A Comparative Policy Study of Social Security and Tax-Deferred Retirement Savings Plan Legislation:

Redundancy, Harmony, or Conflict

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A COMPARATIVE POLICY STUDY OF SOCIAL SECURITY AND TAX-DEFERRED RETIREMENT SAVINGS PLAN LEGISLATION: REDUNDANCY, HARMONY, OR CONFLICT

Abstract of Dissertation

Submitted to the
Faculty of Argosy University Schaumburg Campus
College of Business

In partial fulfillment of
the requirements for the degree of
Doctor of Business Administration

by

Susan Diann Ferrell

Argosy University Schaumburg Campus

August, 2009

Chair: Wayne Stone, DBA, Committee Chair

Committee: Herbert Hupfer, Ph.D., Committee Member

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College of Business

Abstract

This research is a comparative policy study of Social Security legislation, including Medicare, and tax-deferred retirement savings plan legislation. Specifically the study sought evidence that would indicate whether the systems are independent, work together, reinforce one another, conflict with one another, or work against one another. Additionally the research looked at whether the original intent of legislation had been fulfilled. Research indicates that employees need additional pre-retirement education so they learn to save more and invest wisely to maximize their earnings potential.

Dedication

This dissertation is dedicated to the Father, Son, and Holy Spirit. It is also dedicated to my sons, Richard (wife Heather) and Michael (wife Ednamay), their father, Joe, my grandchildren Alexis, Noah, Zachary, Abigail, and Natalie Brandenburg and my wonderful parents Paul and Floye Ferrell who have supported my educational pursuits since 1975. It has been a lengthy process. I am thankful for the countless hours my family and friends listened to me talk about my educational challenges, hurdles, and triumphs. I never considered quitting.

In addition, I commend the hundreds of students I have worked with over the past seven years while pursuing my doctorate because they inspired me to keep moving ahead with the process. All the prayers and encouragement they gave led me to the realization of my dream of being Dr. Susan Diann Ferrell. It is an accomplishment I have wanted to reach for a very long time. Bless you each and every one!

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CHAPTER ONE: THE PROBLEM

Retirement is a time when most Americans look forward to staying home rather than spending long hours each day in the workplace. The normal retirement age in the United States is 66 (formerly 65) years of age although, when possible, it may come at an earlier age. Having adequate income in retirement is a concern for many. An article written by Purcell in 2004 called *Retirement Savings and Household Wealth: A Summary of Recent Data* said that "Pension analysts refer to Social Security, employer-sponsored retirement plans and personal savings as a 'three-legged stool' of retirement income but for some at least one of the legs is missing" (p. 3). The three-legged stool refers to Social Security, pensions, and personal savings. Individual workers have no control over Social Security but in most cases they do have the option of working for employers that offer a pension plan of some type and they have options for personal savings. When employers offer tax-deferred retirement savings plans, employees are expected to manage their own investment plans. The "three legged stool" should not be confused with President Franklin Roosevelt's idea for three social systems to assist the elderly, the unemployed, and the infirmed. Workers may not save as much as they should or they may not have an employer-sponsored retirement plan, but if they have worked enough to qualify for Social Security retirement benefits, they will receive benefits.

Through the years, United States government officials have realized the need for people to financially prepare for retirement. In order to prevent elderly poverty, Congress has passed various financial incentives to either provide

retirement funding or to encourage people to save toward retirement (Federal Reserve Bank of San Francisco, 2008). Although the government has addressed the issue, they have not found adequate solutions for everyone.

Two of the financial incentives implemented by the United States government are outlined in Social Security legislation and tax-deferred retirement savings plan legislation. The question addressed in this study is whether these two policies are independent, work together, reinforce one another, conflict with one another, or work against one another. These are issues because retirees need adequate income to provide for their living expenses when they retire (Federal Reserve Bank of San Francisco, 2008).

Social Security was enacted in 1935 (H.R. 7260, Public Law No. 271, 74th Congress) after many families lost all or most of their savings during the Great Depression. Social Security-Old Age, Survivors, and Disability Insurance pays benefits to retirees 62 years of age and older with full retirement benefits currently being paid to retirees at 66 (formerly 65) years of age. Social Security survivors include benefits covering spouses and children when they meet the qualifications and Social Security disability is available to individuals who are no longer able to work due to serious medical conditions (Social Security Online, 2009f).

