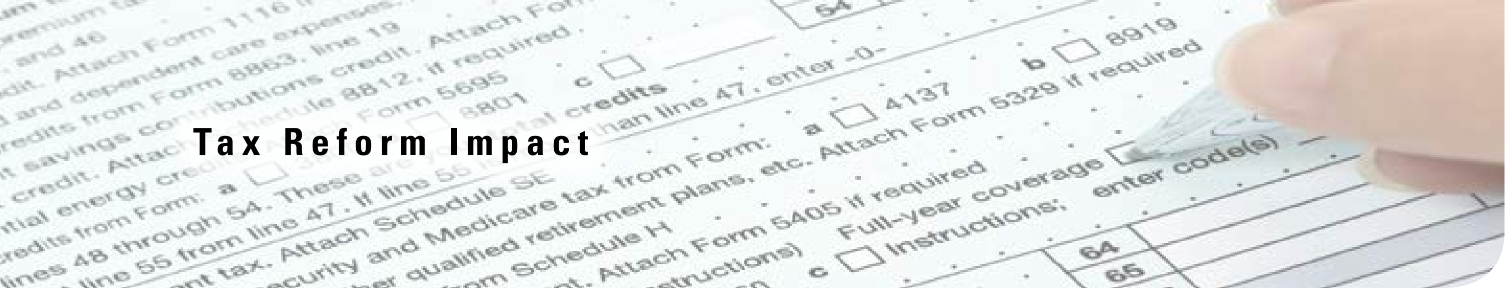


The Importance of Preserving Tax-Preferred Status for Employer-Sponsored Health and Retirement Plans

The future of employer-sponsored health and retirement plans may be at risk. For years, employers have struggled to maintain and pay for these plans despite the increasing compliance and financial burdens imposed by legislative and regulatory action. Now, as Congress begins to lay the foundation for comprehensive tax reform, the need to raise federal revenue may trump the continuation of the tax preferences for employer-provided health and retirement benefits. Recent actions illustrate that the drive for federal revenue may not be sufficiently tempered by the potential negative impact on employers and employees who must bear the brunt of these revenue-induced changes. This article considers the erosion of protections offered by the Employee Retirement Income Security Act (ERISA) and the importance of maintaining the tax treatment of employer-provided benefits.

by **Annette Guarisco Fildes** | *The ERISA Industry Committee*

The viability of employer-sponsored retirement and health plans is in danger as the prospects for congressional tax reform improve. In the past, threats to employee benefits stemmed from the heavy regulatory and reporting requirements placed on employers or an attack on the foundation of the Employee Retirement Income Security Act (ERISA). This current threat targets changes to laws based on how much money can be raised for the federal budget. This approach could significantly jeopardize the future of employer-sponsored plans. How this could happen is worth closer inspection.

The Promise of ERISA

ERISA was passed in 1974 to bipartisan acclaim, heralding a law intended to protect the pension promises given to workers by their employers. Employer-sponsored health plans also became subject to stricter rules.

Employers received some safeguards as well: Large, multistate employers were reassured by the "preemption" provisions that they need comply with only one federal law on benefits—ERISA—rather than a multitude of state and local laws and ordinances. In addition, restrictions on the benefits that may be derived from ERISA lawsuits have kept the plaintiffs' bar at bay.

In many respects, a balance was acknowledged between the needs of employers that voluntarily choose to offer workers and their families health and retirement benefits and those of employees, for whom these benefits represent a lifeline to a secure working life and comfortable postemployment years.

Since 1974, however, federal laws have been enacted almost every year (sometimes more than once per year) that modify ERISA in some fashion—generally applying more restrictions on employers. This poses challenges from both an administrative and financial point of view. These new laws and regulations were promoted with the idea of furthering a social "good" that would presumably offset the burden to employers of accommodating these changes. For employers, this loss of flexibility in plan design impairs their ability to tailor benefits for their workforces. The cost of compliance often disadvantages employees as well, to the extent that these expenses represent funds that will no longer be available to be used for maintenance or expansion of their benefits.

