Center for American Progress

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The Universal Savings Credit

By Christian E. Weller and Sam Ungar July 19, 2013

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Introduction and summary

The financial crisis of 2007 to 2009 took a tremendous toll on household wealth and shattered the sense of financial security for millions of American families. American households lost more than $20 trillion in wealth (in 2012 dollars) in the Great Recession, and households still had $10 trillion less in wealth at the end of 2012 than they had before the crisis.[1] This massive wealth decline contributed to a widespread loss of economic security, particularly among lower-income and moderate-income families, single women, and communities of color.

This economic insecurity can have long-ranging adverse effects on U.S. economic growth as American families:

- Invest less in new businesses, which slows productivity growth and innovation

- Save less for large long-term expenses such as retirement and their children's college tuitions, which leads to less-stable financing for capital investments

- Become less likely than they would with more wealth to switch jobs and careers when better opportunities arise, which slows employees' productivity

The bottom line: Economic insecurity from decimated household wealth today could potentially reverberate through our nation's economy for a long time through slower growth, fewer jobs, and lower living standards. Helping households rebuild their wealth should therefore be a top policy priority.

The federal government already uses the tax code to incentivize people to save, typically through tax advantages for particular forms of savings. Employers and employees can often deduct their contributions to retirement savings vehicles, such as 401(k) plans, from their taxable income, and the capital gains in retirement savings plans are not subject to taxation until people withdraw the money. The federal government loses income tax revenue that it otherwise would have received while people save and then recuperates some of the lost tax revenue when people withdraw money for retirement and then pay income taxes. The underlying idea is that these tax advantages encourage more people to save more money for retirement than they otherwise would have. Similar incentives exist for people to save for health care and their children's education, but retirement savings incentives are by far the most prevalent and largest tax savings incentives that the federal government offers.

Yet a closer look at the tax incentives for retirement savings as well as other similar incentives for health care savings and educational savings suggests that the current system suffers from two key inefficiencies:

- **Upside-down tax incentives:** Tax deductions carry a greater value for people with a high marginal tax rate than for people with a lower marginal tax rate. A person whose last dollars earned fall into the top income tax bracket, for instance, faces a marginal tax rate of 39.6 percent. That is, each dollar of a tax-advantaged contribution to a retirement savings account reduces the taxes that this person owes to the federal government by 39.6 cents. A lower-income earner with a marginal tax rate of 10 percent, however, reduces the money they owe to the federal government by only 10 cents for every dollar that they contribute to retirement savings. The value of the tax incentive is upside down, as it is almost four times larger for high-income earners—who arguably do not need much help to save—than it is for lower- and moderate-income earners, who typically have a hard time saving.

- **Savings complexities:** Employers and employees can choose from a wide range of retirement savings vehicles. There are defined-benefit pensions and defined-contribution savings plans, the latter of which come in a whole host of flavors—401(k)s, 403(b)s, SIMPLEs, SEPs, IRAs, and Roth IRAs, just to name a few. Moreover, all of these retirement savings plans come with their own rules of who can save with them, how much money people can save, and when the tax advantages occur—during the contribution phase, during the investment phase, or during the withdrawal phase. This complexity often stands in the way of people taking full advantage of all of the tax incentives available to them.

Because of these two inefficiencies, the federal government is not getting as much additional savings as it ideally could from the foregone tax revenue. More efficiently designed savings incentives, however, would generate more bang for the buck, as people would save more than is currently the case for every dollar in tax incentives.

We propose to vastly simplify existing savings incentives by turning all existing deductions into one single tax credit—the Universal Savings Credit. With this credit, people would receive a flat percent of their contributions to a predetermined savings account, regardless of their income and how much money they owe in federal income taxes. People can use the savings that they accumulate with the Universal Savings Credit for a wide range of purposes, such as paying for health care or education, putting a down payment on a first residence, starting or expanding a business, an economic emergency such as unemployment, and retirement.

We also envision only one set of rules for contributing money, investing money, and withdrawing money that will govern savings for these purposes, as discussed further below.

Our goal is to end the current system of upside-down savings incentives and to streamline savings incentives to make it easier for people to understand what they can save, how much they can save, and when they can withdraw their money. Lower-income households, who need more help in saving, will get more help from the new tax incentives than from the existing ones, and everybody will find it easier to understand tax incentives. The result of these changes should be more-efficient savings incentives and thus more saving.

