Statement of Martella Turner-Joseph, MSPA

On behalf of the

American Retirement Association

House Small Business Committee Hearing on

Unlocking Small Business Retirement Security

March 27, 2019

Thank you, Chairwoman Velázquez, Ranking Member Chabot, and the other members of the House Small Business Committee for the opportunity to speak with you about how to achieve a secure retirement for small business owners and their employees. My name is Martella Joseph and I am an enrolled actuary. My husband Eugene Joseph and I are co-founders and partners of Joseph & Turner Consulting Actuaries, LLC located in Central Harlem, New York City. Joseph & Turner Consulting Actuaries, LLC provides actuarial, consulting, and plan administrative services for retirement plans covering thousands of participants.

I am also a member of the American Retirement Association and served on the Board of Directors of the organization for 12 years. The American Retirement Association (ARA) is an organization of more than 25,000 members nationwide who provide consulting and administrative services to millions of American workers, savers and the sponsors of retirement plans. The ARA is the coordinating entity for its five underlying affiliate organizations, the American Society of Pension Professionals and Actuaries (ASPPA), the ASPPA College of Pension Actuaries (ACOPA), the National Association of Plan Advisors (NAPA), the National Tax-deferred Savings Association (NTSA) and the Plan Sponsor Council of America (PSCA). The ARA has two key missions: to educate and inform retirement benefits professionals like myself and to advocate for policies that give every working American the ability to have a comfortable retirement.

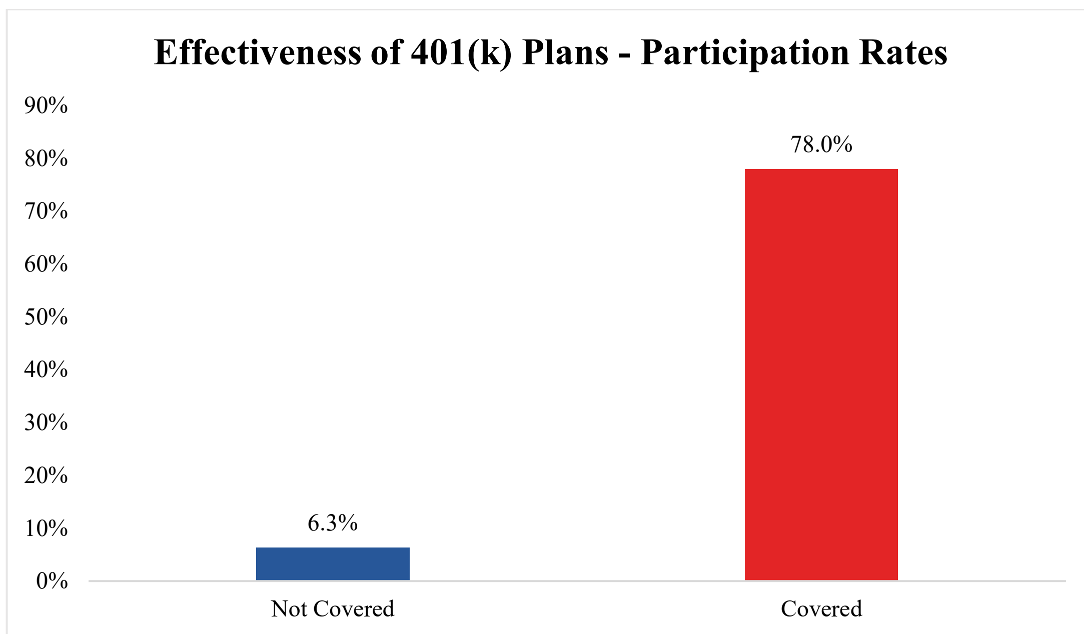
Today, I want to convey the following points:

- Despite the retirement industry's best efforts, too many Americans lack access to a workplace retirement plan.
- Increasing the availability of workplace savings plans will increase the financial and retirement security of American families.
- Congress needs to address this coverage gap by enacting the first comprehensive retirement legislation in over a decade and by incentivizing small businesses to offer their employees access to a payroll deduction savings program.