The Affordable Care Act (ACA) further broke new ground when, for the first time, employers with more than 50 employees were required to offer health coverage to their employees. The level of potentially applicable penalties firmly removed employer-sponsored health coverage from the "voluntary" category. This represents a major fissure in the compact of ERISA.

Why Benefits Are Important

Health and retirement plans offer significant benefits to workers. The employer-sponsored retirement plan system has been incredibly successful at providing retirement benefits to middle-income workers and getting them to save. According to the Employee Benefit Research Institute (EBRI), more than 70% of workers making between $30,000 and $50,000 save when covered by a workplace savings program, whereas less than 5% of those same workers save on their own when not covered by a plan.[1]

Defined contribution (DC) plans are designed to be portable and transparent; 401(k) plans are highly portable so workers can take their DC plan assets with them when they change jobs. The Government Accountability Office highlighted the benefits of employer-sponsored retirement plans in its report on rollovers, stating that retirement plans "generally [have] lower fees [and] better comparative information, and ERISA plan fiduciaries are required to select and monitor reasonable investment options."[2]

Retirement plans also are very important to the capital markets. As of September 30, 2015, retirement assets totaled $23.5 trillion, of which $9.3 trillion is attributable to employer-provided plans.[3] This pool of capital helps to finance productivity, which enhances investments and business expansion. Employees and employers continued to contribute to DC plans even through the recent years of financial stress.

Employers offer not only retirement plans but financial wellness programs, investment education and other support for employees.

Changes to defined benefit (DB) and DC plans must be considered carefully to avoid driving employers away from supporting employees and their families.

Employer-sponsored health plans similarly play an important role across the country and in all sectors of the U.S. economy. These plans represent the most vibrant health coverage available today for millions of workers, retirees and their families. In addition to providing top-quality, highly efficient health care, these plans also are the source and inspiration for creativity and innovation in the U.S. health care system. Employers are the innovators behind wellness initiatives, on-site clinics, delivery system reforms and other measures designed to improve access to high-quality care at lower costs.