More savings are good not only for individuals but also for the economy as a whole. Building wealth more quickly increases economic security. People will have more money available for short-term emergencies and for longer-term goals such as buying a house, starting a business, and sending their children to college. Greater short-term and long-term economic security should translate into faster economic growth, as people can better handle changes in the economy. More economic security will allow people to take a longer-term view and better plan for possible economic changes such as sending children to college, starting a business, and switching jobs and careers.

Inefficiencies in the current system

Existing tax incentives are skewed toward the rich

Existing savings incentives in the federal tax code are mostly deductions from taxable income. Employee and employer contributions into a tax-advantaged savings plan—primarily into retirement savings vehicles such as 401(k) plans, IRAs, and defined-benefit pension plans—typically reduce the taxable amount of income for employees and employers. The money in a tax-advantaged savings vehicle then accumulates without employers and employees having to pay taxes on the capital gains in the savings plans. Taxes are due, however, when money is withdrawn for retirement or other purposes.[2]

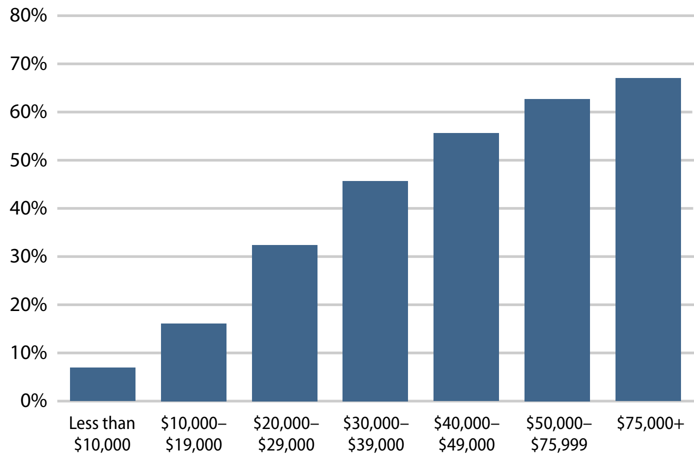
The federal government uses these tax incentives primarily to get people to save for retirement, but similar tax incentives exist for health care savings—into Health Savings Accounts, for example, which allow people to pay for health care costs that are not covered by insurance—and for children's college education to subsidize tuition payments.

The percentage of the contribution to a tax-advantaged savings plan that can be deducted from taxable income—thereby lowering one's tax burden—is determined by a household's tax bracket: The more a taxpayer makes, the more they are incentivized to save. The highest tax bracket—for those annually making more than $400,000 individually or $450,000 jointly—is 39.6 percent.[3] Those Americans fortunate enough to earn more than that sum of money pay 39.6 percent of every dollar above that ceiling in taxes, but they are also able to deduct 39.6 cents of each dollar contributed to an eligible 401(k) or IRA from their total tax burden. This is also true for contributions to eligible Coverdell Education Savings Accounts, or ESAs, for anticipated college tuition expenses and eligible Health Savings Accounts, or HSAs, for savings toward medical care.

The richest Americans are also those who are most likely to have access to an employer-sponsored savings plan in the first place, allowing them to build a healthy nest egg with unneeded tax incentives. Sixty-seven percent of workers making $70,000 or more a year participate in an employer-sponsored retirement plan, but that number drops off precipitously for lower-income households. Only 32.4 percent of workers making between $20,000 and $29,999 a year participate in an employer-sponsored plan, and just 6.9 percent of those making less than $10,000 a year participate.[4] Similarly, higher-income earners are more likely to get access to health savings accounts—through so-called cafeteria benefit plans such as tax-advantaged parking and transportation and child care expenses from their employers.[5]

FIGURE 1

Total Employee Participation in Employer Sponsored Defined Benefit and/or Defined Contribution Retirement Plans, by Annual Earnings



Source: Craig Copeland, "Employment-Based Retirement Plan Participation: Geographic Differences and Trends: 2011" (Washington: Employee Benefits Research Institute, 2012).

Empirical evidence shows that higher-income earners only replace nontax-advantaged savings with tax-advantaged savings—that is, higher-income earners would save similar amounts without savings incentives.[6] This inefficiency means that the federal government may spend as much as $92 billion in fiscal year 2013 on retirement savings incentives for the top quintile of earners alone, without actually increasing personal savings beyond where savings would have already been if taxpayers in the top fifth of the income distribution save as much as they do with or without the federal tax benefits.[7]

On the other hand, middle-class families in the 20 percent to 30 percent tax brackets are less likely to take advantage of existing incentives because those incentives do not reward long-term financial planning nearly as well.

