Statement of the U.S. Chamber of Commerce

ON: Tax Reform

TO: U.S. Senate Finance Committee
Working Group on Savings and Investment

DATE: April 15, 2015

1615 H Street NW | Washington, DC | 20062

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations. The Chamber is dedicated to promoting, protecting, and defending America's free enterprise system.

More than 96% of Chamber member companies have fewer than 100 employees, and many of the nation's largest companies are also active members. We are therefore cognizant not only of the challenges facing smaller businesses, but also those facing the business community at large.

Besides representing a cross-section of the American business community with respect to the number of employees, major classifications of American business—e.g., manufacturing, retailing, services, construction, wholesalers, and finance—are represented. The Chamber has membership in all 50 states.

The Chamber's international reach is substantial as well. We believe that global interdependence provides opportunities, not threats. In addition to the American Chambers of Commerce abroad, an increasing number of our members engage in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on issues are developed by Chamber members serving on committees, subcommittees, councils, and task forces. Nearly 1,900 businesspeople participate in this process.

Statement to
United States Senate Finance Committee
Working Group on Savings and Investment
Wednesday, April 15, 2015

On
Tax Reform

Testimony of
U.S. Chamber of Commerce

INTRODUCTION

Chairman Hatch, Ranking Member Wyden, Members of the Committee, and savings and investment working group members, the U.S. Chamber of Commerce greatly appreciates the opportunity to comment on the potential impact of tax reform on retirement plans.

The Chamber appreciates the commitment of the Committee and the Working Group towards comprehensive tax reform. However, as Congress considers comprehensive tax reform and reducing the deficit, it must not fundamentally alter one of the central foundations – the tax treatment of retirement savings. Doing so would imperil the existence of employer-sponsored retirement plans and the future retirement security of working Americans.

REVENUE AND SCORING ISSUES

Much of the discussion surrounding comprehensive tax reform has focused on base broadening which eliminates or reduces tax expenditures. Unfortunately, the tax treatment of retirement plans is treated as a tax "expenditure" for the purposes of budget scoring. However, the tax incentives for retirement plans are not a complete revenue loss, rather, they are a deferral of taxable income. At the time of retirement, deferred amounts are then taxed at normal income tax rates. Therefore, retirement incentives are not truly a tax expenditure but are often recouped outside of the Congressional 10-year budget window. Thus, the costs of the incentives are often overestimated. As such, we urge the Committee to keep this inconsistency in mind during tax reform. Any changes to tax incentives for retirement plans would not create the "savings" that is reflected in the scoring process and would have a detrimental impact on the retirement security of millions of American workers.

In addition, we are extremely concerned about the use of Pension Benefit Guaranty Corporation (PBGC) premiums to raise revenue. The PBGC was established to act as a backstop for private retirement plans in the event a plan sponsor goes bankrupt. The PBGC is funded entirely by the private sector and does not receive any funds from the general treasury of the United States. Nonetheless, when PBGC premiums are increased, they are scored as raising revenue for the general treasury. This circumstance creates a false incentive for Congress to increase the

premiums.[1] Moreover, raising the PBGC premiums, without making contextual reforms to the agency or the defined benefit system, amounts to a tax increase on employers that have voluntarily decided to maintain defined benefit plans. An increase in PBGC premiums, when added to the multi-billion dollar impact of accelerated funding enacted in 2006, could divert critical resources from additional business investment and subsequent job creation. Raising PBGC premiums also creates additional disincentives for employers to provide defined benefit pensions. Rather, PBGC premium increases should be considered only in the context of comprehensive pension reform and after there has been ample opportunity for discussion, careful consideration of the potential impact, and buy-in from all interested parties.

COMPREHENSIVE TAX REFORM

Maintaining current tax incentives for retirement saving is critical. Today, about 80 million households[2] have a combined $24.7 trillion earmarked for retirement within defined benefit plans, defined contribution plans, IRAs, and annuities.[3] As Congress considers comprehensive tax reform, we urge Congress to carefully consider the impact of changes to tax incentives for retirement plans.