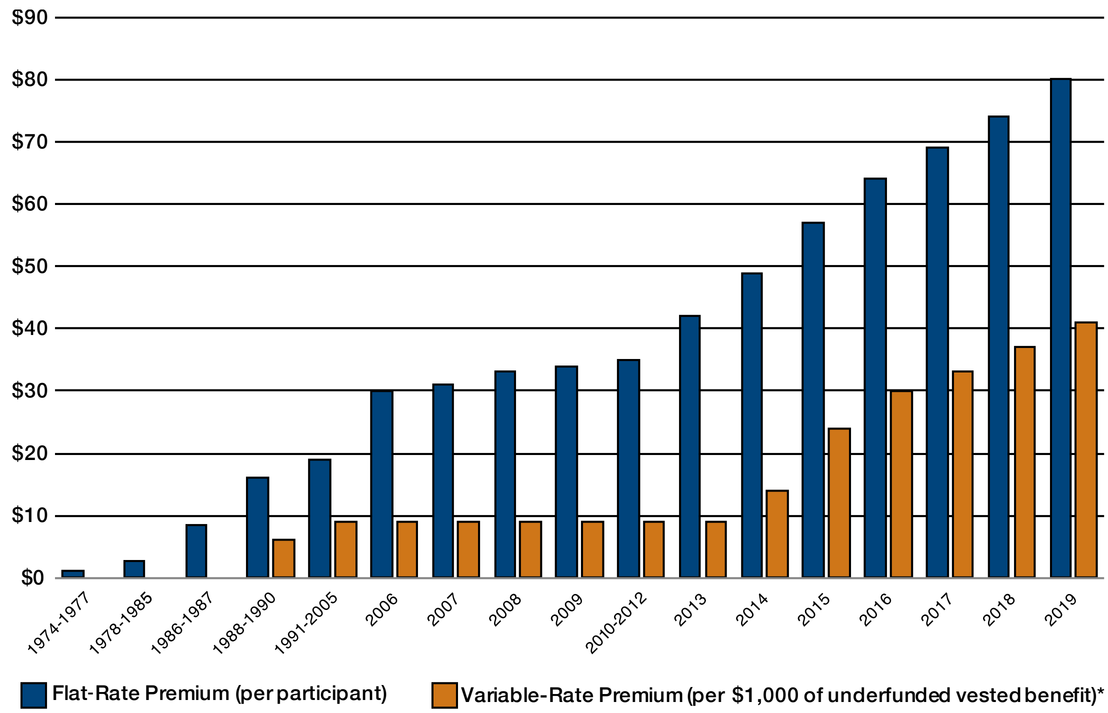
Erosion of the Promise

Since the enactment of ERISA, a subtle threat to the viability of the employer-sponsored benefit system has emerged: the adjustment of federal tax-favored treatment to achieve an unrelated congressional budgetary revenue goal. Although the Internal Revenue Code has long been acknowledged as a tool to influence taxpayer behavior, the use of Code revisions for the explicit purpose of generating federal revenue has become much more prominent in recent years. This is extremely disruptive to employers and employees alike.

Changes to federal retirement and health laws made for the sole purpose of raising budget revenue have resulted, for instance, in employees being able to save less for retirement and in encouraging employers to drop their DB plans because the regulatory and financial cost of maintaining the plan has increased substantially and unpredictably. By limiting or curtailing benefits or raising premi-

FIGURE

Historical PBGC Premium Rates for Single Employer System



**Variable-Rate Premiums from 2017-2019 are subject to indexing and therefore might be higher than the amount shown above. After 2019, all rates are subject to indexing. There are no scheduled increases (other than indexing) for years after 2019.*

ums in order to raise federal revenue for unrelated purposes, these legislative changes force employers to reduce the benefits they offer to their workers or, in the worst-case scenario, no longer offer benefits at all.

Some examples include the following:

- The combined limit on employer and employee contributions to a DC plan was set at $25,000 annually (and indexed to inflation) when ERISA was enacted in 1974[4]; by 1982, this limit had increased to $45,475.[5] The Tax Equity and Fiscal Responsibility Act of 1982 reduced this limit to $30,000 and postponed indexation until after 1985. Indexation was again deferred to after 1987 by the Deficit Reduction Act of 1984. As a result of the Tax Reform Act of 1986, the limit was frozen at $30,000 through 2000, and numerous other changes were made as well. The Economic Growth Tax Relief Reconciliation Act of 2001 increased the prevailing $35,000 limit[6] to $40,000 and again indexed the limit to inflation. Today, the limit is $53,000,[7] not much above the 1982 limit of $45,475 and far under the amount of $133,673[8] that the 1974 limit of $25,000 would represent in 2016 dollars.
- Similar limits restrict the amounts that may be contributed on an individual's behalf to an employer-sponsored DB plan, although in this case it is the benefit that is limited and not the contributions per se. In 1974, ERISA limited to $75,000 (to be indexed for inflation) the benefit payable to an individual at the age of 65 under a DB plan.[9] For the past three years (2014-2016), that limit remained unchanged at $210,000[10] and was a minimal increase from 2013, when the limit was $205,000.[11] Congress in the past has also acted to freeze cost-of-living adjustments on these contributions. The original 1974 limit of $75,000 in today's dollars would represent a benefit of $401,018.37.[12]
- Sponsors of single employer DB plans must pay an annual premium to the Pension Benefit Guaranty Corpo-

ration (PBGC) of $64 per year for each participant in a DB plan, which will increase to $80 in 2019.[13] This premium was $1 per participant when ERISA was enacted in 1974[14] (and would amount to $5.35 in today's dollars).[15] Premiums increased far in excess of any need to stabilize PBGC's financial health. (See figure.) In fact, premiums were increased substantially last year even though the financial health of the single employer trust was sound.[16] The author believes PBGC premiums should be dedicated solely to support the PBGC and not to pay for unrelated federal programs and that Congress should pass legislation preventing premiums from being counted as general revenue in the budget.

