Joint Letter From ASPPA and SBCA on Tax Bill

May 20, 2003

The Honorable William M. Thomas, Chairman
Committee on Ways & Means
Longworth House Office Building, Room 1102
Washington, DC 20515

The Honorable Charles E. Grassley, Chairman
Senate Finance Committee
Senate Dirksen Building, Room 219
Washington, DC 20510

Dear Chairman Thomas and Chairman Grassley:

As you negotiate the best dividend proposal possible within the budgetary and political constraints currently facing you, we ask you to remain mindful of the serious potential for harm to the ability of our nation's small business workers to save for retirement. Specifically, we are referring to the issue of modifying any dividends proposal to extend its benefits to stock held by annuities. It is imperative that if you include such a modification that it also be extended to stock held by retirement plans, especially retirement plans with 25 or fewer participants. This is necessary to avoid creating an incentive for small business owners to abandon their retirement plans for their employees in favor of the much better returns they would be able to realize if they instead invested their own retirement savings in annuities.

The American Society of Pension Actuaries (ASPPA) is a national association of over 5,000 retirement plan professionals who assist employers, particularly small businesses, in designing, implementing and maintaining qualified retirement plans for their employees. The Small Business Council of America (SBCA) is a national nonprofit organization that represents the interests of privately-held and family-owned businesses on federal tax, health care and employee benefit matters. The SBCA, through its members, represents well over 20,000 enterprises in retail, manufacturing and service industries, virtually all of which sponsor retirement plans. Both ASPPA and SBCA extend our full support for your efforts to craft a sound dividends provision, along with our pledge to help you in any way possible to achieve a provision that promotes sound tax, economic and retirement savings policy.

In the case of small business retirement plans, the relative returns available to the small business owner for his or her investment dollar is a compelling factor in making the decision whether to invest in a retirement plan or instead to use after-tax bonus money to make personal investments. When a small business owner is considering the adoption of a retirement plan, a variable annuity, which offers investment options identical to a retirement plan, is an alternative often considered. Retirement plans are subject to stringent nondiscrimination and administrative requirements that typically cost a minimum of 30 cents for every dollar the owner wants to save for retirement. For example, a small business 401(k) plan will have to make matching contributions, paid for by the small business owner, in order to satisfy these rules. By contrast, variable annuities are not subject to any of these requirements or costs.

For both retirement plans and variable annuities, income taxes on investment returns are deferred until distributed. Also, under current law, distributions from both are subject to ordinary income tax rates. But, contributions to a retirement plan are tax deductible, whereas contributions to a variable annuity are not. However, from the perspective of a small business owner, the tax deduction for making a retirement plan contribution is simply making up for the added nondiscrimination and administrative costs associated with maintaining the retirement plan. When you consider the added costs of maintaining a retirement plan, a retirement plan and a variable annuity effectively produce the same level of retirement savings for the small business owner. The decision then becomes a choice between paying taxes currently or paying for the cost of maintaining the plan. Many times the small business owner will choose the plan and its benefits for employees.

If the dividend exclusion proposal is extended to annuities without any accommodation for retirement plans, the cost of adopting a retirement plan, in terms of forgone after-tax returns, as well as the nondiscrimination and administrative costs, will in many cases discourage the small business owner from adopting the plan. This will not harm the small business owner who will choose the option that will best suit his or her needs. However, it will hurt the small business workers who will be left without a meaningful way to save for retirement. According to the Employee Benefits Research Institute, middle-income workers are 11 times more likely to save through an employer-sponsored 401(k) plan than on their own through an IRA. This is because of both the power of the matching contribution, and the convenience of the employer-sponsored program.

To summarize, please be sure the final dividends proposal retains the equitable balance in current law between annuities and small business retirement plans. It is critical that we continue to promote workplace retirement plans that have been so extremely effective in encouraging retirement savings by our nation's small business workers.

Sincerely,

American Society of Pension Actuaries
Small Business Council of America

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