Contact: Bob McIntyre

Congress Poised to Extend Special Tax Advantages to Wealthy Families In Guise of "Savings Incentives"

The latest budget-busting tax cut passed by the U.S. House of Representatives on July 28 is likely to be considered by the Senate this week. The bill, HR 4, would make permanent so-called "savings incentives" tax breaks that benefit higher-income families who need the least help in trying to save—and reduce federal revenues by billions of dollars at a time when deficits remain worryingly large.

Making Permanent "Savings Incentives" for Wealthy Americans

The House-passed bill would make permanent a provision of the 2001 Bush tax cuts that temporarily raised the contribution limits for Individual Retirement Accounts (IRAs) and elective deferrals to 401(k) and similar plans. The 2001 tax bill increased the amount a person can contribute to an IRA each year from $2,000 to $5,000, and boosted the elective deferral limit from $10,000 to $15,000. One problem with this change is that even before the 2001 tax cut, very few Americans were making the maximum allowable contribution to begin with (only 6 percent reached the limit for IRAs and only 2 percent for 401(k)s in 2000, the year before the 2001 tax cuts were enacted). The vast majority of people who are affected by the limits are upper-income people — meaning that the higher limits generally subsidize only well-off families' retirement savings.

If This Tax Break is a Solution, What's the Problem?

Well-off families do not need help saving as much as low- and middle-income families. In fact, the well-off are likely to respond to this new tax break not by saving more, but rather by shifting already existing savings into tax-sheltered accounts. It is therefore not surprising that tax breaks that are ostensibly designed to encourage savings have accomplished nothing of the sort. Since the contributions limits were raised in 2001, the U.S. personal savings rate has continued to decline and was actually negative in 2005.

The Senate should stick with the pension legislation it passed earlier this year, which does not include extensions of the IRA and 401(k) tax breaks. Extending these tax breaks at a time when the federal government is running half-trillion-dollar deficits makes any talk of "encouraging savings" particularly outrageous, since it would actually reduce *overall* national savings by adding tens of billions to federal borrowing.

"Five years of Bush tax cuts have made our tax system less fair— and have endangered our ability to fund essential public services," noted CTJ Director Robert S. McIntyre. "Enacting the House-passed pension bill would be an unwise first step towards the Bush administration's goal of making all of its unaffordable (but temporary) tax cuts permanent."

–000–