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Will Fiscal Cliff Deal Harm 401k Investors?

By Christopher Carosa, CTFA | November 27, 2012

Are Congress and the Obama administration getting ready to balance the budget on the backs of the nation's retirees? If history, a bipartisan report and the rumblings of Washington are any indication, then workers across America better be prepared from some sad news.

According to Brian Graff, Executive Director and Chief Executive Officer of the American Society of Pension Professionals & Actuaries (ASPPA), "Already we have Simpson-Bowles proposing to cut retirement plan deductions by 60%. In addition, there's talk of placing a cap on all deductions, including those associated with retirement plans." Graff fears if Washington turns this talk into action, it can have dire consequences on America's workers. "The single most important factor in determining if a worker is saving for retirement is whether or not there is a plan at work," he says, "Last time Congress took up tax reform in 1986, employees' 401k plans were cut by 70%, resulting in a mass termination of plans."

Increasing taxes, both directly through higher rates and indirectly through deduction reduction, acts as a double edged sword. "An increase in marginal tax rates on 401k withdrawals during retirement will immediately reduce the purchasing power of the investor's existing 401k balance," says Adam Cufr, Principal at Fourth Dimension Financial Group in Perrysburg, Ohio. Likewise, he adds, "A proposed reduction in the allowable contribution amounts would result in investors needing to seek out investment alternatives to their 401k plan, causing many investors to lose the tax deduction on those dollars redirected from their plan (unless they qualify for a tax-deductible IRA)."

Worse, still, is the talk of changing the tax code. Such talk only increases uncertainty, and that, by itself, has repercussions. Clark Kendall, President and Founder of Kendall Capital Management in Rockville, Maryland, says, "Investors/employees do not know what their income tax rate will be next year. Employees do not if it's better to contribute to a retirement plan with before tax dollars or to a Roth with after tax dollars. Investors do not know if it is better to sell their appreciated Apple stock before the end of the year at a capital gains rate of 15% and contribute to a retirement plan next year with an income offset deduction of 15, 25, 28 or 35%."

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But not all feel changing tax rates will have any real impact on 401k savings. Although he would "personally and professionally" oppose cutting retirement plan contribution limits, Dustin TenBroeck, Co-Founder of Poole & TenBroeck Wealth Management in Del Mar, California, is among those who believe it doesn't matter. "I am unsure of what affect it would have on 401k participants," he says. "On one hand, you can look to the statistics which site that 95% of baby boomers have not saved enough money for retirement and 55% of all Americans did not save even one penny in 2011. This would indicate that the government should be doing more to incentivize our citizens to save for when they can no longer work, especially if we foresee cuts to social programs in the future. Conversely, you may look at these statistics and suggest that most Americans would be unaffected by these changes in tax law."

The *New York Times* added its opinion to the debate in its November 25, 2012 article "Study Questions Tax Breaks' Effect on Retirement Savings." The article states a study, based on Denmark data, concludes, like other similar European studies, people save more when they're forced to. The article then goes on further to claim tax deductions do not provide an adequate incentive to save in retirement plans.

Graff, whose organization, an umbrella group of plan service providers, is promoting a "Save My 401k" campaign, believes the *Times* article, if not the study itself, "has nothing to do with reality." He says the article is "yet another example of misinformation," pointing out, contrary to assertions made by the *Times* reporter, "there actually is research on American taxpayers that you can rely on. An ICI study says 83% of those who contribute to their 401k plan oppose any reductions in the tax deduction."
A November 26, 2012 ASPPA press release promoting the "Save My 401k" effort references data from the Employee Benefit Research Institute (EBRI) that says more than 70% of workers earning from $30,000 to $50,000 participate in their employer 401k plans, compared with only 5% who save for retirement without a plan at work. Moreover, these plans have grown more important. When families have a retirement savings account, those savings represent more than 65% of their financial assets.

"We understand Congress needs to reduce the debt and raise revenue but raiding the tax incentives for 401k plans will put American workers' retirement security at risk. Tens of millions of Americans participate in these retirement plans, and 80% of them earn less than $100,000 per year. This is a battle that American workers simply can't afford to lose," said Graff.

Financial professionals tend to agree lowering the retirement plan contribution limits would likely damage America's already fragile retirement system. Rather than do anything that might discourage more savings, they feel Congress and the White House need to focus on policies that encourage more savings. One area that has been spoken of is legislation broadening the eligibility for plans to participate in Multiple Employer Plans (MEPs).

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Tenbroeck notes when the DOL last year issued "Advisory Opinion 2012-04A [it] eliminated many of the benefits that employers gain with an MEP. Each plan must be subject to a separate Form 5500 filing, when needed an annual audit requirement, and a separate Form 8955-SSA with the IRS." He believes that "if 'open' MEPs can be treated as a single plan, then small businesses would see cost savings as the third party administer can perform the functions which are currently a burden of the company." Tenbroeck is hopeful "we will get legislation that is required for MEPs to act as a single employer plan for ERISA's tax reporting and fiduciary requirements."

Cufr concurs, adding "Allowing plans to pool through an MEP makes incredible sense to smaller plans. Not only are there gains in plan administrative cost efficiencies, the plan sponsors are able to reduce, if not eliminate, their personal fiduciary liability – a responsibility most small plan sponsors have no idea they are shouldering."

Washington does have the opportunity to do well by retirement plan investors, but not by tampering with the tax code. Just ask any of those closest to the action and you'll see.

Interested in learning more about this and other important topics confronting 401k fiduciaries? Explore Mr. Carosa's book 401(k) Fiduciary Solutions *and discover how to solve those hidden traps that often pop up in 401k plans.*

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