

NEW IRA PROPOSAL MEANS BIGGER SAVINGS

The House Ways and Means Committee recently approved an amendment to the \$12 billion tax bill now before Congress that would allow employees to make an extra \$1,750 contribution--in addition to the \$2,000 contribution now allowed--to an Individual Retirement Account. The Senate Finance Committee seems likely to give serious consideration to the amendment.

Under the proposal, the additional contribution to an IRA would not be tax-deductible, but the earnings from it would accumulate untaxed until withdrawn from the account. If the bill became law, the maximum annual contributions to IRAs would rise from \$2,000 to \$3,750 for single wage earners, from \$2,250 to \$4,000 for those with non-working spouses, and from \$4,000 to \$7,500 for two-earner couples.

The Economic Recovery Tax Act of 1981 made Individual Retirement Accounts available to all workers under the age of 70½, and raised the maximum annual tax-deductible contribution to \$2,000 or 100 percent of earned income, whichever is lower. These changes have been very popular, with 20 to 25 million Americans depositing about \$40 billion into IRAs during the 1982 tax year. This explosive growth in IRAs has two important implications. First, it means Americans are using private savings to build retirement security; and second, it may indicate the beginning of a significant increase in the personal savings rate, which would stimulate capital formation and economic growth. The amendment to the tax bill is a small but important step that strengthens those results.

Allowing a \$1,750 non-deductible extra contribution to IRAs would encourage Americans to save for retirement. It also would assure higher retirement incomes for them, since tax on the IRA earnings would be deferred until funds are withdrawn.

The proposed IRA expansion would make the tax code more equitable. The present tax system is biased against saving, imposing on it a double tax. This is because both saved income and the earnings from these savings are taxed, while income used for consumption is taxed only once.

Increasing the ceiling on the IRA contribution would at least reduce this discrimination in the tax code by delaying the tax on earnings from the added contributions. It is fairer and more conducive to economic expansion to tax what Americans take from the economy, rather than what they contribute in the form of new capital.

Another key advantage of the IRA system, and its proposed expansion, is that it provides an alternative to the ailing Social Security system--an alternative that assures a more certain retirement income for Americans while reducing the strains on Social Security. This is important because the so-called reform package passed earlier this year did not solve the system's problems. This package completely neglected the system's underlying structural weakness--its attempt to reconcile the conflicting objectives of insurance and welfare. Expanding the IRA system would at least give younger workers a savings vehicle to supplement the dismal returns they will get from Social Security.

Allowing IRA owners to deposit an additional non-deductible sum would also treat them similarly to owners of Keogh Plans and Qualified Pension Plans, who are permitted to use after-tax dollars for contributions, above the annual deductible limit as long as they do not exceed 10 percent of their compensation. And unlike the original IRA deduction, the new proposal involves little revenue loss for Washington. For fiscal year 1984 it is projected to be \$15 million, rising to \$285 million by fiscal year 1988. This loss is tiny compared with the enormous benefits it offers Americans.

As it should, the proposal has attracted a large number of supporters. Groups representing employees, business, and the retired all support the additional \$1,750 annual non-deductible IRA contribution. These include the American Association of Retired Persons, the National Retired Teachers Association, the American Bankers Association, the Disabled Officers Association, and the National Association of Realtors.

IRAs are a popular and powerful incentive for Americans to increase the nation's extremely low savings rate. Congress is wise to consider enhancing this new savings instrument by expanding and modifying the IRA deduction.

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For further reading:

Peter G. Germanis, "Increasing the IRA Advantage," Heritage Foundation Background No. 285, August 24, 1983.

Robert S. Mudge (ed.), Social Security and Retirement (Washington, D.C.: Congressional Quarterly Inc., 1983), Chapter 6.