Why Workplace Retirement Plans are Essential

For most Americans – especially those with more moderate income – the key to a secure retirement is having access to a workplace-based retirement savings plan. Moderate income earners almost exclusively save at work through plans like the 401(k) – the most widely known section of the tax code. Workers earning between $30,000 and $50,000 per year are *twelve times* more likely to save for their families' retirement at work than to set up an IRA and save on their own (see figure one).

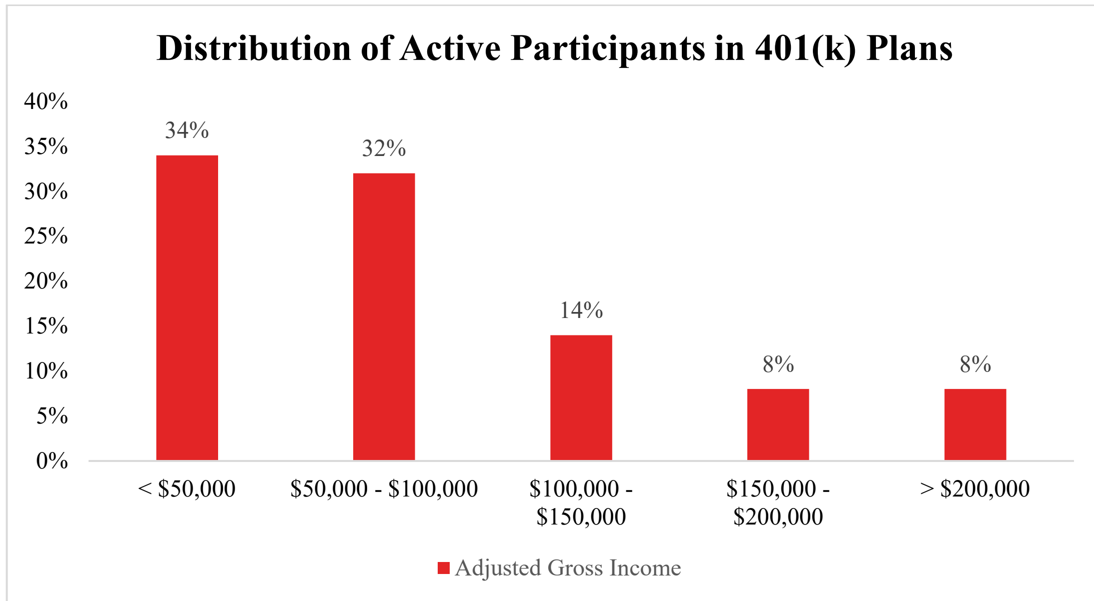
Figure One



Source: Vanguard, *How America Saves 2018* (DC plan participation);
EBRI estimate based on 2015 IRS SOL tabulation (IRA-only participation)

Middle-class workers are the primary beneficiaries of 401(k) plans. Sixty-six percent of active participants in 401(k) and other profit sharing plans have an adjusted gross income of less than $100,000 per year. Thirty-four percent of participants in these plans have income less than $50,000 per year (see figure two).

Figure Two



Source: Internal Revenue Service. Statistics of Income. Individual Income Tax and IRA Studies - 2015

Simply stated, saving at work, works. That is why it is critical that businesses – particularly small businesses – are encouraged to maintain workplace retirement plans.

The Retirement Savings Tax Incentives Underpin the Workplace Based System

The current tax incentives for workplace-based retirement savings plans are efficient and effective in encouraging Americans across the income spectrum to build a secure retirement. As someone who talks to small business owners about these plans every day, I can tell you that these tax incentives are a critical component in a small business owner's decision to set up and maintain a workplace retirement plan. The contribution limits to workplace retirement plans are higher than for IRAs. However, in exchange for these higher contribution limits, these plans are subject to coverage and nondiscrimination rules that require employer contributions on behalf of employees to maximize the contributions for the owner. For a small business owner, the ability to use tax savings on his or her contributions to generate all or part of the cash flow needed to pay these required contributions for other employees is an important factor in the decision to establish and maintain a workplace retirement plan.

How do retirement savings tax incentives differ from other incentives?

Unlike many tax incentives, the tax incentives for retirement savings are not permanent deductions or exclusions from income. As long as the savings remain in the plan, the taxes are only *deferred* until later years when distributions are made from the plan. The distributions are then subject to tax at *ordinary income* tax rates, even though lower capital gains and dividends rates may have applied if the investments had been made outside of the plan.