The section 403(b) of the Internal Revenue Code became law in 1958 as a result of passage of P.L. 85-840 (Internal Revenue Service [IRS], 2009c). Keogh plans for sole proprietors and partners were enacted in 1962, the result of P.L. 87-792. Individual Retirement Arrangements (IRAs) came about in 1974 as

a result of the Employee Retirement Income Security Act through P.L. 93-406 (Congressional Budget Office, 2009a). Tax-deferred retirement savings plan legislation for the section 401(k) of the Internal Revenue Code became law in 1978 as a result of P.L. 95-600 (Whitehouse, 2003). The section 457(b) of the Internal Revenue Code deferred compensation plan legislation occurred in 1978 as a result of P.L. 95-600 (IRS, 2009d). Most tax-deferred retirement savings funds are not taxed when contributions are made into them and the earnings grow tax-free until they are withdrawn (Whitehouse, 2003). One of the features of the 403(b) that is unique is that some contributions are made post-tax while others are pre-tax or tax-deferred. Those that are post-tax will not be taxed again on the principle, but the earnings will be taxed when they are withdrawn (IRS, 2009c). Roth IRAs are post-tax and their earnings are not usually taxed even when they are withdrawn (IRS, 2009b).

The gap in knowledge is whether or not these two legislations, Social Security and tax-deferred retirement savings plan legislation, over time have fulfilled their original purposes as designed. Are the programs independent, do they work together, reinforce one another, conflict with one another, or work against one another?

Problem Background

Social Security was created in 1935 and began collecting taxes in 1937. It was introduced in the 1930s after the Great Depression because many individuals and households lost or used their savings during that period of time (Cooley & Soares, 1999). President Franklin Roosevelt wanted a public pension

program that would give retirees regular income as reflected in the following quote by Cooley & Soares (1999).

> The original intent of the Social Security Act was to create a fully funded pension system, with benefits tied to contributions. That intent changed fairly quickly, and by 1939, the original act was amended in ways that effectively made it a pay-as-you-go social insurance system. (p. 136)

Medicare was added to the Social Security program in 1965 to assist the elderly, those 65 years of age and over, and qualified disabled persons who are under 65, with medical costs (U.S. Department of Health and Human Services, 2009b).

Tax-deferred retirement savings plans which include 403(b), Keogh, IRAs, 401(k), 457, Simplified Employee Pension (SEP) IRA, and the Savings Incentive Match Plan for Employees (SIMPLE) IRA plans that many people simply refer to as 401(k) plans. The 403(b) and Keogh plans preceded the 401(k) which was first introduced by the Tax Reform Act of 1978 but “proposed regulations [were] promulgated by the IRS on Nov. 10, 1981” (Whitehouse, 2003, p. 2). Funds in these plans are also referred to as defined contribution plans (IRS, 2009g). For purposes of this study, the primary focus will be on 403(b), Keogh, IRAs, 401(k), 457, SEP IRA, and SIMPLE IRA plans.

The Research Problem

The Social Security program, including Medicare, is having financial difficulties, and future benefits may need to decrease to meet the increased

demand of the Baby Boom and Baby Bust generations (Freedman, Harris & Roma, 1999). “For two-thirds of elderly, Social Security is their major source of income. For a third of those elderly, Social Security is virtually their only source of income” (Social Security Online, 2009e). Even though tax-deferred retirement savings programs have been in place for 50 years, many workers are not taking full advantage of the savings (Federal Reserve Bank of San Francisco, 2008). More and more employers are offering tax-deferred retirement savings through payroll deductions and defined-benefit retirement annuities are being replaced. There are advantages to the employee and the employer with tax-deferred retirement savings plans (Purcell, 2004). In 401(k) type programs employees bear the responsibility of the success of their contributions and investments but upon termination, the plans can be cashed out or rolled over without tax consequences to another eligible plan (Blackburn, 2004).

Defined-benefit plans are paid for by the employer and provide consistent monthly annuity payments for the life of the owner and his or her spouse. The payments are based upon the employee’s pay and years of service with the employer. Retirees may actually receive greater benefits from a defined-benefit plan. Businesses may offer these types of retirement plans in order to retain their employees but the cost and the maintenance of these plans is significant. Employers bear the market risk in defined-benefit plans and the Pension Benefit Guaranty Corporation insures the plans. For these reasons and the fact that people change jobs frequently, employees and employers may prefer tax-deferred retirement savings vehicles (Blackburn, 2004).

Purpose of the Study

The purpose of this study was to compare and contrast federal Social Security legislation, including Medicare, with tax-deferred retirement savings plan legislation (a tax-incentive savings program to encourage retirement savings) that falls under the U.S. Treasury Department and is administered through the Internal Revenue Service (IRS) using a comparative policy study. The designed intent of legislation was examined rather than analyzing the cost and the dissertation considered whether the programs are independent, work together, reinforce one another, conflict with one another, or work against one another.

Interpretive and Comparative Policy Analysis

Interpretive policy analysis involves researching a policy issue in order to advise a policymaker on issues relative to that issue. Usually the analysis takes place prior to legislation but sometimes evaluations are made after legislation is enacted. Policy analysis may focus on the anticipated future outcomes or actual results of the legislation. Policy research is typically conducted in universities but may also take place in independent agencies or consulting firms (Yanow, 1999).

