	$552,851	$37

Table 8: Impact of AGI on Marginal Tax Rate, Single Filers

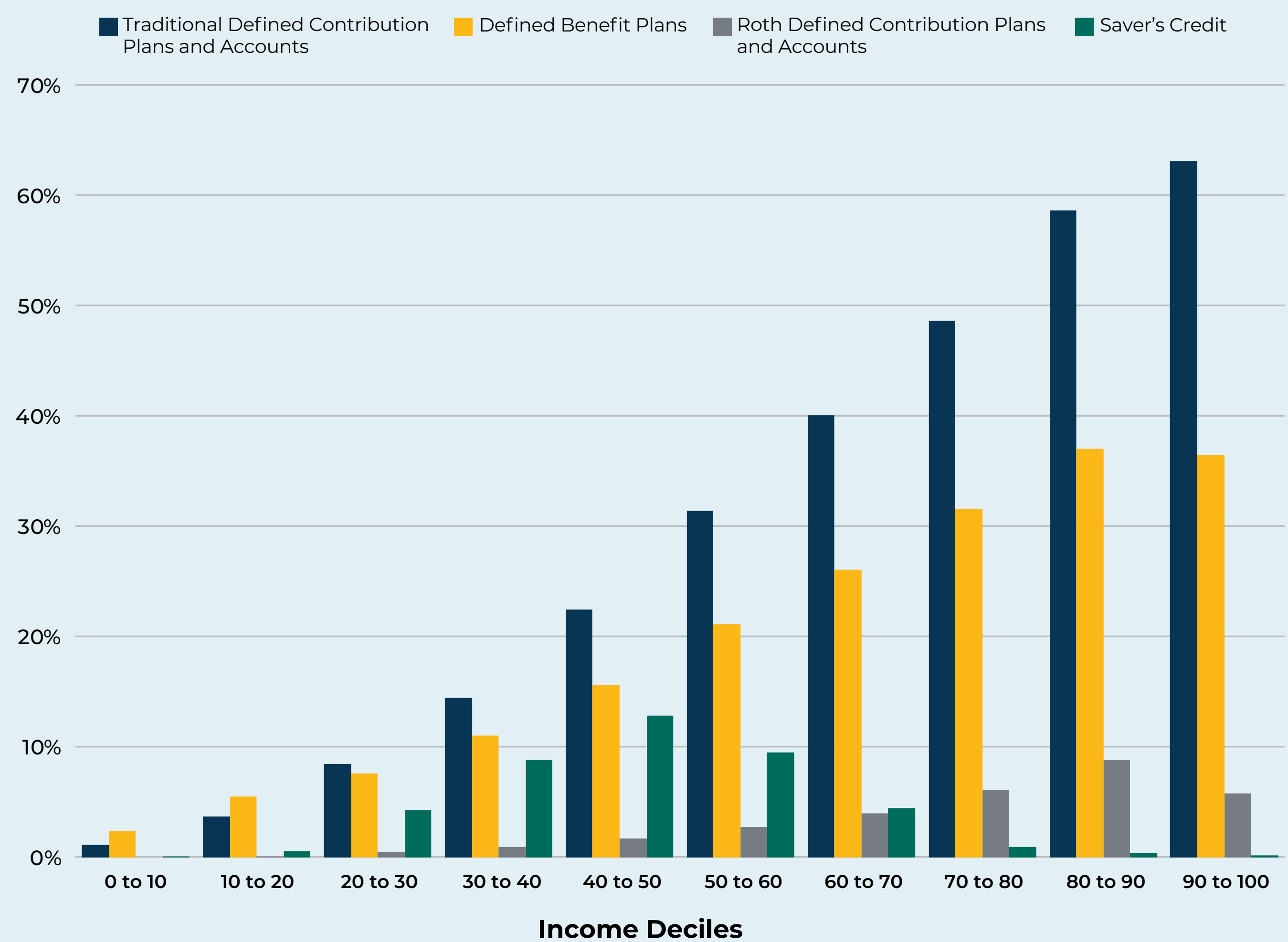
AGI Grouping	Number of Filers	% of Joint Filings	Most Common Marginal Tax Rate
<$15,000	25,464,760	33%	0%
$15,000-24,999	11,833,984	15%	10%
$25,000-49,999	20,890,433	27%	12%
$50,000-99,999	14,405,434	19%	22%
$100,000+	5,023,391	6%	24%

RETIREMENT SYSTEM PARTICIPATION TRENDS CONTRIBUTE TO THE REGRESSIVITY OF THE SYSTEM

Another major factor contributing to retirement incentives being skewed toward higher income earners has nothing to do with tax policy, but is simply a function of the fact that there is a strong correlation between participation in an employer-based plan and income level.

As shown in **Figure 5**, participation in workplace retirement plans, including both DC and DB pension plans, rises as income levels increase. The same trend holds for Roth IRAs. The only tax incentive bucking this trend is the share of families receiving the Saver's Credit, but the highest decile for utilization of the Saver's Credit (40-50th percentile of earners) tops out at only 13 percent of households. Utilization of the Saver's Credit virtually disappears at higher income levels due to the means testing built into the credit.

Figure 5: Percent of Families Receiving Tax Benefits for Retirement Savings (2017)



* Data from Distribution of Selected Tax Expenditures, Treasury Department and authors' calculations. Deciles are based upon cash income adjusted for family size, as follows: "Families are placed into deciles based on cash income adjusted for family size, by dividing income by the square root of family size."