Employer-sponsored retirement plans have introduced tens of millions of American workers to retirement saving. Eliminating or diminishing the current tax treatment of employer-provided retirement plans would jeopardize the retirement security of these workers, impact the role of retirement assets in the capital markets, and create challenges in maintaining the quality of life for future generations of retirees.[4]

Qualified plans provide significant benefits to employers and employees by encouraging retirement saving through favorable tax treatment. They allow employers to obtain a tax deduction for plan contributions and allow employees to delay paying taxes on this benefit until funds are distributed. Furthermore, studies show that employees save more when an employer plan is available than they would save on their own.[5] Payroll deduction facilitates the savings habit, and employer matching contributions as well as the Savers' Tax Credit provide further

---

[1]In June 2012, Congress imposed over $9 billion of new premiums on employers in the MAP-21 Transportation Bill to pay for the highway trust fund. In December 2013, Congress imposed another round of increases, totaling just under $8 billion, as part of the budget package.

[2] *See* Figure 1 in Sarah Holden and Daniel Schrass, "The Role of IRAs in U.S. Households' Saving for Retirement, 2014," *ICI Research Perspective* 21, no. 1 (January 2015); available at www.ici.org/pdf/per21-01.pdf.

[3] *See* Investment Company Institute, *Retirement Assets Total $24.7 Trillion in Fourth Quarter 2014* (March 25, 2015), available at www.ici.org/research/stats/retirement/ret_14_q4. These figures also include assets held in government-sponsored plans.

[4] United States Senate Committee on Finance Hearing, "Tax Reform Options: Promoting Retirement Security," September 15, 2011, http://finance.senate.gov/hearings/hearing/?id=ba387157-5056-a032-5252-c7bf71fc6c90.

[5] Investment News. *A Survey of Retirement Readiness.* October 2, 2011. http://www.investmentnews.com/apps/pbcs.dll/article?AID=/20111002/REG/310029977.

incentives. Recent research finds that the single best predictor of retirement readiness is participation in a work-based savings plan.[6]

A number of proposals have been put forth as alternatives to the current tax treatment for retirement plans. However, there is substantial evidence that changing the tax treatment or lowering contribution levels will reduce retirement savings and result in fewer employers offering retirement plans to their employees. The lowest paid employees likely would suffer the most.

A case in point is the proposal authored by William Gale of the Brookings Institution to substitute a tax credit for the present tax deferral. In recent testimony before the House Committee on Ways and Means, Jack VanDerhei, Research Director at the Employee Benefit Research Institute (EBRI), stated that under the Gale proposal the average reductions in 401(k) accounts at the normal retirement age under Social Security would range from a low of 11.2 percent for workers currently age 26-35 in the highest-income groups, to a high of 24.2 percent for workers in that age range in the lowest-income group.[7]

Another analysis by EBRI reveals that the recommendation by the National Commission on Fiscal Responsibility to limit contributions to defined contribution retirement plans to the lesser of $20,000 or 20 percent of compensation will reduce retirement security for workers at all income levels, not just high-income workers. According to the study, those in the lowest-income quartile will have the second highest average percentage reductions. Also, small business owners may be less likely to offer a plan to their employees if contribution limits are lowered.[8]

Furthermore, a large majority of households with defined contribution plans say that immediate tax savings from their plans are a big reason to contribute and 79% of U.S. households think that it should be a national priority to continue to provide tax incentives to promote retirement saving.[9] Therefore, the ramifications of eliminating tax incentives for retirement plans are far too great to dismiss lightly. It is critical to future retirees to ensure that we not only keep the private retirement system but also enhance and strengthen the system to ensure further retirement security for millions of Americans.

PENSION AND RETIREMENT REFORM UNDER THE TAX CODE

As a large part of the Employee Retirement Income Security Act of 1974 (ERISA) encompasses the Internal Revenue Code (Code), the discussions on tax reform have understandably led to larger conversations about possible reform to the retirement system beyond tax incentives. In

[6] Id.

[7] Testimony of Dr. Jack VanDerhei, Research Director, Employee Benefit Research Institute before the House Committee on Ways and Means Hearing, "Tax Reform and Tax-Favored Retirement Accounts," April 17, 2012, http://www.ebri.org/pdf/publications/testimony/T-172.pdf.

[8] Id.

[9] Holden, Sarah and Steven Bass. Investment Company Institute. *America's Commitment to Retirement Security: Investor Attitudes and Actions, 2013*. February 2013, pp. 2-3.