- Starting in 2020, ACA will impose a 40% excise tax on the cost of a worker's health coverage over a specified threshold, one for individuals and one for families. Although one stated reason for this tax was to reduce the costs of health care in this country, in reality almost no employers—let alone plan participants—can influence the cost of their health plan, which is primarily attributable to factors such as geography, industry and plan demographics, enough to avoid this mammoth new tax.[17]

The New Threat

Health

With renewed attention to the promise of a large-scale tax overhaul as well as efforts to repeal and replace or modify ACA comes the prospect of another effort to curtail the health benefit promises of employers to workers and their families: the federal income tax exclusion for health benefits provided by an employer to its employees, which is the bedrock of the private health system in this country. Employers would reconsider how and if they sponsor health plans for their employees and their families if this exclusion were curtailed or eliminated altogether. If employer-sponsored plans were abandoned, a sector of health plans that functions efficiently would be lost and, along with it, a key source of new ideas and advances in U.S. health care.

Retirement

Retirement plans seem unable to escape from the cross hairs of congressional cost cutters, and there is no reason to suspect these benefits would be off-limits in tax reform discussions.

The employer retirement system provides the bulwark of retirement security for working Americans. As a result, it is important that Congress protect the value provided by the current retirement plan system and avoid unnecessary changes that likely could result in unintended adverse consequences to the country and its workers and retirees.

It is important for employers to be able to design plans that work effectively and efficiently based on the needs of their workforces and the industries in which they operate. Rules that are too onerous or restrictive can chill an employer's commitment to offer a retirement plan. Worst of all is the lack of ability to predict with confidence what contribution limits and PBGC premiums will prevail in the future.

The current limits on contributions to retirement plans should not be reduced, nor should changes be made to the taxation of the benefit; to do otherwise would almost certainly jeopardize the retirement security of millions of American workers.

Changes to the tax treatment of retirement plans that would reduce contributions or discourage employers from establishing and maintaining plans could also negatively impact the role of these pivotal players in the capital markets, as well as the capital markets themselves. Importantly, Congress should consider carefully the impact that changes to the tax treatment of corporate earnings—so-called corporate integration proposals—would have on retirement plans.

The tax-favored treatment of retirement plan contributions and accounts is unique because it generally is, in actuality, a deferral of taxation and not lost revenue to the government. Unlike tax expenditures, which do represent lost revenue, retirement deferrals merely postpone taxation until the time of distribution to the individual—generally at retirement. Because of the intricacies of federal budget rules, the deferral of taxation unfortunately is counted as a revenue loss, while the corresponding deferred gain is not taken into account because it occurs years later (and outside the ten-year federal budget window) when payments are made from the retirement plan. This revenue or budget mismatch can make for bad retirement policy decisions.

Conclusion

Tax incentives provide the means for an impressive range of employers with a diverse array of employees to adapt their benefit structures to fit the needs of their workforces. Retention of this flexibility is vital not only to addressing the needs of our workers but to ensuring that our wide variety of industries and employers can remain globally competitive.

Tax reform as a whole, as well as any changes to the employer tax exclusion for health coverage or to retirement savings incentives, must focus on policies that will result in better long-term outcomes for Americans rather than on short-term revenue needs or deficit reduction. The effects of significant benefit cutbacks for individuals, employers and the system as a whole are simply too harmful and must be avoided, especially when the goal is to generate revenue rather than to achieve any positive substantive impact from a benefits standpoint. We must instead protect, support and expand our current benefits system to allow future generations to lead healthy, productive lives while preparing for retirement.

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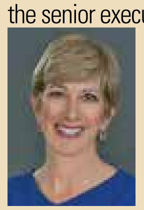

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