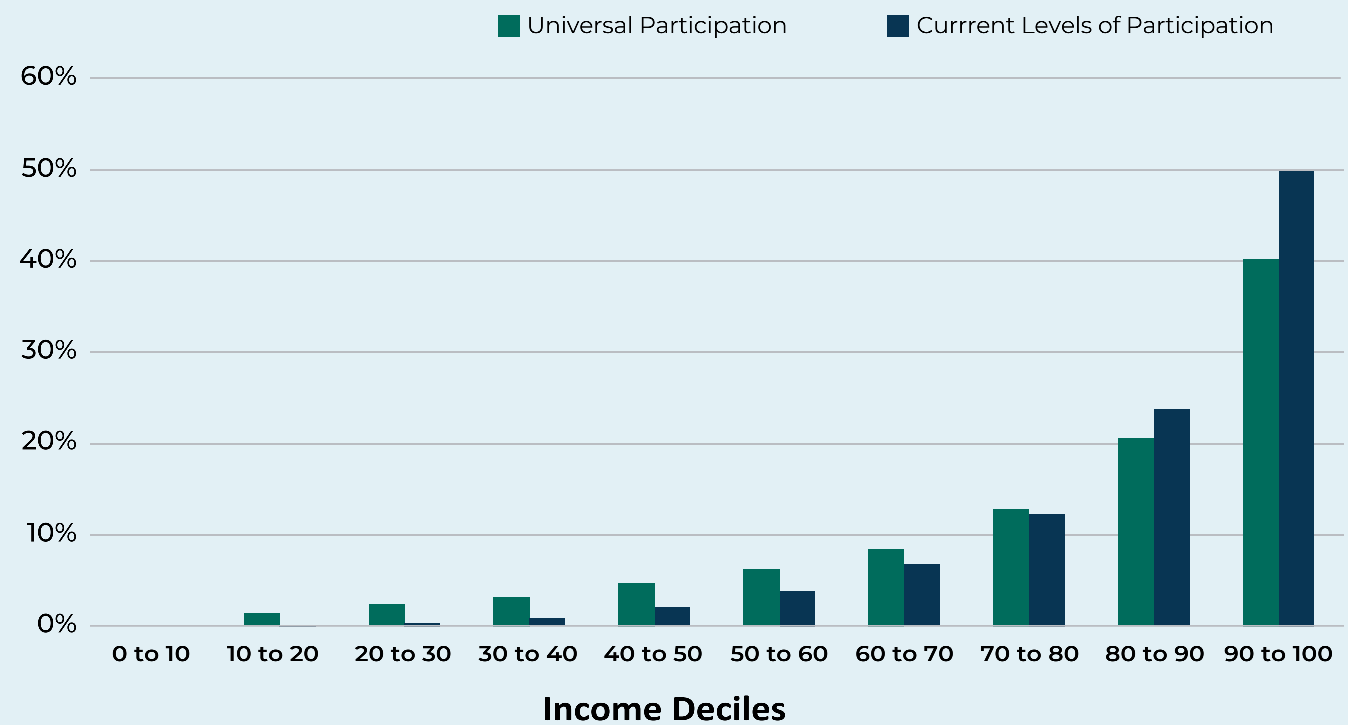
Beyond access, it is apparent how the value is distributed over income deciles as well. This factors in both the increased likelihood of participating in these systems and the higher value of the incentives to individuals based on marginal tax rates, as well as the fact that incomes are simply larger in the higher deciles. The combination of these factors means half of the benefit of DC tax expenditures went to the families in the top 10 percent of income in 2017.

DB tax incentives also skewed upwards, but not as drastically. This is likely a function of a few factors, including access to a plan. Workers who are in a union, work for a large employer, or work in the public sector are all more likely to have access to a DB pension.[22] Two of these traits (union representation, working at a larger employer) are correlated with higher pay levels, while public employment has relatively fewer workers that are paid very low wages.[23] Few service sector workers have access to a DB pension. In fact, service sector workers have the lowest level of access to any type of retirement plan. And non-service, private sector workers at small or medium-sized employers have less access to DB plans than employees of large firms.[24]

So, when considering all of these factors impacting access to a pension or savings plan, it starts to become clear why much of the benefit of retirement plans, whether DB or DC, goes to those with higher earnings. Both employer behavior and the structure of the retirement savings system contribute to those with higher earnings benefiting disproportionately, but also those with regular, full-time employment, all of which leads to the bulk of the benefit accruing to the top 30 percent.

Figure 6 features an analysis of the distribution of DC tax savings and a comparison of how these incentives would be distributed if there was universal participation in retirement plans to get a sense of how much the differences in participation are driving the distributional outcomes. Of course, if there was universal participation, the cost of the tax expenditures would be much larger. (The universal participation figures are adjusted for participation only, not the differences in the level of savings in each pay range.) The top decile's share drops from 50 percent to 40 percent with universal participation, and there is a much larger share going to the lower and middle classes. While universal participation in retirement savings plans would reduce some of the disparities, it alone would not eliminate the other disparities that are inherent in the design of the tax code and the retirement savings system.

Figure 6: Distribution of DC Tax Incentives: Current Rates of Participation vs. Universal Participation



*The Office of Tax Analysis at the U.S. Department of the Treasury uses percentiles based on family size-adjusted cash income. Families are placed into deciles based on cash income adjusted for family size, by dividing income by the square root of family size.