April of 2012, the Chamber issued a white paper entitled, *"Private Retirement Benefits in the 21st Century: A Path Forward*" to respond to concerns about retirement security.[10] The white paper offers guidelines on initiatives and reforms that will bolster the voluntary employment-based retirement benefits system and retirement security for workers. These recommendations include ways to encourage employers to create and maintain retirement plans while encouraging greater savings by workers, and to identify ways to make retirement assets last for future retirees. We are submitting this paper to the Working Group in its entirety; however, we would like to highlight certain retirement issues that have come up in tax and retirement reform conversations.

The private retirement system is a success. Most importantly, we ask Congress to do no harm. Conventional wisdom suggests that today's retirees receive less income from employment-based plans than in the "good old days." However, income from defined benefit and defined contribution plans represented 19% of retiree income in 1975; whereas, by 2009, it accounted for 26% of retiree income.[11] The number of retirees receiving retirement income from employment-based plans has also grown, from 20% of retirees in 1975 to 31% in 2009.[12] Consequently, any proposals to undo the current system or substantially change the current private retirement system would undermine the success of the system. Rather, "reform" of the private retirement system should focus solely on building on the current system.

Innovative plan design is central to the success of the private retirement system. One of the great successes of the private retirement system has been the ability of employers to implement new plan designs to accommodate changing demographics and evolving workforce needs. No single plan design is perfect for every company or every worker. As such, the private retirement system has encouraged innovation in plan design. Many employers have more than one type of plan as part of their retirement program to reflect various needs of its workforce.

In addition, the Chamber believes that the key element to the private retirement system is the voluntary nature of the system. For employers that choose to implement retirement programs, flexibility and choice are key considerations. We hope the mix of types of benefit plans in the future will be as diverse as it is today – defined benefit, defined contribution, multiemployer, and hybrid plans. Demographic and competitive needs will likely spur the creation of plan designs that we have not even begun to contemplate. Consequently, it is critical that there are no statutory, practical, or political barriers to innovation that would discourage participation in the private retirement system.

Enhance the Small Business Tax Credit. Congress implemented a tax credit for small businesses to encourage the formation of retirement plans.[13] However, the current credit is too small and short-lived to change behavior. Lawmakers should consider expanding the credit and making it refundable to increase the incentive for small businesses to set up retirement plans.

---

[10] https://www.uschamber.com/sites/default/files/reports/1204Private_Retirement_Paper.pdf.

[11] Investment Company Institute. *Helping Working Americans Achieve a Financially Secure Retirement: How the 401(k) System is Succeeding,* July 2011, available at http://www.ici.org/pressroom/speeches/11_pss_ayco_401k.

[12] Id.

[13] The credit is allowed for the first three years of start-up costs of a new small business retirement plan (with fewer than 100 participants) of up to 50 percent of the first $1,000 (i.e., $500) in startup administrative and retirement-education expenses. I.R.C. section 45E.

Address Non-Discrimination Testing for Grandfathered Pension Plans. Many companies designed their transition from a defined benefit structure to a defined contribution structure in a way that allowed older, long service employees who were close to retirement to maintain accruals under the defined benefit pension plan. However, more of these grandfathered are becoming highly-compensated employees. Since there are no new entrants to the plan, the number of non-highly compensated employees is becoming smaller. This phenomenon is making it difficult for companies to pass the discrimination testing. In order to pass the tests, companies may be forced to change the retirement benefit structure (i.e., defined benefit to defined contribution) of employees who are closest to retirement with the least amount of time to make up the difference – the outcome they sought to avoid by implementing the transition period in the first place.

The Chamber recommends revising the nondiscrimination rules so that if a group of employees is grandfathered (*i.e.*, allowed to continue to accrue a benefit after a plan is otherwise frozen to new entrants) and that group of employees is a nondiscriminatory group when the plan is frozen, it would be treated as a nondiscriminatory group permanently (unless the group or the benefit formula applicable to the group is modified by plan amendment).[14] This recommendation would prevent frozen plans from violating the rules prohibiting discrimination in favor of highly compensated employees and allow these long-serving employees to continue to accrue benefits under a defined benefit plan.[15]

Eliminate/Minimize Administrative Burdens. There are several rules that add unnecessary burdens on employers but provide minimal benefits to participants or the plan. For example, the Chamber recommends eliminating the top-heavy rules and simplifying discrimination testing. The Chamber's white paper discusses these recommendations along with several others in further detail.