The system offers even less help for lower-income Americans, who do not have as strong of an incentive to save as the rich. Working families in the 15 percent tax bracket are only able to claim 15 cents for every dollar contributed to a deduction-eligible savings plan, and most working families generally do not receive the benefit of employer 401(k)-plan contributions either. This is in spite of the fact that they are the families who need the most help to build long-term wealth in times of economic uncertainty and financial insecurity.

Indeed, some working-class families pay no federal income tax at all, though they do pay payroll taxes. This is one of the most important facets of the nation's progressive system of taxation: The working poor, who struggle to make ends meet on a day-to-day basis, should not be forced to pay federal taxes beyond their means. Because their marginal tax bracket is zero percent, however, they are able to deduct zero percent of money saved toward retirement, education, or health care. For these Americans, there is no incentive from tax deductions to save toward their living expenses in retirement.

These upside-down savings incentives result in a pronounced imbalance in who benefits from the tax deductions on the books. The federal government forgoes about $140 billion in revenue annually from tax deductions for contributions to savings, but only 3 percent of that $140 billion goes to the bottom 40 percent of earners, who need the most help to save. On the other hand, 80 percent goes to the top 20 percent of earners, with almost 50 percent of the tax subsidies going to the top 10 percent of earners.[8]

Academic research also confirms that tax incentives are the least-effective way to generate new savings in the highest tax bracket of earners.[9] These high-income earners are largely taking advantage of incentives in the tax code to be rewarded for behavior they would have engaged in anyway.

A potential counterargument may be that low-income Americans would not benefit from savings incentives anyway since they cannot save, as they need to spend all of their money on life's necessities. Academic studies have shown, however, that low-income households can and do indeed save with targeted and progressive incentives. From March 5 to April 5, 2005, 14,000 tax filers at H&R Blocks in low- to middle-income neighborhoods of St. Louis, Missouri, were randomly assigned matching offers for IRAs of zero percent, 20 percent, and 50 percent up to $1,000 ($2,000 for married tax filers). Only 3 percent of filers took the zero percent matching offer, while 8 percent and 14 percent of filers accepted the 20 percent and 50 percent matching offers, respectively. The lower incentive of 20 percent alone caused nearly three times as many people to sign up for an IRA than the plan with no incentive at all.[10]

A similar experiment in Tulsa, Oklahoma, lends further credence to the willingness of low-income Americans to build long-term wealth, finding that participants "were capable of planning and implementing their financial goals over a multi-year time horizon."[11] Low-income families were encouraged to set up Individual Development Accounts, or IDAs, a form of subsidized savings account in which withdrawals can only be made for certain authorized purposes such as purchasing a home or starting a business. To incentivize the use of these accounts, withdrawals for purchasing a home were matched at a 2-1 rate and were matched for all other allowed purposes at a 1-1 rate, with $750 in withdrawals per year eligible for matching. The program had "significant favorable impacts on asset-building among low-income persons."[12]

The bottom line is that lower-income Americans would likely save more than they currently do if they received higher savings incentives than they currently do.

