



Individual Retirement Accounts (IRAs): Issues and Proposed Expansion

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Summary

Current law provides many incentives to promote saving. The goal of these provisions is to increase saving for special purposes such as education or retirement, and to increase national saving. Increased national saving can lead to faster wealth and capital accumulation, which can boost future national income.

An increasingly important retirement saving vehicle is the individual retirement account (IRA). IRA savings is encouraged by two mechanisms—a carrot approach and a stick approach. First, tax provisions allow individuals to defer taxes on IRA contributions and investment earnings or to accumulate investment earnings tax free. Second, withdrawals before the age of 59½ are generally subject to a 10% penalty tax in addition to regular taxes.

There are two types of IRAs: the traditional IRA and the Roth IRA. The traditional IRA allows for the tax-deferred accumulation of investment earnings, and some individuals are eligible to make tax-deductible contributions to their traditional IRAs while other individuals are not. Some or all distributions from traditional IRAs are taxed at retirement. In contrast, contributions to Roth IRAs are not tax deductible, but distributions from Roth IRAs are not taxed on withdrawal in retirement. Expanded contribution limits were adopted in 2001, but were scheduled to expire after 2010; the Pension Protection Act of 2006 made those increases permanent.

In November 2006, the President's Advisory Panel on Federal Tax Reform proposed changes to IRAs. The panel's plan would create Save for Retirement Accounts (SRAs) to replace traditional and Roth IRAs. In recent budgets, President Bush proposed consolidating the traditional and Roth IRAs into a single Retirement Savings Account (RSA). Both the RSA and SRA would be modeled on the Roth IRA. Implementation of these proposals could increase retirement saving and could reduce administrative costs.

Neither conventional economic theory nor the empirical evidence on savings effects tends to support the argument that increased IRA contributions are primarily new savings. Roth-style accounts are less likely to induce new private savings than are traditional ones. Since both the RSA and SRA are modeled on Roth IRAs, neither appears likely to appreciably increase national saving. Furthermore, with no income limits on owning RSAs and SRAs, as well as the higher contribution limit for SRAs, it is likely that tax expenditures would increase, especially beyond the typical budget five- or 10-year horizon, thus exacerbating future budget pressures. Additionally, these proposals would predominantly benefit higher-income individuals and families who are the ones most likely to save without the added incentive.

This report will be updated as legislative developments warrant.

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Retirement experts generally argue that there are three pillars to retirement income security: Social Security, employer-provided pensions, and private savings. Coverage by Social Security is nearly universal, but its benefits are limited, and many workers reach retirement with small pensions and little savings. Over the past few decades, Congress and the President have offered tax incentives to encourage businesses to offer pensions and workers to save. The Joint Committee on Taxation estimates that tax incentives to encourage retirement saving could cost the U.S. Treasury \$735 billion between 2008 and 2012.

An increasingly important retirement saving vehicle is the individual retirement account (IRA). IRAs were created by ERISA, the Employee Retirement Income Security Act of 1974 (P.L. 93-406), which was signed into law by President Ford on Labor Day. ERISA was passed to protect the interests of pension plan participants and pension beneficiaries. IRAs were originally designed to give individuals not covered by an employer pension plan a chance to save in a tax advantaged retirement account. Since ERISA was passed in 1974, the law has been amended several times to change the tax treatment of IRAs and create new types of IRAs. Currently, nearly everyone is eligible to contribute to at least one type of IRA.

IRA savings is encouraged by two mechanisms—a carrot and a stick approach. First, tax provisions allow individuals to defer taxes on IRA contributions and investment earnings or to accumulate investment earnings tax free, effectively raising the rate of return on IRA contributions. Second, nonqualified withdrawals before the age of 59½ are subject to a 10% penalty tax in addition to regular taxes.

Several times in during his Administration, President Bush had proposed a major change to IRAs. Under the President’s proposal, all IRAs would be combined into a single Roth-style IRA called Retirement Savings Accounts (RSAs) with an annual contribution limit of \$5,000 and no income limits. The President also proposed a Lifetime Savings Account (LSA) with a \$2,000 limit.

