

Supplemental Social Security-Based Retirement Savings Accounts: Savings Scenarios

April 27, 2005

The Institute for SocioEconomic Studies has developed a supplemental Social Security-Based Retirement Savings Account (RSA) concept aimed at facilitating the partial pre-funding of retirement as soon as possible.¹

The Retirement Savings Account (RSA) concept would operate as follows:

- Voluntary contributions would be in addition to social security taxes.
- Contributions would supplement those made in the form of payroll taxes.
- Each year, a person could contribute an amount of up to 50% of the total payroll tax attributable to his/her income.
- Contributions would be tax-deductible.
- RSA assets could be invested in broad-based equity, bond, money market, commodity index, and real estate investment trust portfolios as the RSA account owner chooses.
- RSA investments grow tax free.
- Distributions commence at the time one becomes eligible for Social Security; one does not have to retire in order to begin distributions.
- Distributions could be taken as a lump-sum or as an annuity
- Distributions would be taxed at half one's income tax rate for the year in which such distributions are received, as only half the distributions would be included in one's ordinary income.
- Tax revenue on distributions would be directed to the Social Security Trust Fund.

Maximum Savings:

Each year, a person would be permitted to add an amount up to 50% of the total payroll tax for the OASDI Program attributable to his or her income. Most economists agree that while the payroll tax burden is shared between employers and employees, the total burden of the tax is borne by employees in the form of lower wages or fringe benefits.² The self-employed are responsible for both the employer and employee share of payroll taxes.³ Thus, from an economic standpoint and for purposes of parity among workers employed by others and the self-employed, it makes sense to measure the maximum RSA contribution against the total OASDI tax.

Under current law, of the total 15.3% payroll tax, 12.4% is used to finance the OASDI Program.⁴ In 2004, this tax was levied on earnings up to \$87,900. The "taxable wage base" is adjusted each year based on average wage growth in the economy.⁵ The following table shows the maximum RSA contributions based on seven salary and wage levels:

Maximum RSA Contributions:

Annual Salaries/Wages ⁶	Maximum RSA Contribution ⁷
\$15,000	\$ 930
\$25,000	\$1,550
\$35,000	\$2,170
\$45,000	\$2,790
\$55,000	\$3,410
\$65,000	\$4,030
\$75,000	\$4,650

Federal Tax Benefits of Making RSA Contributions:

Contributions to tax-deferred RSAs are tax-deductible. A person making RSA contributions could choose to spend or save his/her federal tax saving from such contributions. In the seven cases outlined in this brief paper, one could reduce one's annual federal income tax liability from \$90 to more than \$900 per year⁸ by making maximum allowable RSA contributions.

Annual Federal Tax Savings from Maximum RSA Contributions⁹:

Annual Salaries/Wages ¹⁰	Single	Married Filing Jointly
\$15,000	\$ 93	\$ 93
\$25,000	\$196	\$160
\$35,000	\$296	\$266
\$45,000	\$445	\$363
\$55,000	\$600	\$456
\$65,000	\$767	\$552
\$75,000	\$922	\$682

The Growth of Assets:

Moderate-income workers could accumulate meaningful retirement assets by taking advantage of the RSA option. Assuming annual maximum contributions made in monthly installments and applying historic real rates of return on Treasury securities, corporate bonds and equities,¹¹ portfolios comprised of 50% Treasuries and 50% equities and 50% Treasuries/50% Corporate Bonds would grow to the following values after 30 and 40 years respectively:

RSA Assets After 30 and 40 Years:

Annual Salaries/Wages	50% Treasuries/50% Equities	50% Treasuries/50% Equities	50% Treasuries/50% Corporate Bonds	50% Treasuries/50% Corporate Bonds
	<i>30 Years</i>	<i>40 Years</i>	<i>30 Years</i>	<i>40 Years</i>
\$15,000	\$ 67,150	\$129,418	\$ 47,203	\$ 76,366
\$25,000	\$111,916	\$215,696	\$ 78,672	\$127,276
\$35,000	\$156,683	\$301,975	\$110,141	\$178,187
\$45,000	\$201,449	\$388,253	\$141,610	\$229,097
\$55,000	\$246,215	\$474,532	\$173,079	\$280,007
\$65,000	\$290,982	\$560,810	\$204,548	\$330,918
\$75,000	\$335,748	\$647,088	\$236,016	\$381,828

It should be noted that these numbers might, in fact, be conservative. According to the “life-cycle hypothesis” of earnings, as people grow older and their work experience accumulates, their earnings increase. Hence, if a worker started out earning \$20,000 per year, his or her earnings would almost certainly have increased as he or she progressed through his/her career.

Conclusion:

RSAs would allow most workers to accumulate meaningful assets by which they could supplement their Social Security income. RSA contributions would also allow workers to reduce their overall federal income tax liability. Consequently, workers would gain in the long-run from enhanced retirement income and in the immediate-term from lowering their federal income tax liability.

Endnotes

¹ “Supplemental Social Security-Based Retirement Savings Accounts: An Introduction,” <http://www.socioeconomic.org/Publications/sssbra.htm>.

² Committee on Ways and Means, U.S. House of Representatives, *2004 Green Book*, March 2004, p.1-5.

³ Self-employed workers with annual net earnings of \$400 or more are required to make payroll tax payments (Committee on Ways and Means, U.S. House of Representatives, *2004 Green Book*, March 2004, p.1-5).

⁴ Committee on Ways and Means, U.S. House of Representatives, *2004 Green Book*, March 2004, p.1-5.

⁵ Committee on Ways and Means, U.S. House of Representatives, *2004 Green Book*, March 2004, p.1-5.

⁶ For purposes of this table, “salaries/wages” refers to the total income base against which payroll taxes can be levied.

⁷ Maximum RSA Contribution = 50% * (12.4% * Salaries/Wages).

⁸ Based on 2004 marginal tax rates.

⁹ During the 1999-2001 period (the most recent for which statistics are available), salaries/wages averaged 83.9% of adjusted gross income (*Statistical Abstract of the United States 2003*: Table 490 and *Statistical Abstract of the United States 2004-2005*: Table 475). On average, adjusted gross income translated into taxable income as follows: AGI \$15,000 to \$19,999: 33.1%; AGI \$25,000 to \$29,999: 51.5%; \$40,000 to \$49,999: 62.7%; \$50,000 to \$74,999: 67.2%; \$75,000 to \$99,999: 70.6% (IRS Statistics: Table 1.2-2002). For purposes of calculating the expected tax benefit from the maximum RSA contributions, 2004 tax rates for the relevant taxable income were applied.

¹⁰ For purposes of this table, “salaries/wages” refers to the total income base against which payroll taxes can be levied.

¹¹ The SSA’s Office of the Chief Actuary estimated nominal rates of return of 6.3% for Treasuries, 6.8% for corporate bonds, and 10% for equities. The OMB uses a discount rate of 3.0% and the CBO uses a discount rate of 3.3%.