What are the current tax incentives?

Employer (a.k.a. plan sponsor) contributions to a qualified retirement plan are tax deductible to the employer and are not subject to FICA taxes. Taxes on any investment earnings on the contributions are deferred and then taxed at ordinary income rates upon distribution. When an employee (a.k.a. plan participant) receives a distribution from the plan, those amounts are also subject to ordinary income tax rates. For lower-income workers, a Savers Credit is available to qualifying individuals with adjusted gross income (AGI) of less than $38,500, and married couples with AGI of less than $64,000. The tax credit ranges from 10% to 50% of the first $2,000 the individual contributes to an employer-sponsored defined contribution plan or IRA.

Limits are placed on both contributions to defined contribution plans and benefits payable from defined benefit plans (pension plans):

- Certain defined contribution plans permit employees to elect to have a certain dollar amount or percentage of compensation withheld from pay and deposited to the plan. These "elective deferrals" are excludable from income for income tax purposes, but FICA is paid on the amounts by both the employer and the employee. For 2019, the maximum annual elective deferral to a 401(k) or similar plan is $19,000. Employees age 50 or over can also make an annual "catch-up contribution" of up to $6,000. Annual elective deferrals to a SIMPLE plan are limited to $13,000, plus a $3,000 per year catch-up contribution for those age 50 or over.

- If the employer also contributes to a defined contribution plan (such as a 401(k) plan) the maximum annual contribution per employee is $56,000. A plan participant that is age 50 or over, and who makes the full $6,000 catch-up contribution to the plan, would have a total annual limit of $62,000.

- The maximum annual benefit payable to an individual from a defined benefit plan cannot exceed the lesser of the average of three year's pay or $225,000. If retirement is before age 62, the dollar limit is reduced. Employers can deduct the amount required to fund promised benefits.

- Annual IRA contributions are limited to $6,000, plus "catch-up" contributions of $1,000 for those age 50 and over.

Compensation more than $280,000 cannot be considered in calculating contributions or in applying nondiscrimination rules under either defined benefit or defined contribution plans. For example, if a business owner makes $400,000, and the plan provides a dollar for dollar match on the first 3% of pay the participant elects to contribute to the plan, the match for the owner is 3% of $280,000, not 3% of $400,000.

What are the Current Nondiscrimination Rules?

Higher contribution limits for qualified retirement plans – both defined contribution and defined benefit plans – come with coverage and non-discrimination requirements. For example, a small business owner with several employees cannot simply open a defined contribution plan and contribute $56,000 solely to his or her account. Other employees who have attained age 21 and completed one year of service with at least 1000 hours of work must be taken into consideration, and the employer must be able to demonstrate that benefits provided under the plan do not discriminate in favor of "Highly Compensated Employees" ("HCEs"), which would include the owner.

Generally, contributions or benefits that are proportionate to an individual's compensation are considered fair. Age can also be considered when determining the amount of contributions that can be made on a participant's behalf. A larger contribution (as a percentage of pay) can be made for older employees because the contribution will have less time to earn investment income before the worker reaches retirement age (usually age 65). Safe harbors are also available. For example, if all employees covered by a 401(k) plan are provided with a contribution of 3% of pay that is fully vested, the HCE can make the maximum elective deferral, regardless of how much other employees choose to contribute on their own behalf.

These nondiscrimination rules, coupled with the compensations limits that can be considered under these arrangements, are designed to ensure that qualified employer-sponsored retirement plans do not discriminate in favor of HCEs. *Non-discrimination rules do not apply to other forms of tax-favored retirement savings.* For example:

- IRAs share the incentive of tax deferral. However, if a small business owner makes a personal contribution to an IRA, there is no corresponding obligation to contribute to other employees' IRAs. However, under the current rules, the contribution limit for IRAs is set low enough (and the limit for employer-sponsored plans high enough) to make a qualified retirement plan attractive to a business owner who can afford that type of plan.
- Annuities purchased outside of a qualified plan share the benefit of "inside buildup" - the deferral of income tax on investment earnings until distributed from the arrangement – but have no limit on contributions or benefits, and no non-discrimination requirements.

