TAX TREATMENT Is Key to Retirement Saving Success

TAX TREATMENT

In a voluntary retirement savings system, it is important to provide incentives. In the United States, tax deferral provides the incentive for employers to offer and for employees to participate in retirement plans.

- Current compensation set aside for retirement in an employer plan or an individual retirement account (IRA) is typically tax-deferred—that is, workers pay no income tax on retirement plan contributions or the investment returns earned on those contributions until distributions are taken in retirement.
- Tax deferral is the incentive that has fueled the growth of the US retirement market—encouraging employers to voluntarily offer plans to their employees and encouraging employees to voluntarily participate.
  - Workers who wish to save for retirement value the tax benefits and seek out employers who offer retirement plans, participate in an employer plan if offered, or contribute to an IRA.
  - Employers incur costs offering a retirement plan because it helps them attract and retain qualified workers.
- The desire of employers to sponsor retirement plans, and of workers to participate in them, has created a robust competitive market for the provision of services to employer plans and IRAs.

LAWS

In the United States, regulations regarding the tax treatment of retirement accounts fall under the Internal Revenue Code (IRC) enforced by the Internal Revenue Service (IRS).

Employer and employee contributions to qualified retirement plans—which include defined benefit (DB) plans, defined contribution (DC) plans, and IRAs—are generally tax-deferred. Employees may also make Roth contributions* to IRAs and some DC plans.

- Tax-deferred contributions are excluded from a worker's current income, as are investment returns on the contributions when earned. Instead, tax-deferred contributions and investment returns are included in the worker's income when they are distributed from the plan.
- Roth contributions, in contrast, are included in a worker's current income. Both investment returns and distributions, however, are excluded from the worker's income in future years.
- Tax-deferred and Roth contributions provide similar tax benefits to workers.

Contributions and benefits are subject to limits.

Types of Retirement Plans
www.irs.gov/retirement-plans/plan-sponsor/types-of-retirement-plans

Retirement Topics: Contributions
www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-contributions

Traditional and Roth IRAs
www.irs.gov/retirement-plans/traditional-and-roth-iras

Designated Roth Accounts
www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-designated-roth-account

"Different Paths to the Same Destination: Roth vs. Traditional," *ICI Viewpoints*
www.ici.org/viewpoints/view_13_deferral_explained#different

*Roth contributions are named after the US senator who sponsored the legislation that created Roth IRAs.

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RESULTS

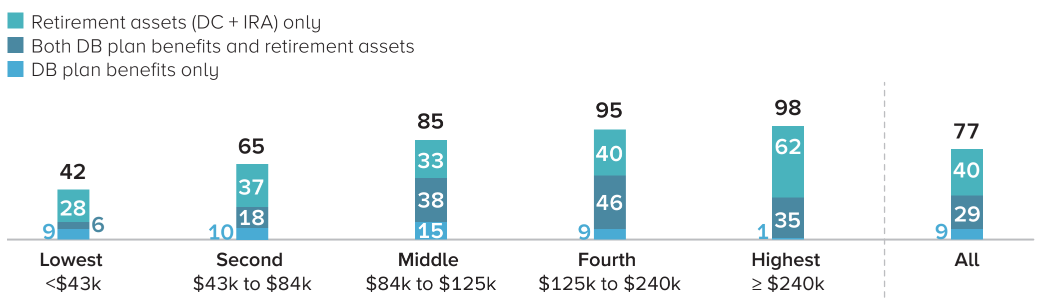
Tax treatment encourages high participation in voluntary employer plans

Percentage of working taxpayers who participate or who have a spouse who participates, 2018

Source: IRS Statistics of Income Division

More than three-quarters of near-retiree households have accumulated resources from the voluntary system

Percentage of working households aged 55 to 64, 2022



Source: Federal Reserve Board's Survey of Consumer Finances

Tax treatment is an important incentive for DC plan participants

Percentage of DC-owning individuals agreeing with the statement, fall 2023

Source: ICI tabulation of NORC AmeriSpeak® survey data (fall 2023)

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