Streamline Notice Requirements and Allow for Greater Use of Electronic Disclosure. Consolidating and streamlining certain notice requirements would make retirement plan sponsorship more attractive for all business and small businesses, in particular. In general, the Chamber recommends a congressional review of all retirement plan notices under ERISA and the Code to determine where there is overlap and duplication. A thorough congressional review could identify many ways of relieving unnecessary administrative burdens of little or no marginal utility while ensuring that participants receive information that is meaningful and relevant.

In addition to consolidation and elimination, it is important for regulators to recognize the benefit of electronic delivery. We believe that it is critical that the Department of Labor, Treasury and the PBGC create a single, uniform electronic disclosure standard. Specifically, the Chamber recommends a uniform standard for electronic delivery to encourage the use of electronic delivery and to allow, for those plan sponsors that wish, that electronic delivery be the default

[14] Bills have been introduced in the 113th Congress to address this issue: Rep. Tiberi (R-OH) and Rep. Neal (D-MA) introduced H.R. 5381 and Sen. Cardin (D-MD) and Sen. Portman (R-OH) introduced a companion bill, S. 2855. We anticipate these bills being re-introduced in this Congress.
[15] In 2014, the Treasury Department issued temporary guidance through the end of 2015. This guidance has been extended through the end of 2016. While we appreciate these temporary measures, a permanent solution is required.

delivery option for benefit notices. The Chamber believes that modernizing the restrictive rules on electronic delivery in this manner is a critical element in the larger task of reforming employee benefit plan notice and disclosure requirements. These changes can allow for the provision of important information without it being submerged in an avalanche of rarely used information.

Furthermore, eliminating obstacles to the use of electronic delivery sends a clear message that Congress supports sustainability efforts in addition to providing meaningful information to participants.

Encourage Financial Education for Retirement. The workplace is the primary source of retirement savings options and education for most workers. Education is critical to employees' understanding of their retirement savings options and the need to plan for retirement. Employers understand their role in providing education to their workers and rely heavily on Department of Labor Interpretive Bulletin 96-1 ("IB 96-1") in defining the "educational information" that can be provided by employers without fear of liability.

While many employers want to provide retirement education to their workers with regard to accumulation and decumulation strategies, a major concern is the ability to do so without incurring fiduciary liability. While employers recognize providing financial advice is a fiduciary action, they believe providing general retirement education should not be held to the same standard. For example, employers would like to provide a general discussion of the pros and cons of seeking a distribution and managing retirement assets outside the plan without incurring fiduciary liability.

The Department of Labor encouraged participant investment education when it preserved the status of Interpretive Bulletin 96-1 ("IB 96-1"). The Department has since asked for comments regarding the provision of information to help participants make choices regarding decumulation strategies. It might consider adding to Interpretive Bulletin 96-1 that providing educational information to participants and beneficiaries about retirement distribution options does not constitute investment advice.

Help Preserve Retirement Assets. An important component of retirement security is ensuring that retirees have sufficient assets to fund their retirement. Congressional action in key areas could help ensure that participants are able to continue to make retirement contributions during financially difficult times.

The Chamber encourages Congress to allow 401(k) plan participants to continue to make elective contributions following a hardship withdrawal. Due to the current financial crisis, many workers have had to take hardship distributions from their retirement plans. The loss of retirement savings should not be exacerbated by prohibiting these workers from making ongoing contributions to their retirement plan. In addition, the Chamber supports an extended rollover period for plan loan amounts after a termination of employment. A participant who defaults on a loan is treated as receiving a deemed distribution of the outstanding loan at the time of the default. The participant is taxed on the amount of the default unless he or she makes a "rollover" contribution to an IRA within a 60-day period. Since relatively few participants make a rollover

contribution in connection with a plan loan default due to termination of employment, extending the rollover period could decrease the number participants who default on their outstanding loans and incur tax penalties in addition to the loss of retirement savings.