This report provides background information on IRAs, including a description of current law and the tax benefits of IRAs. In addition, the effects of IRAs on saving and other national objectives is discussed. A final section describes and analyzes recent IRA reform proposals. The **Appendix** contains a history of the development of IRAs.

Current Rules Regarding Individual Retirement Accounts

Although IRAs have been around for over 30 years, the rules regarding IRAs have changed several times (see the **Appendix** for a brief history of IRAs). The current rules were set in the Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16). For 2008, both the traditional and Roth IRAs have an annual contribution limit of \$5,000, which will be adjusted to inflation (in \$500 blocks) after 2008. Individuals 50 years or older may make additional annual “catch-up” contributions of \$1,000. The provisions of the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) will expire after 2010 unless extended by Congress. The Pension Protection Act of 2006, however, made the pension and IRA provisions of EGTRRA permanent.

Traditional (Front-loaded) IRAs

Contributions to traditional IRAs by certain individuals are tax deductible. The amount of the deduction depends on the level of the individual's modified adjusted gross income (AGI) and whether the individual or the individual's spouse is covered by an employer pension plan.¹ **Table 1** shows the income limits for the deductibility of contributions. Generally, individuals not covered by an employer pension plan and lower-income individuals are entitled to at least a partial deduction. Single individuals with modified AGI of less than \$53,000 are entitled to a full deduction even if they are covered by an employer pension plan. Married individuals filing jointly and not covered by an employer pension plan but whose spouses are covered by a pension plan are entitled to deduct part of their traditional IRA contribution if their modified AGI is between \$159,000 and \$169,000. The Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222), which became law in May of 2006, allowed a temporary window in 2010 to allow high-income individuals to convert any of their IRAs to Roth IRAs, so that their partially tax-favored plans become fully tax exempt. Taxes on the conversions are due in 2011 and 2012.

Table 1. Income Limits for Tax Deductions of Contributions to Traditional IRAs

Income Tax Filing Status	Modified AGI	Deduction
Individual Covered by Employer Pension Plan		
Single; or head of household	\$53,000 or less	Full
	\$53,000 to \$63,000	Partial
	\$63,000 or more	None
Married, filing jointly; or qualifying widow(er)	\$85,000 or less	Full
	\$85,000 to \$105,000	Partial
	\$105,000 or more	None
Married, filing separately	less than \$10,000	Partial
	\$10,000 or more	None
Individual Not Covered by Employer Pension Plan		
Single; head of household; or qualifying widow(er)	Any Amount	Full
Married, filing jointly; or married, filing separately with spouse not covered by employer pension plan	Any Amount	Full
Married, filing jointly with a spouse who is covered by employer pension plan	\$159,000 or less	Full
	\$159,000 to \$169,000	Partial
	\$169,000 or more	None
Married, filing separately with a spouse who is covered by employer pension plan	less than \$10,000	Partial
	\$10,000 or more	None

Source: Congressional Research Service.

¹ Modified adjusted gross income does not include certain deductions and income exclusions that are included in adjusted gross income from the 1040 or 1040A tax form.

Whether or not contributions are deductible, investment earnings on traditional IRA assets are tax deferred until distribution at retirement. Taxable distributions from traditional IRAs are taxed as ordinary income. All deductible contributions to traditional IRAs are fully taxable when withdrawn. However, nondeductible or after-tax contributions are not taxed when withdrawn; only the investment earnings on these contributions are taxable. Taxable distributions from traditional IRAs made before the individual has reached 59½ years of age are subject to an additional 10% penalty tax.