Pensions Versus Savings-Based Tax Incentives

There are some crucial aspects to consider when thinking about the tax incentives offered via DB pension plans versus those for individual-based DC retirement savings plans.

First, DB pension benefits typically are provided to retired workers until they pass away. Some plans may offer death benefits, but such benefits usually are not generous. Thus, the dollars spent through the tax code on DB pension plans are laser-focused on generating retirement income, not inflating estates that will be passed on to heirs. This is a significant contrast to individual-based DC savings plans, which some Americans think of as a way to accumulate wealth for their children. In fact, recent efforts to increase the age for RMDs from 70.5 to 72, and now to 75 likely will produce even larger intergenerational wealth transfers for heirs, with fewer retirement resources used to generate retirement income for seniors.

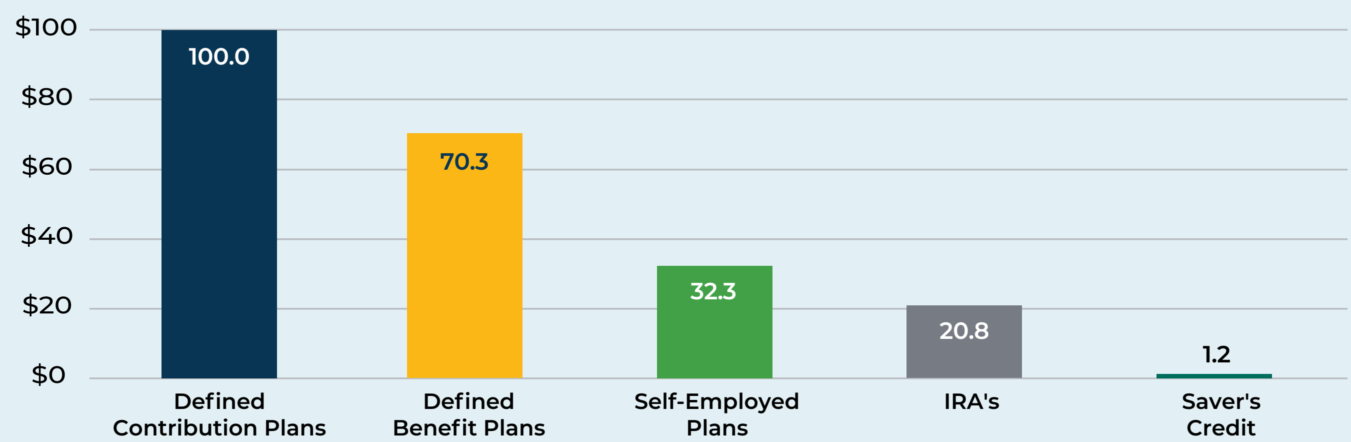
Second, as mentioned above, much of the tax incentives for DB pensions tends to be provided through employers. This means the tax incentives flow through the corporate tax code (in the case of private plans) and do not directly impact individuals' taxes or income disparities. Thus, workers would not choose to forgo participation due to the incentives presented by their tax bracket. However, when employers switched employees from DB pensions to 401(k) plans, they shifted much of the cost of retirement to private sector workers (along with the risks). As costs were passed on to workers, so were the tax incentives that encourage retirement saving. On an individual basis, the distribution of tax incentives can impact saving behaviors.

THE MISSED OPPORTUNITY OF THE SAVER'S CREDIT

The federal government does offer a program for retirement savings to low and moderate income earners through the Saver's Credit. This program has real value for workers with incomes between the 30th and 70th percentile of earnings–a group that is too often not well served by workplace plans and tax incentives–and has great potential for rewarding lower income savers. A better designed Saver's Credit could spur more saving among those in the middle, who are stuck between low-income households, who usually are better served by Social Security, and high-income households, who enjoy the vast majority of tax benefits. In other words, the Saver's Credit is not playing the role it could for middle-class workers and families.

Furthermore, the amount spent annually on the Saver's Credit pales in comparison to what is spent on other retirement tax expenditures: $1.2 billion in FY 2021 for the Saver's Credit compared to more than $100 billion in the same year for employer-sponsored defined contribution plans - nearly one hundred times as much (**Figure 7**). The Saver's Credit also is plagued by design flaws that contribute to its underutilization.

Figure 7: Annual Amounts Spent on Retirement Tax Expenditures ($'s in Billions)



The Saver's Credit could not be claimed on the 1040 EZ form, which was used by many tax filers who qualified for it. Low-income workers are less likely to need the long form for income tax filing or to have an accountant prepare their taxes, meaning awareness of the program is likely limited. This translates into a behavioral hurdle related to knowing about and accessing a key program designed to help lower to middle income workers save.

Additionally, there are sharp income cliffs in the Saver's Credit (**Table 9**). When a tax filer claiming the Saver's Credit moves from one income level to the next, the amount of the credit they receive can be cut in half. For example, in tax year 2022, a married couple filing a joint tax return with income below $41,000 can receive 50 percent of their contribution to a retirement savings plan (capped at a $4,000 contribution) through the Saver's Credit for a maximum credit of $2,000. However, a similar couple with income of $41,001 would only receive 20 percent of their contribution or $800.[25]

The Saver's Credit is not refundable either. Tax filers who don't owe taxes won't receive any benefit from the credit, even if they saved for retirement during the previous tax year. Finally, there is no guarantee that the money from the Saver's Credit will go toward retirement savings. Even if a moderate income tax filer successfully claims the credit and receives the money from the credit, there is no mechanism for that money to be automatically deposited into a retirement savings account. On the one hand, this credit can be thought of as the federal government rewarding taxpayers for engaging in a desired behavior - saving for retirement - and in that sense, the credit could be viewed as a reward for saving. But if the goal is to promote greater retirement savings, that goal would be better served if the money from the credit could be automatically deposited into a retirement savings account so that it functions as a boost to savings as well.