This means the attraction of a workplace retirement savings plan for a small business owner is heavily dependent on the interaction of non-discrimination rules and the tax incentives for saving through a workplace retirement savings plan.

Expanding Workplace Retirement Plan Coverage

It has been 13 years since Congress enacted comprehensive retirement legislation, the Pension Protection Act of 2006. Since then, the retirement marketplace has continued to innovate through new retirement-related products, financial wellness tools, and decumulation strategies, but public policy enhancements that could assist the innovations in the retirement arena have not kept pace.

I recognize that, despite the retirement industry's best efforts, far too many Americans lack access to a retirement plan at work. Increasing the availability of workplace savings plans will increase the financial and retirement security of American families. There are actions that Congress can and should take to address this lack of access. An excellent first step would be to make it easier and more meaningful for a small business to adopt a workplace retirement savings plan.

I support proposals that will both enhance the incentives for and simplify the administration of workplace-based retirement savings plans. Many of these proposals were included in the bipartisan and bicameral legislation called the Retirement Enhancement and Savings Act or RESA. RESA includes several provisions that, when taken together, will make it easier for small businesses to adopt and maintain a workplace-based retirement savings plan.

RESA increases the incentives for small business owners to offer a qualified retirement plan by significantly increasing the tax credit available to small employers who offer a plan. Further, it adds a new credit to encourage plan designs that automatically enroll workers into plans with the ability to opt-out, a practice proven to be successful to increase plan participation. RESA allows business owners the proper time to decide whether to adopt a qualified retirement plan by extending the deadline up until the due date of their tax return since it is only then when those decision makers know their true financial situation. RESA gives plan sponsors increased flexibility to choose an administratively streamlined 401(k) safe harbor plan with generous employer contributions for rank and file workers. All these provisions are sorely needed because small businesses face real challenges when deciding to provide a retirement benefit. These new policies will help these businesses make that critical decision with more certainty, clarity, and confidence.

While RESA would improve retirement plan coverage, I also recognize that this could still not be enough to get some businesses to act and that a further nudge is needed. I believe that any requirement placed on employers to offer employees access to a payroll deduction savings program should be designed to minimize the burden on the employer while achieving the desired policy outcome of increasing the availability of workplace savings opportunities.

I applaud Congressman Richard Neal, now Chairman of the House Ways & Means Committee, for his continued effort for more than a decade now to make the availability of workplace savings as widespread as possible. Chairman Neal's Automatic IRA and Automatic Retirement Plan bills will close the retirement plan coverage gap to the greatest extent possible while imposing the minimum possible burden on employers. This approach leverages existing private sector solutions in the marketplace instead of replacing the entire system with a government-run program. These approaches deserve serious consideration and widespread support.

Student Loans and Retirement Savings

A separate legislative proposal would encourage participation in workplace retirement plans, particularly among the millennial generation. The proposal aims to solve a vexing issue for millennial workers – how to save for retirement while decreasing student loan debt. The proposal – included in Senator Wyden's Retirement Parity for Student Loans Act and Senators Portman and Cardin's Retirement Security and Savings Act from the last Congress – would allow employees to receive employer matching contributions into their 401(k) plan account based on the student loan payment amount. Student loan repayments would be treated as if the individual were contributing to their 401(k) plan, which would enable the individual to not miss out on the "free money" on the table that represents the employer matching contribution.

I support a much-needed improvement to this legislative proposal that would allow this innovative plan design to be more attractive to small businesses. The proposal needs to clarify that student loan payments that are matched would be treated as elective deferrals for purposes of the nondiscrimination test called the "Actual Deferral Percentage" or "ADP" test. The ADP test is critical to ensure a retirement plan is not favoring highly compensated employees. Otherwise, the test

would be significantly harder to pass, especially for small businesses, since the individuals with student loans would most likely be non-highly compensated employees (NHCEs) who would not have the resources to make elective deferrals.

Summary

Access to a retirement plan at work plays a critical role in ensuring moderate income earners achieve a secure retirement. The workplace-based retirement system has done extremely well for employees who are offered a plan at work. Our primary challenge is to expand access to this successful system and help more small businesses to offer a plan. Congress must promptly enact a long overdue comprehensive retirement bill with the proposals discussed above included to address this challenge.