Roth (Back-loaded) IRAs

Contributions to Roth IRAs are not tax deductible, but qualified distributions from Roth IRAs are tax free. Not everyone, however, is eligible to contribute to a Roth IRA—there are income limits on participation (see **Table 2**). At a certain income level (for example, \$101,000 for a single individual), the contribution limit is reduced. The contribution limit is eventually reduced to zero, and the individual is not eligible to contribute to a Roth IRA. Although qualified distributions from Roth IRAs are tax free, early distributions may be subject to a 10% penalty tax in addition to regular taxes.²

Table 2. Income Limits for Contributing to Roth IRA

Income Tax Filing Status	Modified AGI	Contribution
Married, filing jointly; or qualified widow(er)	less than \$159,000	full contribution
	\$159,000 to \$169,000	reduced contribution
	\$169,000 or more	no contribution
Married, filing separately and lived with spouse at any time during the year	\$0	full contribution
	\$0 to \$10,000	reduced contribution
	\$10,000 or more	no contribution
Single; head of household; or married, filing separately and did not live with spouse during the year	less than \$101,000	full contribution
	\$101,000 to \$116,000	reduced contribution
	\$116,000 or more	no contribution

Source: Congressional Research Service.

Required Minimum Distributions

Owners of traditional IRAs are required to begin taking minimum distributions from their IRA beginning at 70½ (Roth IRA owners face no such requirement). The rules applying to the required minimum distribution are the same as those for qualified employer-sponsored retirement plans (e.g., 401(k)s). The individual must receive the distribution by April 1 following the calendar year in which the owners reaches 70½. The amount that is required to be distributed

² A qualified distribution is a payment from a Roth IRA made at least five years after the contribution was placed in the IRA account and the individual is at least 59½ years old.

depends on the IRA balance at the end of the preceding year and life expectancy. For example, an unmarried 71 year old with an IRA balance of \$26,500 would be required to take a minimum distribution of \$1,000.

With the precipitous decline in the stock market in 2008, Congress was concerned that many elderly retirees would be disadvantaged because they would be required to withdraw retirement monies by selling stocks when the market is down. Furthermore, basing the distribution amount on the account balance as of the end of the previous year could mean that the distribution is a larger proportion of the actual balance at the time of the distribution. Consequently, Congress passed the Worker, Retiree, and Employer Recovery Act of 2008 (P.L. 110-458), which provides for a one-year waiver of the required minimum distribution rules for calendar year 2009. The minimum distribution rules, however, only require that IRA owners move a certain proportion of their IRA balance from a tax-advantaged investment account to a taxable investment account and pay the appropriate taxes on the distribution (which had been deferred). Moreover, since the market will presumably recover, paying taxes at a time when asset values are low could be beneficial compared to normal circumstances, because it will defer taxes to the future when asset values rise.

Tax Consequences of IRAs

The main tax advantages of a traditional IRA are the deductibility of contributions for some individuals and the tax deferral of investment returns on IRA assets. The advantages are due to (1) tax-deferred compounding of interest, and (2) the possibility of postponing tax liability from a time when income is high and the individual is in a high tax bracket, to a time when income may be lower and the individual is in a lower tax bracket. However, there is no guarantee that income will be lower after retirement than before, or that the tax brackets will be the same after retirement as before.

Contributions to a Roth IRA are taxable, but the returns earned on Roth IRA assets are not taxable. Consequently, in this important respect, Roth IRAs are like a tax-exempt bond. Very-high-income individuals and families, however, are not eligible to establish and contribute to a Roth IRA.

Losses on both traditional and Roth IRA investments can be included on an individual's tax return.³ The loss, however, can only be included if the individual itemizes, and after all the amounts in the IRA have been distributed with the total distributions being less than total nondeductible contributions.

When Traditional and Roth IRAs are Equivalent

The ultimate tax treatment of a front-loaded deductible traditional IRA and a back-loaded Roth IRA can be equivalent under certain circumstances. Assuming that tax rates are the same at the time of contribution and withdrawal, a deductible traditional (front-loaded) IRA offers the equivalent of no tax on the return to savings, just like a Roth (back-loaded) IRA. The initial tax

³ The loss is claimed as a miscellaneous itemized deduction, subject to the 2% of adjusted gross income limit, on schedule A of the 1040 tax form.