Reforming the Saver's Credit in these ways - making it refundable, smoothing the income cliffs, or not requiring a long-form tax filing - would increase the cost of the credit because more people would claim it and a larger benefit would be given. However, the money spent on the Saver's Credit is a relatively minor part of overall federal spending on retirement. Even if the annual amount expended via the Saver's Credit was doubled, that amount would still be less than three percent of that expended on employer-sponsored DC plans in 2021.

Table 9: Saver's Credit Income Limits (2022)

Credit Rate	Married Filing Jointly	Head of Household	All Other Filers*
50% of your contribution	AGI not more than $41,000	AGI not more than $30,750	AGI not more than $20,500
20% of your contribution	$41,001- $44,000	$30,751 - $33,000	$20,501 - $22,000
10% of your contribution	$44,001 - $68,000	$33,001 - $51,000	$22,001 - $34,000
0% of your contribution	more than $68,000	more than $51,000	more than $34,000

*Single, married filing separately, or qualifying widow(er)

SOCIAL SECURITY: PROGRESSIVE STRUCTURE, BUT ADEQUACY DECLINES QUICKLY

The retirement security provided by Social Security is unparalleled within the United States, in scope and scale. The system covers nearly all American workers. In addition, participation follows individual workers from job to job. Furthermore, the benefit is designed to provide a higher income replacement to lower paid workers, making it extremely effective at reducing elder poverty.

It is worth understanding the benefit design and how benefits are determined, particularly when examining the distribution of other federal benefits aimed at providing retirement security. It is important to note that benefits are based upon average indexed wages throughout one's career rather than final average pay.[27]

The benefit formula bend points (for workers with first eligibility in 2021) are:

Primary insurance amount (PIA) equals

- 90% of the first $11,592 of average indexed annual earnings*, plus
- 32% of average indexed annual earnings over $11,592 through $72,024, plus
- 15% of average indexed annual earnings over $72,024 up to $142,800 (in 2021).

The benefit (in 2021) cannot exceed $37,776 annually.

**Amounts are annualized, but SSA typically shows monthly indexed earnings (AIME).*

The result of this formula is that the replacement rate is high if earnings are very low. For instance, if the average indexed annual earnings–a proxy for average income in today's dollars–are $11,592, the program replaces 90 percent of pay (before any deductions) at full retirement age. However, income replacement above the first $11,592 drops to 32 percent, meaning workers should plan to have some other resources to fill the gap that comes with higher incomes. These benefits are further adjusted based upon the age one is when benefits start, based on the idea that receiving benefits earlier could result in greater lifetime benefit amounts if benefits were unadjusted (there is a similar adjustment made for delayed claiming).

With DB pensions, the replacement rates of retirement income typically are measured in comparison to recent earnings of workers, but Social Security indexes all wages and bases benefits upon career earnings, which the Congressional Budget Office (CBO) describes:

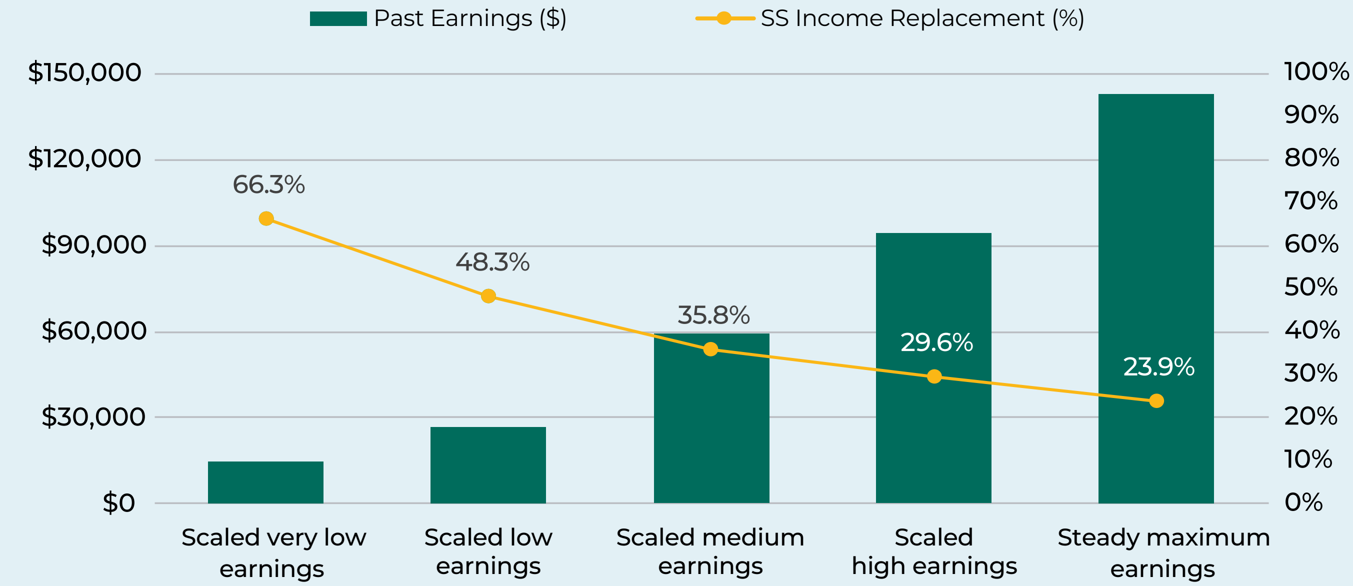
Social Security replacement rates vary substantially depending on how they are measured. On the one hand, replacement rates designed to compare benefits with earnings just before retirement—that is, late-career replacement rates—show that benefits alone are generally insufficient to maintain workers' preretirement income as they leave the labor force. For example, for workers born in the 1960s, median late-career replacement rates that are based on substantial earnings (adjusted for changes in prices over time) in the last five years before the workers reach age 62 amount to less than 40 percent. (Substantial earnings are annual earnings that are at least half of the worker's average indexed earnings—that is, earnings over a person's lifetime, adjusted for changes in average wages over time.) On the other hand, replacement rates that focus on the overall changes in the standard of living between all working years and retirement show that Social Security benefits replace a significantly higher percentage of average earnings over a lifetime, adjusted for changes in prices over time. For workers born in the 1960s, the median replacement rate based on all earnings from age 22 through age 61, including years with no or very low earnings, is 55 percent.[28]