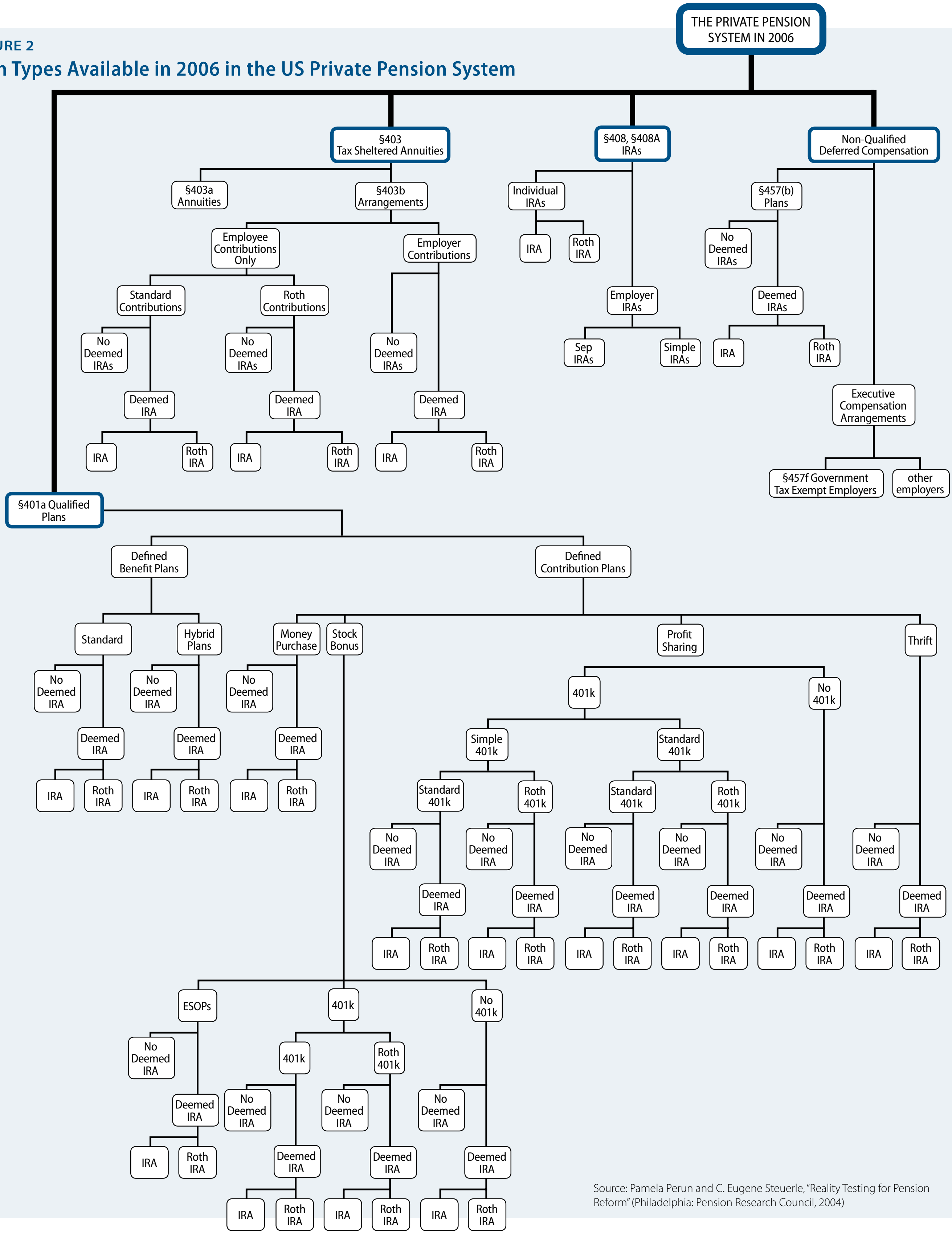
Confusion over existing savings incentives results in saver paralysis

The tax code's incentives to encourage retirement, education, and health care savings are so confusing that even those households that would like to take advantage of them are deterred from doing so. They find it difficult to find a way through the red tape created by government incentives and private plans.

The retirement savings system alone is a complex web of accounts and incentives that is difficult to navigate without the assistance of a financial professional.[13] The confusing nature of this system may be best illustrated graphically. (see Figure 2)

FIGURE 2

Plan Types Available in 2006 in the US Private Pension System



Source: Pamela Perun and C. Eugene Steuerle, "Reality Testing for Pension Reform" (Philadelphia: Pension Research Council, 2004)

In order to claim retirement deductions, one must navigate this system—not only choosing the most effective plan but then also finding and claiming the deductions that will most effectively reward savings choices. The average household must navigate similar systems in order to decide on and set up a Coverdell ESA or an HSA.

Providing choice is not in and of itself a flaw with the system, but behavioral economics has shown that overwhelming consumers with choices is effectively the same as providing no choice at all. Multiple studies elucidate evidence that choices in some decisions can overwhelm and frustrate consumers, resulting in consumers choosing the most familiar option—or making no choice at all.[14] This is compounded by the fact that savings decisions can be life-altering for oneself and one's family, so individuals are even more likely to abstain from choosing anything altogether out of a fear of making a choice that could end up damaging the financial well-being of the household.[15]

There is widespread agreement across party lines that savings incentives need to be streamlined. Former President George W. Bush's Advisory Panel on Federal Tax Reform recommended the simplification of savings incentives in the tax code in 2005, as the "piecemeal addition of savings incentives with complicated rules [has] made it increasingly hard for ordinary Americans to navigate the system while allowing for well-advised taxpayers to take advantage of the code's many loopholes."[16]

The Universal Savings Credit balances and simplifies savings incentives

Balancing incentives

Addressing the upside-down savings incentives and their complexity could create more savings for millions of middle- and low-income households. Congress should act to replace the various employer and employee deductions to retirement, health, and education savings accounts with one Universal Savings Credit, or USC.