benefit from the deduction is offset, in present value terms, by the payment of taxes on withdrawal. Here is an illustration. Suppose an individual had earned \$100 before taxes to invest in an IRA and faces a tax rate of 25%. With a deductible traditional IRA, the individual could invest the \$100, earn a 10% return, and have \$110 after one year. At a 25% tax rate, the individual would receive an \$82.50 after-tax distribution from his or her IRA.⁴ If the individual instead chose a Roth IRA, he or she would first pay taxes on the \$100 (equal to \$25) and contribute \$75 to the Roth IRA. After one year and a 10% return on investment, the individual would receive an \$82.50 distribution from his or her Roth IRA (\$75 in principal and a \$7.50 return on investment, neither of which would be taxed). In this example, the after-tax distributions from each type of IRA are the same.⁵

Differences Between Traditional and Roth IRAs

There are three ways in which these tax treatments can differ: if tax rates vary over time, if the dollar ceilings are the same, and if premature withdrawals are made. There are also differences in the timing of tax benefits that have some implications for individual behavior as well as revenue costs.

Variations in Tax Rates over Time

The equivalence of front-loaded and back-loaded IRAs holds only if the same tax rate applies to the individual at the time of contribution and the time of withdrawal in the case of front-loaded IRAs. Taking the same example as before, assume that the individual's tax rate at the time of contribution is 25%, but is 15% at the time of withdrawal. The individual with the Roth IRA would still receive a distribution in the amount of \$82.50 after one year. The individual contributing to the deductible traditional IRA would still have \$110 in pre-tax principal and interest after one year, but would be taxed at the 15% rate with an after-tax IRA distribution of \$93.50.⁶ In this case, the deductible traditional (front-loaded) IRA has better tax advantages than the Roth IRA. The reverse could be true if the individual faces a higher tax rate at the time of withdrawal than at the time of contribution.

Contribution Limits

The contribution limits for traditional and Roth IRAs are the same. For individuals contributing at the limit, however, the back-loaded Roth IRA is more generous than both deductible and nondeductible traditional IRAs. Suppose the contribution limit is \$4,000 (the limit for 2005), the interest rate is 8%, and the tax rate is 25%. If the individual has \$4,000 (after tax) for a one-time

⁴ By deducting the \$100 the individual does not have to pay \$25 in taxes in the year the contribution is made to the IRA. However, this \$25 will be paid as taxes a year later when the individual withdraws the funds from the IRA. This is essentially equivalent to borrowing \$25 from the government at a 0% annual interest rate and investing the loan in the financial markets.

⁵ The tax treatment is different from those who are not eligible for either a deductible traditional IRA or Roth IRA. This individual would contribute the after-tax \$75 to an IRA, earn a return of \$7.50 which will be taxed at the 25% tax rate. The after-tax IRA distribution will be \$80.62.

⁶ This is essentially equivalent to the individual borrowing \$25 from the government (the taxes not paid because of deductibility), investing the money, and paying the government back \$15. The individual is borrowing at a -40% interest rate.

investment in an IRA, the after-tax dollar yield after 20 years is shown in **Table 3** for each type of IRA and for a conventional taxable investment account.

Table 3. Net Distribution from Taxable Savings Account and Various Types of IRAs

	Net Distribution of Qualified Withdrawal After 20 Years	Net Distribution of Nonqualified Withdrawal	
		After 1 Year	After 20 Years
Roth IRA	\$18,644	\$4,208	\$13,518
Deductible Traditional IRA	\$17,190	\$3,868	\$15,326
Nondeductible Traditional IRA	\$14,983	\$4,208	\$13,518
Taxable Investment Account	\$12,829	\$4,240	\$12,829

Source: Congressional Research Service.

After 20 years, the distribution to the individual from a Roth IRA would be \$18,644. No taxes would be due on this amount. An individual investing in a nondeductible traditional IRA would receive a \$14,983 distribution after 20 years. This individual would have to pay taxes on \$14,644 in accumulated investment earnings. An individual investing \$4,000 in a front-loaded deductible traditional IRA would be able to deduct the \$4,000 and would consequently have an extra \$1,000 to save (assuming a 25% tax rate).⁷ After 20 years, the IRA balance would be \$18,644, which is taxed at the 25% tax rate. The balance in the taxable investment account would be \$3,207. The total after-tax income would be \$17,190.⁸ In comparison, with a \$4,000 investment, the balance in a taxable investment account after 20 years would be \$12,829.