This means the replacement rates based upon average indexed earnings vary from those typically used by pension professionals, as career based earnings measurements typically produce a more positive illustration of benefit adequacy.

The important takeaway is that the replacement rates in Social Security generally are fairly strong at very low income levels for those who work until normal retirement age (which is age 67 for younger workers today). However, the level of income replacement falls off quickly even as one approaches income levels at half of what SSA refers to as 'medium earnings', if one retires at age 65. With indexed earnings of only $26,579, the income replacement level falls to 48.25 percent of average indexed wages at age 65 (**Figure 8**).[29]

It is difficult to expect those between low ($14,766) and medium levels of earnings ($59,065) to save large sums for retirement, given the pressures created by rising costs of health, housing, and college educations. The problem of the 'missing middle' is compounded when considering that access to retirement plans in the workplace is low for workers in this income range, as discussed above.

Figure 8: Social Security Replacement Rates at Various Income Levels



*Scaled earnings represent different percentiles of the Average Wage Index. Steady maximum earnings represent earnings for each year at or above the contribution and benefit base. Source: Social Security Administration, the 2021 Trustees Report, pg. 175.

INEQUITIES TO CONSIDER

With so many dollars flowing through tax incentives, as opposed to direct spending, it is worth considering various equity issues that arise. This report focuses on two areas where there seem to be obvious impacts: rural versus urban workers, and race. But, other equity impacts, such as gender, likely exist.

Geographic Impacts

The cost of living varies widely among different states, regions, and zip codes throughout the United States. The average cost of a house in one state can be as much as four times the average cost in another state, driving a significant part of these differences. Given that these costs can vary so dramatically by location, an income that can provide a great lifestyle in parts of the country may not be enough to buy a single family home in other areas.[30] Wages in cities (metropolitan counties) are also 29 percent higher than less populated areas (non-metropolitan counties). And, some of these wage differences are codified through higher minimum wages that exceed the federal minimum wage in 30 states and Washington D.C., which help workers in higher cost areas afford to live where they work.[31]

Given these geographic considerations and the fact that retirement incentives flow through the tax code with saving incentives being heavily impacted by income level, the current structure seems likely to provide less savings support to rural areas and areas with a high incidence of poverty. Although, higher mortgage interest deductions may offset some of the difference in marginal tax rates among homeowners in different locations.

Another factor that may begin to impact the distribution of retirement savings benefits is that some states now are establishing state-facilitated retirement savings programs for workers who lack access in the workplace. According to AARP, workers are 15 times more likely to save if they have programs in the workplace, and experts expect state-facilitated programs will reduce behavioral friction to saving much like employer-provided plans achieve. As these programs roll out in the current 14 states and others in the future, more workers will gain access to frictionless retirement savings, and thus retirement tax benefits. However, these gains will be uneven as there still are many areas of the country where workers will not be covered by such a program. By and large, the states currently establishing these state-facilitated savings programs are both large and higher-income states, which could exacerbate differences among workers on the lower end of the income spectrum, depending on whether they have access to these programs and are able to benefit from retirement tax incentives. The wealth equity differentials between high-income and low-income states may become greater over time as a result.

Racial Discrepancies

Additionally, there are racial components to consider. Whites are more likely to have access to and participate in an employer-sponsored plan or to own an IRA than Blacks or other racial and ethnic minorities. Non-white workers are more likely to work part-time or have high job turnover, both of which can limit participation in employer-provided retirement plans. This leads to stark inequalities in the ownership of retirement assets among racial groups. Whites have much more saved for retirement than other groups and, as a result, their levels of retirement income are higher.[34]

These inequalities show up in other places as well. Previous NIRS research has documented the vast inequalities in the ownership of financial assets, both by net worth and by race. While financial assets are a broader category than retirement savings, it is indicative of this broader trend that pushes wealth and resources to the top and leaves everyone else falling behind. In fact, the middle forty percent of Americans by net worth only own a small percentage of financial assets, leaving little wonder why Americans are struggling to save adequately for retirement.[35]

The racial wealth gap also shows up in the ownership of financial assets. Among Baby Boomers in 2019, white Boomers owned 91 percent of that generation's financial assets, while Black Boomers only owned three percent and Hispanic Boomers owned two percent.[36] For Baby Boomers, Generation X, and Millennials, white households owned three-fourths or more of financial assets in all three generations.