Because this incentive is a tax credit rather than a tax deduction, it equally rewards each dollar saved, whether from a taxpayer in the 39.6 percent bracket or a taxpayer in the 10 percent bracket. Importantly, the credit will be revenue neutral. That is, the money to finance it will come from ending the current system of savings incentives. The credit will be a flat matching percent of all contributions to qualified savings vehicles. The savings incentives will only depend on the amount saved.

What would the credit rate look like? Currently, a taxpayer receives a tax benefit by deducting the contributions to a retirement savings account, for instance, from their taxable income. So a taxpayer with income in the 15 percent marginal-income tax bracket as their highest tax bracket who contributes $2,000 to a retirement savings account lowers the amount of income taxes he or she owes by $300—15 percent of $2,000. Put differently, the total savings of $2,000 includes $1,700 of income that the taxpayer would have had even after taxes and an implicit government contribution to his or her savings of $300. The government essentially subsidized each dollar contributed to a savings account with 17.6 cents—$300 relative to $1,700—of tax savings.

A tax credit, however, works differently than a deduction. A taxpayer contributes a fixed amount of money to a qualified savings account, and the government provides a proportional contribution to that savings account in the form of the tax credit. The taxpayer will typically claim a credit on his or her annual income tax filing for the previous year. So a taxpayer in the 15 percent income tax bracket would need to receive a credit of 17.6 cents for each dollar saved in order to be as well off as with a tax deduction.

This is just an illustrative example, but the tax credit for savings should be structured such that most taxpayers will be either as well off or better off with the Universal Savings Credit than they are with current savings incentives in the form of tax deductions. Most existing proposals to convert tax deductions into tax credits envision tax credits of about 15 percent to 20 percent across the board to all taxpayers, up to a predetermined maximum annual savings amount, which would offer larger savings incentives for the majority of taxpayers than the current system of deductions does.[17] The Tax Policy Center also found that an 18 percent matching tax credit is the equivalent of a 15 percent retirement savings deduction.[18]

The same study from the Tax Policy Center concludes that a 30 percent credit across the board would be revenue neutral. That is, the majority of taxpayers would either receive a larger tax benefit from a tax credit than from the current system of tax deductions or the credit would have no effect on their tax liability.[19]

Contribution matches should be progressive so that lower-income earners receive a relatively larger match, such as a 2-1 match or 1-1 match, assuming sufficient funds are available.

Taxpayers would receive the government matches, up to a maximum annual contribution amount. The maximum annual contribution amount would need to be set once the credit rate is established, such that the Universal Savings Credit is revenue neutral relative to the existing system of tax deductions. That is, the newly created system of savings incentives would not cost the government more than the existing system of savings incentives, but it would be more efficient and thus generate more private savings from individuals than is currently the case.

Current savings incentives also include the tax-free receipt of realized capital gains, dividends, and interest payments from investments in a qualified account. As such, there is an upside-down element to the tax treatment of the investment gains since capital gains, dividends, and interest payments are subject to some progressive taxation, with larger investment gains incurring relatively larger taxes. Taxpayers with larger investment gains consequently receive a proportionally larger savings incentive due to the current tax treatment of investment gains.

This comparatively larger tax incentive for higher-income earners when money is saved is offset by the tax treatment when the savings are spent. All of the past contributions and investment gains are subject to income taxation once taxpayers withdraw their money from their accounts. Federal income taxes are still progressive, so that higher-income earners pay a larger share of their income in taxes when they withdraw money. Our proposal envisions that the tax treatment of investment gains in savings accounts and of withdrawals from such accounts remains the same as is currently the case.

Simplifying incentives

The Universal Savings Credit will not make any distinction between savings purposes to eliminate the labyrinth of existing savings incentives. That is, people can use the credit to save for education, homeownership, health care, and retirement. Allowable reasons for withdrawals from these savings accounts should match the reasons for existing allowable hardship withdrawals in retirement savings accounts, including retirement, down payment for a primary residence, an unemployment spell, medical bills, and educational expenses. The flexibility to use money for a wide range of reasons should encourage people to save more money than they would have saved in more restricted savings.