Address Required Minimum Distribution Rules. The Required Minimum Distribution (RMD) rule requires that retirement plan participants receive annual distributions from their 401(k) or IRA accounts beginning at age 70 ½. Participants can delay distributions if they are still working. However, 5% owners must begin receiving distribution at age 70 ½ regardless of whether they are working or retired.

Ideally, employers would like to see the RMD rule eliminated altogether because the rules are complicated and its application provides limited value. If the rule is not eliminated, the Chamber makes the following recommendations:

- Move the starting age to age 75 to match longevity increases;
- Treat 5% owners as all other account holders and permit them to continue working and not begin required distributions;
- Exclude assets invested in longevity insurance from the distribution rules.

Encourage Employers to Offer Voluntary Products. There are a number of voluntary products – such as retiree health care, long-term care insurance, and longevity insurance – that participants might find helpful in managing retirement assets. However, not every product will be appropriate or necessary for every participant. Therefore, we recommend that employers be able to make these products available to their workers in the most efficient and flexible way possible, such as through a cafeteria plan or with 401(k) plan savings.

Barriers to Phased Retirement Need to be Removed. Employers large and small are facing the issue of how to retain critical talent as large numbers of employees are nearing retirement age. With approximately 10,000 baby boomers turning 65 every day for the next 19 years,[16] the United States is expected to lose the services of these highly skilled, experienced workers because the options are limited: continue to work or retire. Companies are experiencing a significant loss in institutional knowledge, leadership, and talent due to retirements, without the opportunity to phase these skilled workers into retirement, while transferring knowledge to the next generation of workers. This loss will continue unless the law is changed to allow employers to offer a new option to employees: voluntary phased retirement.[17]

The benefits of encouraging phased retirement could be significant. Employers won't experience major workforce disruptions, a loss of critical talent and institutional knowledge or

---

[16] Pew Research Center, Baby Boomers Approach Age 65-Glumly. http://pewresearch.org/pubs/1834/baby-boomers-old-age-downbeat-pessimism.

[17] Last summer, the President signed into law a phased retirement option for eligible Federal employees in the Moving Ahead for Progress in the 21st Century Act. The rationale for this is to encourage the most experienced Federal employees to extend their contributions to the Nation and help agencies improve continuity of operations by bolstering mentoring and knowledge retention programs. Private employers also need the flexibility to offer voluntary phased retirement programs to their critical employees in a non-discriminatory manner based on workforce needs.

incur recruiting and training costs. Employees who have a strong economic incentive to retire or want additional financial security can continue to work and earn wages and benefits, yet transition into retirement gradually. Importantly, allowing employers the flexibility to implement phased retirement programs can help not only address the issue of retaining critical, highly skilled talent, it can also broaden the tax base and reduce the pressure on federal retirement programs such as Social Security and Medicare.

However, several barriers exist to implementing a phased retirement program. The Code and ERISA impose requirements that limit flexibility in retirement plans sponsored by private employers. For example, current law prohibits private employer defined benefit pension plans from making in-service distributions for those who have not yet reached normal retirement age[18] or age 62. This age restriction has limited the ability of employers to offer phased retirement to workers eligible for early retirement under their pension plans. Importantly, employers will not offer these programs if they are considered a "protected benefit" subject to anti-cutback rules under Code section 411(d)(6). Also, current regulations would make it difficult to pass non-discrimination testing based on the inclusion of beneficiaries who participate in a phased retirement program. By making targeted changes to the law, phased retirement programs can offer employers the flexibility to design a retirement strategy that makes sense while giving employees the ability to change what it means to retire.

CONCLUSION

The Chamber appreciates the opportunity to comment on comprehensive tax reform and the potential impact on the private retirement system. The private employer-provided retirement system has contributed greatly to the retirement security of millions of American workers. We believe that tax reform efforts should focus on continuing the success of the system and ensuring that employer-provided plans continue to play an important role in retirement security.

We look forward to working with Congress, the Committee, and the working group members as this process continues to make improvements to the Tax Code that will encourage employers to maintain existing plans and sponsor new plans, encourage employees to save more through work-based plans, and identify ways to help make assets last in retirement. The future of the private retirement benefits system depends on it.

[18] It is unclear whether in-service distributions from a defined benefit plan are permitted upon the attainment of the plan's early retirement age.