Comparative policy analysis is a comparison of two or more policies. A policy is a rule or a guiding principle. An analysis is a study, an investigation, or an examination. Policy analysis can be broadly defined as: "determining which of various alternative policies will most achieve a given set of goals in light of the relations between the policies and the goals" (Nagel, 1999, p. 1).

Federal Legislation

Federal legislation, the making of laws, is complex and will be explained in more detail later in this study. The following information came from the U.S. Senate, Library of Congress article *How Our Laws Are Made,* which was updated by Johnson on June 30, 2003. The existence of Congress is primarily for the making of laws. Ideas for legislation may come from campaign promises or they may be an amendment or the repeal of an earlier law. Individuals or groups may petition members of Congress for new laws, a right guaranteed by the First Amendment to the Constitution. Executive communication is a widely used method that involves a message or letter from the President or a member of the President's Cabinet. The drafting of statutes requires great skill, knowledge, and experience and takes months or years to evolve (U.S. Senate, 2003).

Bills and Joint Resolutions

A bill is the form used for most legislation regardless of whether it is permanent, temporary, general or special, public or private. The enacting clause is the same whether it is enacted in the Senate or the House of Representatives. A public bill is one that affects the public and a private bill is one that affects individuals or private parties. Once a bill has been approved by Congress it goes to the President.

Presidential Action

The President has 10 days to approve the bill and if there is no objection, it automatically becomes law. If the President rejects (vetoes) the bill, the veto

can be overridden by a two-thirds vote in each House. Joint resolutions are similar to bills that are introduced in the House or the Senate. These terms are often used interchangeably. In case of conflicting laws between state and federal government, federal laws always take precedence.

Tax Legislation

Taxes evolve through the House Ways and Means Committee and then go to the full House, Senate Finance Committee, and the full Senate. A joint Conference Committee of the House and Senate creates a compromise bill which then goes to the President for enactment or veto. Similar to other legislation, if the President vetoes the bill, the veto can be overridden by a two-thirds vote in each House. After tax legislation is passed, the IRS is responsible for implementation of the bill and for the collection of taxes. The IRS is under the auspices of the Department of the Treasury and is also responsible for the enforcement of tax laws (U.S. Senate, 2003).

Research Questions

1. What are the potential ways that Social Security and tax-deferred retirement savings plans might be in conflict?
2. What are the potential ways the Social Security and tax-deferred retirement savings plans might be connected?
3. As Social Security legislation has evolved, is it still in alignment with the intent of the original legislation?

4. As tax-deferred retirement savings plan legislation has evolved, is it still in alignment with the intent of the original legislation?

Research Design

A comparative policy analysis will be conducted for both Social Security legislation and tax-deferred retirement savings plan legislation. The original intent of legislation will be revealed through an examination of the legislation and literature which will be compared to see if the intent and the results have been realized. The analysis indicates whether the programs are independent, work together, reinforce one another, conflict with one another, or work against one another. Also compared will be the strengths, weaknesses, opportunities, and threats to the two streams of legislation.

Definition of Terms

401(k) plans. Defined contribution plans to which nongovernmental employees contribute that allows them to make tax-deferred retirement savings contributions from pre-tax wages. These are similar to 403(b) and 457 plans and became law in 1978 as a result of P.L. 95-600 (IRS, 2009g).

403(b) plans. Defined-contribution plans for governmental or quasi-governmental employees. These types of plans are unique because they may include pre-tax or post-tax contributions. Those that are post-tax will not be taxed again on the principle when it is withdrawn. In either case, the income from these plans is tax-deferred until they are withdrawn. 403(b) plans, used by nonprofit-sector employees, became law in 1958 as a result of P.L. 85-840 (IRS, 2009c).

457 plans. Voluntary contributions that are deducted pre-tax and are tax-deferred until they are withdrawn. The earnings from a 457 are tax-deferred until they are withdrawn. These plans are accessed by public-sector employees and became law in 1978 as a result of P.L. 95-600 (IRS, 2009d).

Automatic enrollment. The action taken by some employers to initiate the enrollment of employees in a 401(k) or similar type of plan as soon as the employee becomes eligible without any action on the part of the employee.

Baby Boom Generation. Individuals born between the years 1946 and 1964 in the United States (Freedman et al., 1999).

Baby Bust Generation. Individuals born between the years 1965 and 1979 in the United States. May be referred to as Generation X (Freedman et al., 1999).

Defined benefit plans. Retirement plans that are funded by the employer. These plans are usually noncontributory for the employee. They are annuity plan contracts that pay level benefits to retirees based on their salary and years of service to the company. Some plans have cost-of-living provisions although others do not.

Defined contribution plans. Retirement plans that consist of pre-tax or post-tax wages contributed by the employee. These funds may be matched to some degree by the employer. Examples of defined contribution plans are 401(k), 403(b) and 457 plans. The designations are given by the IRS. Funds contributed are tax-deferred until they are withdrawn.

Individual Retirement Arrangements (IRA). A retirement savings plan set up by the owner that permits a tax deduction of some or all contributions.