Nonqualified Withdrawals

Traditional and Roth IRAs differ in the tax burdens imposed if nonqualified withdrawals are made (generally before retirement age).⁹ This issue is important because it affects both the willingness of individuals to commit funds to an account that might be needed before retirement and the willingness to withdraw funds already committed to an account.

The front-loaded deductible traditional IRA provides steep tax burdens for early- year withdrawals which decline dramatically over time because the penalty applies to both principal and interest. (Without the penalty, the effective tax rate is always zero.) For example, with a 25% tax rate and an 8% rate of return, an individual taking a nonqualified distribution from a

⁷ The individual could spend this \$1,000. But it is assumed in this example that he saves this amount in a taxable investment account that earns the nominal yield of 8%. This \$1,000 “loan” is eventually paid back to the government because the original deductible \$4,000 (the investment principal) is taxed at the 25% tax rate when it is withdrawn.

⁸ The ranking of a Roth IRA and deductible traditional IRA depends on the tax rate the individual faces when the money is withdrawn from the account. However, qualified distributions from both Roth IRAs and deductible traditional IRAs will always be greater than from a nondeductible traditional IRA if the rate of return is positive.

⁹ A qualified withdrawal from an IRA is either a withdrawal taken after age 59½ or a penalty-free withdrawal prior to retirement for special purposes. These special purposes include using the distribution for unreimbursed medical expenses, buying or building a first home, and higher-education expenses.

deductible IRA would face an effective interest rate of -6.4% rather than the 8% nominal return because of the 10% penalty tax. In other words, an individual would have effectively lost 6.4% of the original investment. The effective tax burden in this case would be 180%.¹⁰ After three years the effective tax burden would be 63%, and 38% after five years. After about seven years, the tax burden would be the same as an investment made in a taxable account: 25%. Thereafter, tax benefits would occur, with the effective tax burden falling to 20% after 10 years, 10% after 20 years and 6% after 30 years. These tax benefits would occur because taxes would be deferred, and the value of the deferral would exceed the penalty.

The case of the back-loaded Roth IRA is much more complicated. First consider the case where all such IRAs are withdrawn. In this case, the effective tax burdens would be smaller in the early years. Although premature withdrawals are subject to both regular tax and penalty, the taxes apply only to the earnings, which are initially very small. In the first year, the effective tax rate would be the sum of the ordinary tax rate (25%) and the penalty (10%), or 35%. Because of deferral, the effective tax rate would slowly decline (33% after three years, 32% after five years, 28% after 10 years). In this case, it would take 14 years to earn the same return that would have been earned in a taxable account at a 25% tax rate.¹¹ Partial premature withdrawals from Roth IRAs, on the other hand, would be treated more generously, as they would be considered to be a return of principal until all original contributions were recovered.

The dollar consequences of the 10% penalty tax on nonqualified distributions are shown in the final two columns of **Table 3**. After one year, a taxable investment account would yield a higher dollar amount than a nonqualified distribution from any type of IRA. The deductible traditional IRA would incur a loss after one year—not only would the net distribution be less than that for other types of IRAs, it would be less than the original \$4,000 investment. Since the investment earnings from a Roth IRA would be subject to both regular and penalty taxes, the distribution would be the same as for a nondeductible traditional IRA.

After 20 years, the value of the tax deferral of the deductible traditional IRA would exceed the tax penalty, so the net distribution would be greater than that from a taxable investment account (\$15,326 versus \$12,829). The nonqualified distribution from a Roth IRA and nondeductible traditional IRA would be \$13,518 after 20 years—greater than the return from a taxable investment account but less than a nonqualified distribution from a deductible traditional IRA.

These differences suggest that individuals should be much more willing to put funds that might be needed in the next year or two for an emergency in a back-loaded Roth account than in a front-loaded deductible traditional account, since the penalties relative to a regular savings account are much smaller. These differences also suggest that funds might be more easily withdrawn from Roth IRAs in the early years even with penalties. This feature of the back-loaded Roth IRA makes these tax-favored accounts much closer substitutes for short-term savings not intended for retirement.