There should be a limit for preretirement withdrawals, however, in order to prevent abuse. Households should only be able to withdraw the actual amount necessary for the withdrawal reason, along with a predetermined percentage of their accrued savings for emergencies before age 62. Starting at age 62, however, households should be permitted to withdraw all of their money for retirement income. Limiting the amount that people can withdraw from their savings accounts in any one instance will mean that money will actually be available the next time they need to dip into their savings and for retirement.

A substantial share of savings could also pass on to heirs, as savers do not always spend all of their savings during their lifetime. The current system consequently requires that savers start to withdraw a minimum amount of their savings at a specific age, typically once they turn 70-and-a-half years old. To limit the public's tax liability, USC-eligible account holders should also be required to make a minimum withdrawal when they reach a certain age—say, 70-and-a-half years of age, which matches the existing minimum-required withdrawal rules for retirement plans. This would make clear that savings are meant to support people's incomes when other income sources are no longer available.

People can apply the newly created credit to existing savings accounts such as IRAs and 401(k)s, as well as to defined-benefit pensions, but new contribution and withdrawal rules will also apply. Contribution rules, for instance, will be the same for IRAs and for 401(k)s, unlike in the current system, which sets lower contribution limits for IRAs than for 401(k)s. Savers can also withdraw money from these accounts for reasons other than retirement. The point of maintaining existing plans is just to make it easy for people to continue saving in ways that are already familiar to them.

All savings in accounts that are eligible for the credit should also have default investment options. These default investment options will automatically apply unless savers specify other investment options. This will help avoid situations in which saved money simply sits in an account and does not earn any interest. Savers will over time experience faster growth with their savings than with holding money solely in cash.

The Internal Revenue Service should also provide an option for automatic contributions to any savings account eligible for the Universal Savings Credit on annual tax-refund filing forms. This will increase participation in the savings accounts eligible for the credit and thus raise people's savings over time.

Additional issues related to the implementation of the Universal Savings Credit

This report aims to make the argument for ending the existing upside-down tax preferences that provide the largest savings incentives for households who do not need much extra help to save and the smallest incentives for households who arguably need the most help. This report also argues that a change from savings incentives in the form of tax deductions to refundable tax credits should go along with a large-scale simplification of existing savings incentives. There are a number of practical issues, however, that require additional attention.

Trading off maximum contributions and credit rate

This proposal envisions a flat credit for all taxpayers, potentially coupled with a progressive—larger—credit for lower-income taxpayers. Taxpayers would receive the credit up to an annual maximum contribution to all accounts combined. The implementation of the Universal Savings Credit would be revenue neutral relative to the existing system of tax deductions. In other words, the proposed system of the Universal Savings Credit likely will change who receives tax benefits for savings but not how much the federal government spends on such incentives.

The combination of revenue neutrality, annual maximum contributions, and a flat credit rate implies that there is a tradeoff between maximum contributions and the credit rate. A higher maximum contribution per taxpayer means that more contributions are eligible for the credit, thus reducing the money available for the credit.

Consider a basic numeric example to illustrate this point. Let's say, for argument's sake, that the amount annually available for savings incentives is $100 billion for 2013. The federal government could, for instance, allocate this money as a 33.3 percent credit for all taxpayers, without a progressive match.[20] The maximum amount that all taxpayers together could contribute would then be $300 billion, since $100 billion is equal to 33.3 percent of $300 billion. Assume again, for argument's sake, that this means that the maximum amount that any taxpayer could contribute and qualify for the credit for each dollar they contribute to a savings account is equal to $10,000 in 2013—that is, each taxpayer can contribute a maximum of $10,000 and receive $3,333 as credit from the federal government. The government may alternatively decide to raise the maximum savings amount by 25 percent to $12,500. Assuming that this will increase total savings by, for instance, 10 percent to $330 billion[21]—or 110 percent of $300 billion—the credit rate would have to fall to 30.3 percent, since $100 billion—the total amount available for the credit—is equal to 30.3 percent of $330 billion. The numbers will obviously not line up this way in reality, but the basic point remains that a higher maximum allowable contribution will mean a lower credit, and a lower maximum allowable contribution will mean a higher credit.

Different groups of taxpayers will benefit from either a higher maximum amount or a higher credit. Most lower- and moderate-income taxpayers will find it difficult to save thousands of dollars each year and thus will never come close to maximum allowable amounts, which are currently $17,500 for 401(k) plans, for instance. As such, a taxpayer who can realistically save only $2,000 per year will not see any disadvantage from policymakers lowering the maximum contribution amount from, for instance, $17,500 to $10,000. A credit of 33.3 percent compared to a credit of 25 percent on $2,000 of annual savings, however, will provide the taxpayer an additional $166 per year in this example. Lower- and moderate-income taxpayers will most likely benefit more from a higher credit than from higher maximum contribution amounts.

