

PROVIDE FOR AUTOMATIC ENROLLMENT IN INDIVIDUAL RETIREMENT ACCOUNTS OR ANNUITIES (IRAS), INCLUDING A SMALL EMPLOYER TAX CREDIT, AND DOUBLE THE TAX CREDIT FOR SMALL EMPLOYER PLAN START-UP COSTS

Current Law

A number of tax-preferred, employer-sponsored retirement savings programs exist under current law. These include section 401(k) cash or deferred arrangements, section 403(b) programs for public schools and charitable organizations, section 457 plans for governments and nonprofit organizations, and simplified employee pensions (SEPs) and SIMPLE plans for small employers.

Small employers (those with no more than 100 employees) that adopt a new qualified retirement, SEP or SIMPLE plan are entitled to a temporary business tax credit equal to 50 percent of the employer's plan "start-up costs," which are the expenses of establishing or administering the plan, including expenses of retirement-related employee education with respect to the plan. The credit is limited to a maximum of \$500 per year for three years.

Individuals who do not have access to an employer-sponsored retirement savings arrangement may be eligible to make smaller tax-favored contributions to IRAs.

In 2012, IRA contributions are limited to \$5,000 a year (plus \$1,000 for those age 50 or older). Section 401(k) plans permit contributions (employee plus employer contributions) of up to \$50,000 a year (of which \$17,000 can be pre-tax employee contributions) plus \$5,500 of additional pre-tax employee contributions for those age 50 or older.

Reasons for Change

For many years, until the recent economic downturn, the personal saving rate in the United States has been exceedingly low, and tens of millions of U.S. households have not placed themselves on a path to become financially prepared for retirement. In addition, the proportion of U.S. workers participating in employer-sponsored plans has remained stagnant for decades at no more than about half the total work force, notwithstanding repeated private- and public-sector efforts to expand coverage. Among employees eligible to participate in an employer-sponsored retirement savings plan such as a 401(k) plan, participation rates typically have ranged from two-thirds to three-quarters of eligible employees, but making saving easier by making it automatic has been shown to be remarkably effective at boosting participation.

Beginning in 1998, Treasury and the Internal Revenue Service (IRS) issued a series of rulings and other guidance (most recently in September 2009) defining, permitting, and encouraging automatic enrollment in 401(k) and other plans (i.e., enrolling employees by default unless they opt out). Automatic enrollment was further facilitated by the Pension Protection Act of 2006. In 401(k) plans, automatic enrollment has tended to increase participation rates to more than nine out of ten eligible employees. In contrast, for workers who lack access to a retirement plan at their workplace and are eligible to engage in tax-favored retirement saving by taking the initiative and making the

decisions required to establish and contribute to an IRA, the IRA participation rate tends to be less than one out of ten.

Numerous employers, especially those with smaller or lower-wage work forces, have been reluctant to adopt a retirement plan for their employees, in part out of concern about their ability to afford the cost of making employer contributions or the per-capita cost of complying with tax-qualification and ERISA (Employee Retirement Income Security Act) requirements. These employers could help their employees save -- without employer contributions or plan qualification or ERISA compliance -- simply by making their payroll systems available as a conduit for regularly transmitting employee contributions to an employee's IRA. Such "payroll deduction IRAs" could build on the success of workplace-based payroll-deduction saving by using the capacity to promote saving that is inherent in employer payroll systems, and the effort to help employees save would be especially effective if automatic enrollment were used. However, despite efforts more than a decade ago by the Department of the Treasury, the IRS, and the Department of Labor to approve and promote the option of payroll deduction IRAs, few employers have adopted them or even are aware that this option exists.

Accordingly, requiring employers that do not sponsor any retirement plan (and meet other criteria such as being above a certain size) to make their payroll systems available to employees and automatically enroll them in IRAs could achieve a major breakthrough in retirement savings coverage. In addition, requiring automatic IRAs may lead many employers to take the next step and adopt an employer plan, thereby permitting much greater tax-favored employee contributions than an IRA, plus the option of employer contributions. The potential for the use of automatic IRAs to lead to the adoption of 401(k)s, SIMPLEs, and other employer plans would be enhanced by raising the existing small employer tax credit for the start-up costs of adopting a new retirement plan to an amount significantly higher than both its current level and the level of the proposed new automatic IRA tax credit for employers.