It could eventually become more costly to make premature withdrawals from back-loaded accounts than from front-loaded accounts. Consider, for example, a withdrawal in the year before eligibility at age 59½ of all funds that had been in the account for a long time. For a front-loaded

¹⁰ The effective tax burden is the ratio of what the individual lost (compared to what they would have gained without the penalty tax) to what they would have gained in the absence of the 10% penalty tax.

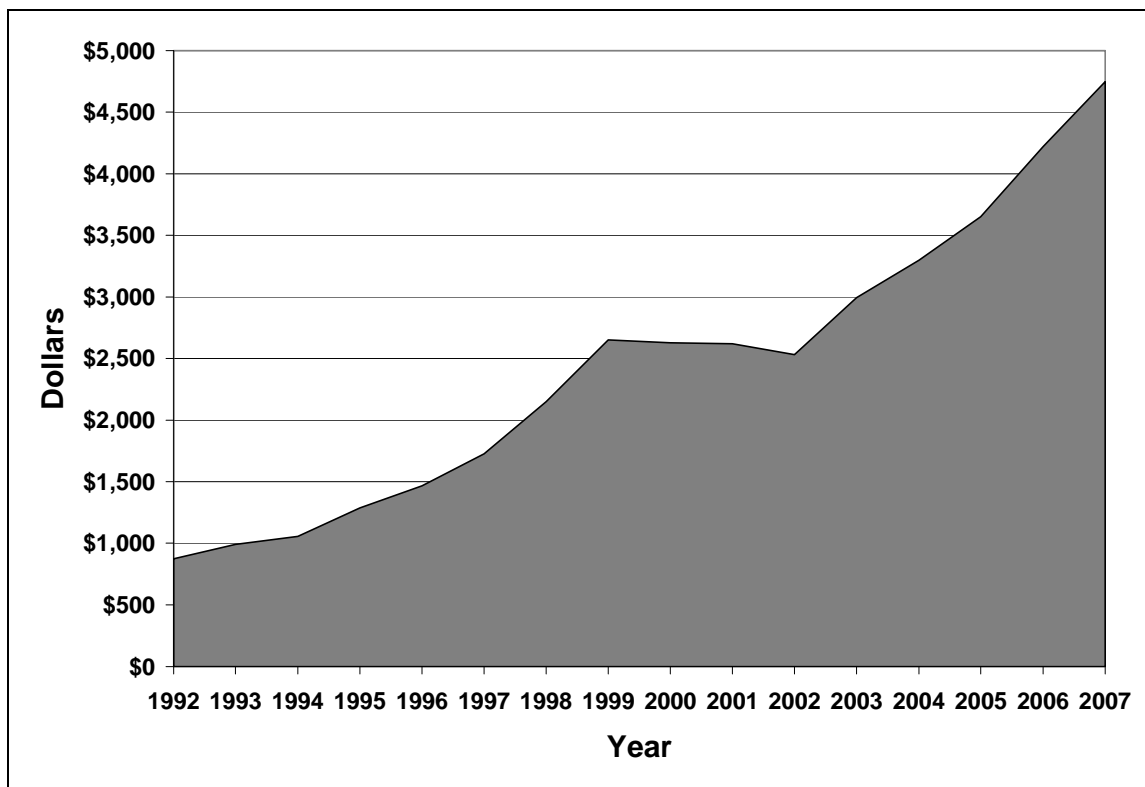
¹¹ These patterns are affected by the tax rate.

IRA, the cost would be the 10% penalty on the withdrawal plus the payment of regular tax one year in advance—both would apply to the full amount. For a back-loaded account, where no tax or penalty would be due if held until retirement, the cost would be the penalty plus the regular tax on the fraction of the withdrawal that represented earnings, which would be a large fraction of the account if held for many years.