Additional NIRS research considered the sources of retirement income for older, non-working households from three sources: Social Security, DB pension plans, and DC plans. When examining net worth, the net worth of those receiving any income from DC plans was significantly and noticeably higher than the net worth of those receiving income from Social Security alone, DB pensions alone, or a combination of those two. This indicates that those who are receiving retirement income from DC plans are high net worth individuals, who were likely higher-income earners during their careers. These are the very people the current retirement savings tax incentive structure benefits the most.

Similarly, that research found older Black households and older Hispanic households both trail older white households in total household income as well as Social Security income per household.[37] Older, non-working white households also are much more likely to have income from a defined contribution plan than either Black or Hispanic households.[38] Consistent with the findings related to financial asset ownership, defined contribution plans appear to be providing much more income to high net worth white households than others.

SOLUTIONS

Many of the distributional impacts of retirement tax incentives are unavoidable when savings-based plans layer over a progressive income tax structure with a deduction-based incentive system. The tax structure also reflects, and sometimes amplifies, the underlying inequities in the retirement savings system. Policymakers should be conscious of the fact that, while Social Security is generous to those with very low income levels, Social Security replacement rates drop off quickly for those in the middle class. However, the tax incentives are not filling that gap until a taxpayer reaches significantly higher income levels.

Social Security

Discussions of how to improve retirement security for all Americans often ignore the fact that the United States already has a nearly universal retirement savings system: Social Security. The overwhelming majority of older Americans will receive some retirement income from Social Security. For low-income older Americans, almost all of their retirement income likely will come from Social Security. A starting place for strengthening retirement security should be with Social Security.

The most recent Social Security trustees' report projects that the trust fund for the Old Age and Survivors Insurance program will be depleted in 2033. At that point, Social Security will be able to provide roughly three-quarters of promised benefits. The first step, therefore, should be shoring up the program's financing to ensure no benefit cuts take place. One area to look for improved financing is to eliminate the "tax max" or taxable maximum amount for earnings and benefits. While the percentage of *workers* with earnings above the tax max has held relatively steady for years, the percentage of *earnings* above the tax max has increased due to the increased amount of income inequality in the U.S. Eliminating the tax max completely would bring more revenue into the program.

After shoring up the financing of the program, a second step could be targeted benefit improvements for certain populations within Social Security. These could take several forms including: restoring a true minimum benefit in Social Security to prevent elder poverty; increasing benefit levels for those who have been receiving benefits for more than twenty years; and reforming the spousal benefit to reflect the realities of working life in the twenty-first century.

A third step to improving retirement security through Social Security could be a broad increase in Social Security benefit amounts by increasing the payroll tax contributions paid by employees and employers. The increases in both benefit amounts and payroll taxes should be coordinated to maintain funding integrity for the program. Generally speaking, a majority of working Americans are likely to benefit in retirement more through contributing an extra one or two percent in payroll taxes in order to receive a larger Social Security benefit than they would through a more generous tax break for defined contribution plan savings.

Another way to use Social Security to help the missing middle class would be to think of individual savings in relation to Social Security. There have been numerous proposals on this front, including buying annuities through Social Security with retirement savings, using savings to delay the Social Security start date, and defaulting workers into catch-up contributions that increase Social Security benefits. While the details vary in important ways, most of these proposals recognize the value and reliability that Social Security provides and aim to expand its utility in a budget-neutral manner. And, most proposals include a reasonable cap that could be implemented based either on the dollar cost of the buy-up or a retirement income level based cap so that this would not become another way for those with the most resources to twist the system disproportionately in their favor. Such proposals offer great hope that a retirement system that has lurched towards lump sums could be nudged back to focus on generating income. However, any reliance upon individual savings would be limited for the groups that are missing out today, unless those areas are strengthened in a significant way.

In recent years, retirement security experts have spent much time focused on shoring up Social Security's funding and combating claims that Social Security won't be there when people retire. As a result, Americans have lost sight of the fact that Social Security is the most important retirement program in the nation and a vehicle for improving retirement security for almost all Americans. Meanwhile, Congress has made changes to retirement policy that primarily benefit high-income savers, but has dragged its feet on fixing Social Security, which benefits working class and middle-class families.

State-Facilitated Retirement Savings Programs

A major development in recent years has been the establishment of more than a dozen state-facilitated retirement savings programs, often called "Secure Choice" programs. These plans are specifically targeted toward private sector workers who are not offered a retirement savings plan through their employer. Many of these workers are also low- or moderate-income, the very people who are often left out of the retirement savings tax structure.

There have been discussions among policymakers about creating a federal program with a structure similar to these state-run savings initiatives, which would fill the gap left by states that are not moving forward with establishing these programs. A federal savings program might be structured like a 401(k) rather than an IRA, which would allow employers to contribute to workers' retirement accounts if they wish (currently, employers are not allowed to contribute in most of these state programs because the account is set up as an IRA). A federal program also would normalize the geographic inequities that seem likely to emerge with the current piecemeal, state-based approach.