Higher-income earners will likely benefit from being able to save larger amounts and receive the full credit for their savings. Let's say that the choice is between a maximum contribution amount of $5,000 at a flat credit of 33.3 percent and a maximum contribution amount of $10,000 at a flat credit of 25 percent. In this example, a taxpayer who can contribute $10,000 will receive either a credit of $166.50 or of $250, depending on which combination of maximum contribution amount and credit rate policymakers choose.

The question is how much more sensitive savings are to changes in the credit rate compared to changes in the maximum contribution amounts for lower-income and middle-income households, who need to increase their savings more than higher-income earners. The a priori assumption is that a higher credit is better than a lower credit, but the empirical question is where the ideal maximum savings cutoff should be to help lower-income and middle-income households most in saving for their future. William G. Gale, co-director of the Tax Policy Center, concluded in a 2011 study that a revenue-neutral credit, assuming the same contribution limits as before, would equal 30 percent.[22] Lower contribution limits than currently are in place would allow for either a larger credit for all taxpayers or for the creation of a progressive match for lower-income taxpayers.

Treatment of existing savings vehicles

The Universal Savings Credit could be applied to any savings account as long as it is properly regulated by the relevant regulatory agencies, such as the Securities and Exchange Commission, the Internal Revenue Service, and the Department of Labor, among others. Contributions to existing savings accounts such as 401(k) plans and IRAs can qualify for the credit, as can newly created savings accounts.

Existing savings accounts, however, would have to operate under the uniform new rules that would apply to all qualified savings vehicles. Existing savings vehicles for retirement, for example, include defined-contribution savings accounts, such as 401(k) plans and IRAs, and defined-benefit pensions, such as single-employer pensions and multiemployer pensions. Defined-contribution accounts offer savers more investment and withdrawal choices, but these choices also come with higher costs and greater risks than is typically the case for defined-benefit pensions. All of these savings vehicles could theoretically continue to exist, but they would operate with a uniform maximum contribution amount, a uniform credit for contributions, and a uniform set of default rules for withdrawing funds.[23]

It is entirely possible that the creation of the Universal Savings Credit, which taxpayers could use in flexible ways to save for whatever purpose is most important to them, will lead to a proliferation of new savings vehicles. People could theoretically go shopping for savings vehicles that better meet their needs than existing savings plans since savings would be less tethered to employers than is currently the case. Financial-service providers could respond to this growing demand by offering a range of savings plans that currently do not exist. Policymakers could encourage the creation of low-cost and low-risk savings options where they do not already exist. The Universal Savings Credit should hence be implemented jointly with a new type of low-cost account for low- and middle-income households—preferably the Center for American Progress's Secure, Accessible, Flexible, and Efficient, or SAFE, plan[24]—but there are a variety of proposed programs that would also provide low-income workers with more-secure and lower-cost retirement savings vehicles.[25] Any such proposal, joined with the Universal Savings Credit, would ensure that savers not only save more money but also that their money is safely invested for future purposes.[26]

Tracking annual contribution limits

The new system of savings with the Universal Savings Credit will allow savers to save as much outside of an employer-sponsored savings plan as with an employer-sponsored savings plan such as a 401(k) plan. The maximum contribution limit will consequently apply to each taxpayer, not to an individual account. This requires, though, that some entity will keep track of how much each taxpayer has already contributed to one or more qualified accounts. It seems easiest to keep track of all contributions through the IRS, since the tax authority will also administer the payment of the credit by handling a taxpayer's annual tax return.

The employer-based savings system

The Universal Savings Credit will interact with the existing employer-sponsored system in different ways since this proposal envisions two critical changes to the tax treatment of employer-sponsored savings. First, the annual contribution limit applies uniformly regardless of whether a taxpayer saves in an employer-sponsored savings plan or not. Second, employers could no longer deduct their contributions to retirement savings plans so that taxpayers could receive higher credits than they otherwise would. The proposed credit will be revenue neutral. Tax incentives that are currently benefiting employers would directly benefit employees under the proposed credit. These changes may lead some employers to cut back or weaken their existing retirement savings plans, especially existing defined-benefit pensions.

