Bad Math

NAPA Net Staff • 12/13/12 • Add Comment

Proposals to scale back or eliminate retirement savings incentives in 401(k) plans not only endanger the ability of low- and moderate-income workers to enjoy secure retirements but are based on faulty math, *Forbes* columnist Jeffrey Brown points out in a Dec. 12 column.

Here's why: When evaluating the cost of the tax deferrals associated with defined contribution plans such as 401(k) and Keogh plans, the congressional Joint Committee on Taxation (JCT) and the Treasury Department's Office of Tax Analysis (OTA) both use current cash-flow analysis. Since workers withdraw money from these plans when they retire, the taxes paid show up outside the 10-year timeframe used in cash-flow analysis, and therefore are "scored" as lost revenue, rather than deferred revenue. These tax deferrals differ from tax credits or deductions, such as those for medical expenses or mortgage interest, since the taxes deferred ultimately are paid.

This faulty analysis dramatically exaggerates the real cost of the tax incentives for retirement plans. In fact, using present-value analysis – which economists typically use for long-term analysis – economist Judy Xanthopoulos and tax attorney Mary M. Schmitt calculated in a 2011 report published by ASPPA that present-value estimates of the five-year cost of the retirement savings tax expenditure (utilizing 2009 data) were 55% lower than those of the JCT and 75% lower than those of the OTA. Brown cites that 2011 report in his *Forbes* column.

Xanthopoulis and Schmitt updated their 2011 report in April 2012. (You'll find the newer version here.) Using data from 2011, they found that the present-value estimates of the five-year cost of the retirement savings tax expenditure are 54% lower than both those of the JCT and the OTA.

The bottom line: Proposed cuts in the tax incentive for retirement saving would not save nearly as much as advertised — even as they jeopardize the future of 401(k)s and other retirement plans.

This is precisely the point ASPPA has been making since the proposed cuts came to light. For example:
• testimony by Judy A. Miller, ASPPA's Director of Retirement Policy, at a hearing held by the House Ways and Means Committee on tax reform in April 2012; and
• background on the "bad math" problem, which includes a helpful "infographic" illustrating the issues at stake.

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What's the largest loss that a participant with 10 years to retirement can withstand, over any

12-month period, and still meet the retirement income goal?

- more than 30%
- 20%-30%
- 10%-20%
- less than 10%
- Other:

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