Another idea that deserves consideration is targeting the Saver's Credit toward workers who are participating in these Secure Choice programs. Many may already be eligible to claim the Saver's Credit, but may not know about it or how to claim it. Others may just be missing out on the benefit due to the sharp income cliffs in the design of the Saver's Credit. States offering these programs could consider establishing a state-level version of the Saver's Credit, but broad reform of the federal Saver's Credit could benefit more than just those saving in these programs, as other low and moderate income workers would be able to take advantage of an improved federal credit.

A Federal Retirement Saving Credit

One idea discussed recently is the elimination of the tax deductions available for retirement savings and replacement with a credit that is a fixed percentage for everyone, regardless of income level. If this credit is made refundable, so that it can be claimed even if no taxes are owed, that would do even more to improve retirement security. Furthermore, if the amount of the retirement savings credit could be directly deposited into a retirement savings account, that would provide an additional boost to retirement savings.

This flat credit would not eliminate the upward skew from larger contributions that are made by people who earn more, but it would make the tax-match more equitable as the tax incentive would no longer be based upon an individual or family's top marginal tax rate. Instead, everyone would receive the same tax-match, regardless of contribution amount. For example, if the retirement saving credit equaled 25 percent of retirement plan contributions, then someone who saves $1,000 would receive a $250 tax credit. Someone else who saves $10,000 would receive a $2,500 tax credit. It would not matter though whether these individuals are in the 12 percent or 37 percent marginal tax bracket because they would each receive the same 25 percent tax-match.

Required Minimum Distributions

The SECURE Act of 2019 increased the start age of required minimum distributions from 70.5 to 72. Pending legislation often referred to as "Secure 2.0" would further raise RMDs from 72 to 75. This seems to be an example of the retirement savings system being used as a wealth building and intergenerational wealth transfer system. The whole point of RMDs is to require money accrued for retirement savings to be distributed in retirement. While the money has to be distributed, it doesn't have to be spent, it just has to be taken out of a tax-preferred account. Raising the age at which RMDs start enables wealthy individuals to further shelter their wealth from taxation, but appears very unlikely to solve the problems facing middle-class Americans.

CONCLUSION

The U.S. retirement savings system too often leaves out the middle class. Social Security, while very effective at reducing elder poverty, has replacement rates that diminish rapidly. Meanwhile, the individual savings system, which is bolstered by generous tax incentives, provides the greatest benefit to high-income earners and middle-class workers often are not well-positioned to take advantage of it.

Those generous tax incentives offered by the federal government to promote retirement savings are layered upon a retirement savings system that is inequitable. The very nature of the tax code itself pushes much of the benefit to the top since high-income taxpayers always will benefit more from deductions in a progressive income tax structure with marginal tax rates. Retirement plan access also drives many of the outcomes relating to adequate savings and plan participation is a necessary first step for utilizing tax incentives.

Essential reforms to the Saver's Credit, which exists to encourage saving among low- and moderate-income households, could go far to increasing saving among the missing middle class. Broader reforms of the retirement tax expenditures, such as eliminating deductions in favor a refundable credit, could do even more to promote greater savings.

Ultimately, tax incentives are a tool to achieve a specific public policy purpose. For the purpose of encouraging retirement savings, these incentives mostly reflect and sometimes exacerbate a fundamentally inequitable system. Perhaps it is time for policymakers to recalibrate their tools to focus on the missing middle rather than foregoing large sums of federal tax revenue for tax expenditures that mostly benefit the highest earners.

ENDNOTES

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14. Employee Benefits Security Administration, "Fact Sheet: Cash Balance Pension Plans" U.S. Department of Labor. November 2011. Available on the web at: https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/cash-balance-pension-plans
15. U.S. Department of the Treasury. "Tax Expenditures FY2023 Tables." Available on the web at: https://home.treasury.gov/policy-issues/tax-policy/tax-expenditures
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17. Federal Deposit Insurance Corporation. "How America Banks: Household Use of Banking and Financial Services" December 17, 2021. Available on the web at: https://www.fdic.gov/analysis/household-survey/index.html#:~:text=and%20Financial%20Services-,2019%20FDIC%20Survey,union%20(i.e.%2C%20bank
18. There is significantly more money in traditional rather than Roth IRAs. At the end of 2019, there were $9.4 trillion of assets in traditional IRAs and $1.0 trillion of assets in Roth IRAs, according to a CRS analysis of ICI data.
19. Total retirement assets in the U.S. were $39.4 trillion at the end of the fourth quarter of 2021. Source: Investment Company Institute, "Retirement Assets Total $39.4 Trillion in Fourth Quarter 2021", March 28, 2022.
20. Tax Policy Center. "What is the Standard Deduction?" Updated May 2020. Available on the web at: https://www.taxpolicycenter.org/briefing-book/what-standard-deduction
21. Urban-Brookings Tax Policy Center. "Historical Highest Marginal Income Tax Rates" February 9, 2022. Available on the web at: https://www.taxpolicycenter.org/statistics/historical-highest-marginal-income-tax-rates