In addition, the process of saving and choosing investments in automatic IRAs could be simplified for employees, and costs minimized, through a standard default investment as well as electronic information and fund transfers. Workplace retirement savings arrangements made accessible to most workers also could be used as a platform to provide and promote retirement distributions over the worker's lifetime.

Proposal

The proposal would require employers in business for at least two years that have more than ten employees to offer an automatic IRA option to employees, under which regular contributions would be made to an IRA on a payroll-deduction basis. If the employer sponsored a qualified retirement plan, SEP, or SIMPLE for its employees, it would not be required to provide an automatic IRA option for its employees. Thus, for example, a qualified plan sponsor would not have to offer automatic IRAs to employees it excludes from qualified plan eligibility because they are covered by a collective bargaining agreement, are under age eighteen, are nonresident aliens, or have not completed the plan's eligibility waiting period. However, if the qualified plan excluded from eligibility a portion of the employer's work force or a class of employees such as all

employees of a subsidiary or division, the employer would be required to offer the automatic IRA option to those excluded employees.

The employer offering automatic IRAs would give employees a standard notice and election form informing them of the automatic IRA option and allowing them to elect to participate or opt out. Any employee who did not provide a written participation election would be enrolled at a default rate of three percent of the employee's compensation in an IRA. Employees could opt out or opt for a lower or higher contribution rate up to the IRA dollar limits. Employees could choose either a traditional IRA or a Roth IRA, with Roth being the default. For most employees, the payroll deductions would be made by direct deposit similar to the direct deposit of employees' paychecks to their accounts at financial institutions.

Payroll-deduction contributions from all participating employees could be transferred, at the employer's option, to a single private-sector IRA trustee or custodian designated by the employer. Alternatively, the employer, if it preferred, could allow each participating employee to designate the IRA provider for that employee's contributions or could designate that all contributions would be forwarded to a savings vehicle specified by statute or regulation.

Employers making payroll deduction IRAs available would not have to choose or arrange default investments. Instead, a low-cost, standard type of default investment and a handful of standard, low-cost investment alternatives would be prescribed by statute or regulation. In addition, this approach would involve no employer contributions, no employer compliance with qualified plan requirements, and no employer liability or responsibility for determining employee eligibility to make tax-favored IRA contributions or for opening IRAs for employees. A national web site would provide information and basic educational material regarding saving and investing for retirement, including IRA eligibility, but, as under current law, individuals (not employers) would bear ultimate responsibility for determining their IRA eligibility.

Contributions by employees to automatic IRAs would qualify for the saver's credit to the extent the contributor and the contributions otherwise qualified.

Small employers (those that have no more than 100 employees) that offer an automatic IRA arrangement could claim a temporary non-refundable tax credit for the employer's expenses associated with the arrangement up to \$500 for the first year and \$250 for the second year. Furthermore, these employers would be entitled to an additional non-refundable credit of \$25 per enrolled employee up to \$250 for six years. The credit would be available both to employers required to offer automatic IRAs and employers not required to do so (for example, because they have ten or fewer employees).

In conjunction with the automatic IRA proposal, to encourage employers not currently sponsoring a qualified retirement plan, SEP, or SIMPLE to do so, the non-refundable "start-up costs" tax credit for a small employer that adopts a new qualified retirement, SEP, or SIMPLE would be doubled from the current maximum of \$500 per year for three years to a maximum of \$1,000 per year for three years and extended to four years (rather than three) for any employer that adopts a new qualified retirement plan, SEP, or SIMPLE during the three years beginning when it first offers (or first is required to offer) an automatic IRA arrangement. This expanded "start-up costs" credit for

small employers, like the current “start-up costs” credit, would not apply to automatic or other payroll deduction IRAs. The expanded credit would encourage small employers that would otherwise adopt an automatic IRA to adopt a new 401(k), SIMPLE, or other employer plan instead, while also encouraging other small employers to adopt a new employer plan.

The proposal would become effective after December 31, 2013.