But the streamlined savings incentives that will be tied to taxpayers could also result in larger participation rates in some defined-benefit pensions. The credit would allow taxpayers to shop around for the best option for their money. There is no reason why some existing defined-benefit pensions, such as multiemployer plans in the private sector or public-sector plans, should not be able to offer retirement savings options to individuals who want to invest their savings and tax credits with them.[27] Some taxpayers who currently do not participate in a defined-benefit plan will want to use their money to get access to these benefits. It is thus conceivable that the Universal Savings Credit will translate into a greater participation in defined-benefit pensions. That is, the newly created credit could result not only in more people saving more but also in more people enjoying low-cost, low-risk retirement benefits.

Conclusion

The federal tax code should help low- and middle-income Americans struggling to rebuild the wealth they lost over the course of the Great Recession, but today's tax incentives for savings are more of an obstacle than an aid. The current system is demonstrably skewed in favor of those who actually need the least help building wealth, and it remains so complex that even those low- and middle-income Americans who are positioned to benefit simply cannot navigate it at all.

The Universal Savings Credit will correct this imbalance and simplify the system. With this credit in place, the American people can finally begin to shift from triaging their finances in the short term to building stability and security for the long term.

About the authors

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Endnotes

1 Author's calculations based on Board of Governors of the Federal Reserve System, "Release Z.1 Flow of Funds Accounts of the United States" (2013).

2 Roth IRAs and Roth 401(k)s receive a different tax advantage. Contributions to those types of savings plans occur after a taxpayer has paid income taxes, but investment gains and withdrawals from these savings accounts are tax free.

3 *American Taxpayer Relief Act of 2012*, Public Law 240, 112th Cong., 2nd sess. (January 1, 2013).

4 Craig Copeland, "Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2011" (Washington: Employee Benefit Research Institute, 2012); Craig Copeland, "Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2007" (Washington: Employee Benefit Research Institute, 2008).

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7 From supplemental data for Congressional Budget Office, "The Distribution of Major Tax Expenditures in the Individual Income Tax System" (2013), available at http://www.cbo.gov/publication/43768. The Congressional Budget Office, or CBO, found that the difference in revenues collected from the top quintile of taxpayers between the current tax system and a system in which contributions to retirement accounts were taxed as ordinary income and in which investment earnings in retirement accounts were taxed as ordinary investment income was $92 billion.

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19 Ibid.

20 Including a progressive match does not change this example since most taxpayers eligible for a progressive match would be earners with a very low income, who will typically not have enough money to contribute at the maximum amount, regardless of what a realistic amount would be.

21 Most taxpayers do not contribute the annual maximum allowable amount to their tax-advantaged savings accounts. The Tax Policy Center found that just 6 percent of workers contributed the maximum allowable amount in 2003. See Janette Kawachi and others, "Making Maximum Use of Tax-Deferred Retirement Accounts" (Washington: Urban-Brookings Tax Policy Center, 2005).

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23 The proposed withdrawal reasons are default reasons—that is, savers can withdraw money for these reasons—unless they contractually agree to a smaller set of withdrawal reasons. Savers could, for instance, agree to invest their money in life-insurance annuities that pay a lifetime income upon retirement in exchange for giving up the opportunity to use their savings for medical expenses, education, and other specified reasons. The choices envisioned under the Universal Savings Credit include the choice to restrict one's options if savers value the associated benefits of the restrictions more than the restrictions.

24 David Madland, "Making Saving for Retirement Easier, Cheaper, and More Secure" (Washington: Center for American Progress, 2012). The SAFE plan was previously called the "collective defined-contribution" plan.

25 For a summary of low-cost and low-risk savings vehicles, see Christian Weller and Amy Helburn, "States to the Rescue: Policy Options for State Government to Promote Private Sector Retirement Savings," *Journal of Pension Benefits* 18 (1) (2010): 37–47.

26 Regulation needs to pay even closer attention to the costs and risks associated with tax-advantaged savings than is currently the case. The Consumer Financial Protection Bureau will play a crucial role in ensuring that savers will save and invest their money in appropriate vehicles, regardless of whether the existing system of tax deductions stays in play or whether a newly created tax credit replaces it.

27 Multiemployer plans and public-sector plans are already standalone entities that are set up to track and manage individuals over the course of their careers. It will be easier to manage contributions from individuals to a defined-benefit pension plan if the benefit follows a cash-balance-plan formula rather than a traditional final-average-pay formula, but all types of benefit formulas should be able to accommodate individual contributions.

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