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Controversial Social Security Proposal Would Ax Retirement Plan Tax Rules

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A controversial new proposal could help save Social Security, but it would come at the cost of current retirement plan tax rules.

Economists Andrew Biggs, who is a Social Security Board nominee, and Alicia Munnell have proposed a plan that could offer more funding to the Social Security Administration, which is largely predicted to become insolvent by 2033.

Conservative Biggs, who has gained criticism for his Social Security proposals in the past, published a new research proposal with left-leaning Munnell for the Center for Retirement Research at Boston College.

Biggs, who is a senior fellow at the American Enterprise Institute, and Munnell, the director of the Center for Retirement Research, are calling for a limit on tax preferences for retirement savings plans to save the ailing Social Security program.

Currently, limits for total employee and employer contributions to 401(k) plans and the like are set at $69,000, with those age 50 and older able to contribute an extra $7,500.

Meanwhile, the limit for sole employee contributions is set at $23,000, or $30,500 if you are age 50 or older, with all contributions generally untaxed until retirement.

Individual retirement accounts (IRAs) also allow employees to save between $7,000 and $8,000 pre-taxed, depending on your age.

In 2020, the tax settings saw federal income taxes decline by up to $189 billion, so Biggs and Munnell are calling for the money lost in these scenarios to fund Social Security.

If the money was used for Social Security, lawmakers would have more time to consider other options to fully save the federal retirement safety net program.

"To reduce retirement tax expenditures, the government could limit contributions or accumulations in tax-favored plans or tax the earnings on these plans each year," Biggs and Munnell wrote in the research report. "While reducing these tax incentives could, perhaps, somewhat reduce interest among employers in offering work-based savings plans, alternative arrangements could be made to ensure that all workers have an organized way to save for retirement.

"Ultimately, reducing tax expenditures for retirement plans could be an effective way to help address other pressing demands on the federal budget, such as Social Security's financing shortfall."

Not everyone is a fan of the proposal, however. The Mercatus Center at George Mason University, the Cato Institute and the National Association of Plan Advisors have come out against the idea.

Pushback typically centers around the idea that without tax benefits, employees will likely choose not to save for retirement using employer plans, which have historically supported Americans throughout retirement, often even more than Social Security.

Biggs was criticized after he said he was open to cutting Social Security entirely during a Senate Finance Committee Hearing.
"Congress should keep all options on the table," Biggs said at the time, adding that he would consider privatizing Social Security and raising the retirement age.

Jordan Mangaliman, the CEO of GoldLine Financial Services, said Biggs' initiative is not without its cons, namely that for many, they may not end up saving as much as they could for their retirement, even if Social Security remains around.

"Limiting tax preferences for retirement savings could discourage individuals from saving for their own retirement, potentially aggravating future financial strains on individuals and the government," Mangaliman told *Newsweek*. "Additionally, it may disproportionately impact higher-income earners who rely more heavily on tax-advantaged retirement accounts."

The proposal would mean lower incentives for contributing to your retirement account, and Americans might choose to opt out entirely, according to Zack Hellman, the owner of Tax Prep Tech.

"The pros might include a more immediate solution to the funding shortfall facing Social Security, potentially securing its future for retirees," Hellman told *Newsweek.* "The cons could involve less incentive for individuals to save independently for retirement, possibly leading to lower overall savings rates."

While faith in the Social Security system could be bolstered, it could stop current savers from contributing to their retirement savings.

"It almost feels like [a] robbing Peter to pay Paul scenario where it may potentially help Social Security recipients but at the same time hurt future retirement savings for those who are still working," Mangaliman said. "This could potentially further dissuade the current workforce from saving for retirement and cause yet another retirement crisis in the future."

Several other ideas are on the table for the ailing Social Security program, with some wanting the administration to raise the age or audit and repurpose funds from inefficient programs. Others propose raising taxes for Social Security on an wage-means basis.

Kevin Thompson, a certified financial planner and the founder and CEO of 9i Capital Group, said many of his clients have money saved only in their 401(k) plan, and it makes a substantial difference in their retirement.

"Cutting tax preferences for retirement savings only hurts the people at the bottom," Thompson told *Newsweek*. "For most, this is their only savings account that they have. For people to say it hasn't changed behavior is disheartening."

If employers also opted to end matching employee contributions, it could spell the end of these types of retirement plans.

"The main question would be: Would companies continue to match employee contributions while no longer receiving the tax deduction?" Thompson said. "That would change the entire landscape because I believe people will no longer place money into the plan."