22. In the private sector, only 17 percent of workers had access to a defined benefit plan, either alone or in combination with a defined contribution plan. Source: Bureau of Labor Statistics, U.S. Department of Labor, *The Economics Daily,* 51 percent of private industry workers had access to only defined contribution retirement plans at https://www.bls.gov/opub/ted/2018/51-percent-of-private-industry-workers-had-access-to-only-defined-contribution-retirement-plans-march-2018.htm (visited *May 02, 2022*).
23. Less than 15 percent of Americans work in the public sector, where access to pensions with life income is typically available. Generally speaking, union workers enjoy higher wages than nonunion workers (source: https://www.epi.org/publication/eroded-collective-bargaining/). Large firms tend to pay higher wages than small firms.
24. Morningstar points out that a relatively small number of firms provide coverage to the majority of participants in DC plans. *Retirement Plan Landscape Report,* March 2022.
25. Internal Revenue Service. "Retirement Savings Contributions Credit (Saver's Credit)" Available on the web at: https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-savings-contributions-savers-credit
26. Approximately 9 in 10 workers are in Social Security covered employment. Sources: Social Security Administration, "Fast Facts & Figures About Social Security, 2020" Available on the web at: https://www.ssa.gov/policy/docs/chartbooks/fast_facts/2020/fast_facts20.html; Social Security Administration, "Fact Sheet: Social Security" Available on the web at: https://www.ssa.gov/news/press/factsheets/basicfact-alt.pdf; and Whitman 2011.
27. Social Security benefits rely on indexing past earnings to approximate one's average standard of living throughout their career, as explained by the SSA: *"Average Indexed Monthly Earnings (AIME) When we compute an insured worker's benefit, we first adjust or "index" his or her earnings to reflect the change in general wage levels that occurred during the worker's years of employment. Such indexation ensures that a worker's future benefits reflect the general rise in the standard of living that occurred during his or her working lifetime. Up to 35 years of earnings are needed to compute average indexed monthly earnings. After we determine the number of years, we choose those years with the highest indexed earnings, sum such indexed earnings, and divide the total amount by the total number of months in those years. We then round the resulting average amount down to the next lower dollar amount. The result is the AIME."* Source: Social Security Administration, "Social Security Benefit Amounts" Available on the web at: https://www.ssa.gov/oact/cola/Benefits.html#:~:text=After%20we%20determine%20the%20number,The%20result%20is%20the%20AIME.
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29. Social Security Administration. *The 2021 Trustees Report.* August 31, 2021.
30. National Association of Realtors, "County Median Home Prices Q4 2021" Available on the web at: https://www.nar.realtor/research-and-statistics/housing-statistics/county-median-home-prices-and-monthly-mortgage-payment.
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32. Neil Bhutta, Andrew C. Chang, Lisa J. Dettling, and Joanne W. Hsu. *Disparities in Wealth by Race and Ethnicity in the 2019 Survey of Consumer Finances.* The Federal Reserve Board. September 28, 2020.
33. Steve Rosenthal, "Retirement Tax Benefits Exacerbate Racial Inequities," *Forbes.* August 25, 2021.
34. Tyler Bond and Frank Porell. *Examining the Nest Egg.* National Institute on Retirement Security. January 2020.
35. In 2019, the middle 40% of Millennials owned 14% of their generation's financial assets; the middle 40% of Generation X owned 8% of their generation's financial assets; and the middle 40% of Baby Boomers owned 6% of their generation's financial assets. Source: Tyler Bond, "The Middle Class Owns Few Financial Assets," National Institute on Retirement Security. September 2021.
36. Tyler Bond. *Stark Inequality.* National Institute on Retirement Security. September 2021.
37. Tyler Bond and Frank Porell. *Examining the Nest Egg.* National Institute on Retirement Security. January 2020.
38. Older, non-working households with income from a defined contribution plan: whites - 29.4%; Blacks - 13.7%; Hispanics - 12.3%. Source: *Examining the Nest Egg.*

WHO WE ARE & WHAT WE DO

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Our Mission

The National Institute on Retirement Security is a non-profit research and education organization established to contribute to informed policymaking by fostering a deep understanding of the value of retirement security to employees, employers, and the economy as a whole.

Our Vision

Through our activities, NIRS seeks to encourage the development of public policies that enhance retirement security in America. Our vision is one of a retirement system that simultaneously meets the needs of employers, employees, and the public interest. That is, one where:

- employers can offer affordable, high quality retirement benefits that help them achieve their human resources goals;

- employees can count on a secure source of retirement income that enables them to maintain a decent living standard after a lifetime of work; and

- the public interest is well-served by retirement systems that are managed in ways that promote fiscal responsibility, economic growth, and responsible stewardship of retirement assets.

Our Approach

- High-quality research that informs the public debate on retirement policy. The research program focuses on the role and value of defined benefit pension plans for employers, employees, and the public at large. We also conduct research on policy approaches and other innovative strategies to expand broad based retirement security.

- Education programs that disseminate our research findings broadly. NIRS disseminates its research findings to the public, policy makers, and the media by distributing reports, conducting briefings, and participating in conferences and other public forums.

- Outreach to partners and key stakeholders. By building partnerships with other experts in the field of retirement research and with stakeholders that support retirement security, we leverage the impact of our research and education efforts. Our outreach activities also improve the capacity of government agencies, non-profits, the private sector, and others working to promote and expand retirement security.

The National Institute on Retirement Security is a non-profit, non-partisan organization established to contribute to informed policy making by fostering a deep understanding of the value of retirement security to employees, employers, and the economy as a whole. NIRS works to fulfill this mission through research, education and outreach programs that are national in scope.

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