Economic Importance of IRAs

Individual retirement accounts held \$873 billion in assets in 1992, which was equivalent to almost 14% of gross domestic product (GDP). By the end of 2007, IRAs held \$4.7 trillion in assets, or the equivalent of 34% of GDP (see **Figure 1**). IRAs held almost \$1 of every \$3 in retirement assets in 2007.¹² IRA assets grew between 1992 and 1999, fueled by the rising stock market and the introduction of Roth IRAs in 1997. After the stock market bubble burst, total IRA assets remained fairly constant at about \$2.6 trillion. After the stock market recovered somewhat in 2002, IRA assets began to increase.

Figure 1. Total IRA Assets, 1992-2007 (billions of dollars)



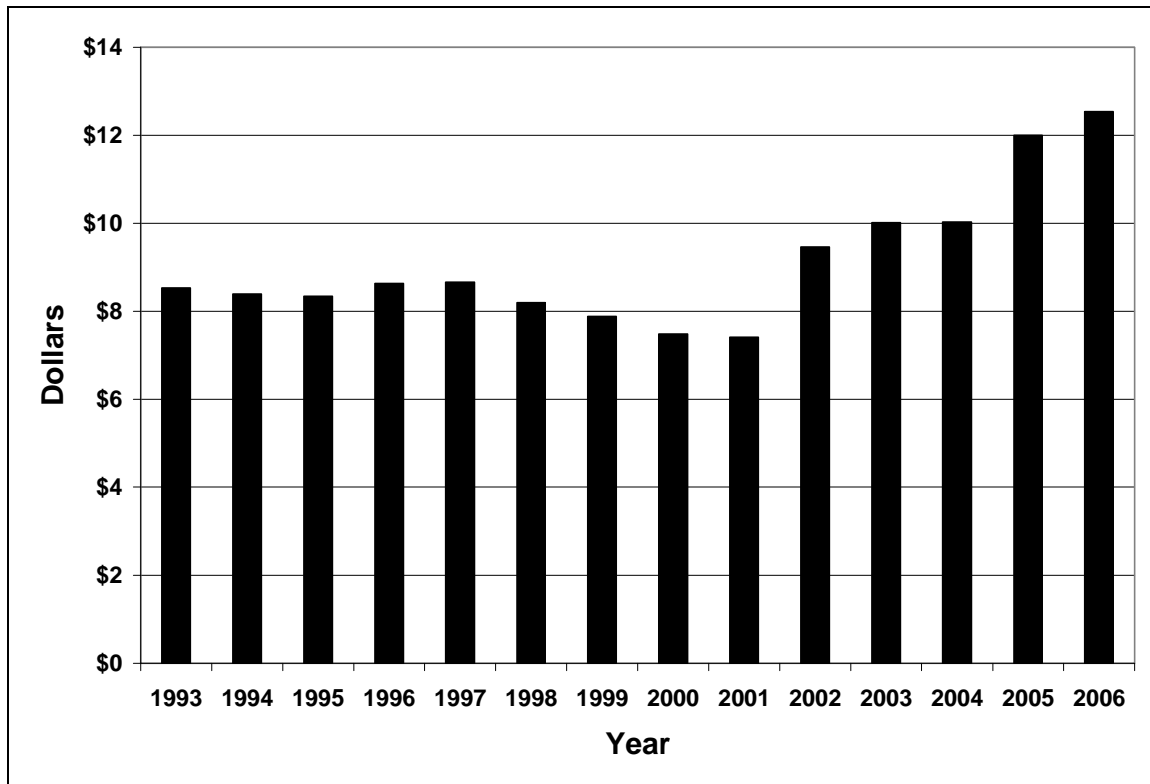
Source: Federal Reserve Board, Flow of Funds Accounts of the United States, table L.225.i.

IRAs have effects on the federal budget. On the one hand, certain IRA contributions are tax deductible, which will reduce income tax revenues. Between 1993 and 2006, annual IRA income tax deductions varied between \$7.4 billion and \$12.5 billion (see **Figure 2**). After Roth IRAs

¹² At the end of 2007, public and private pensions and IRAs held \$15.3 trillion in assets.

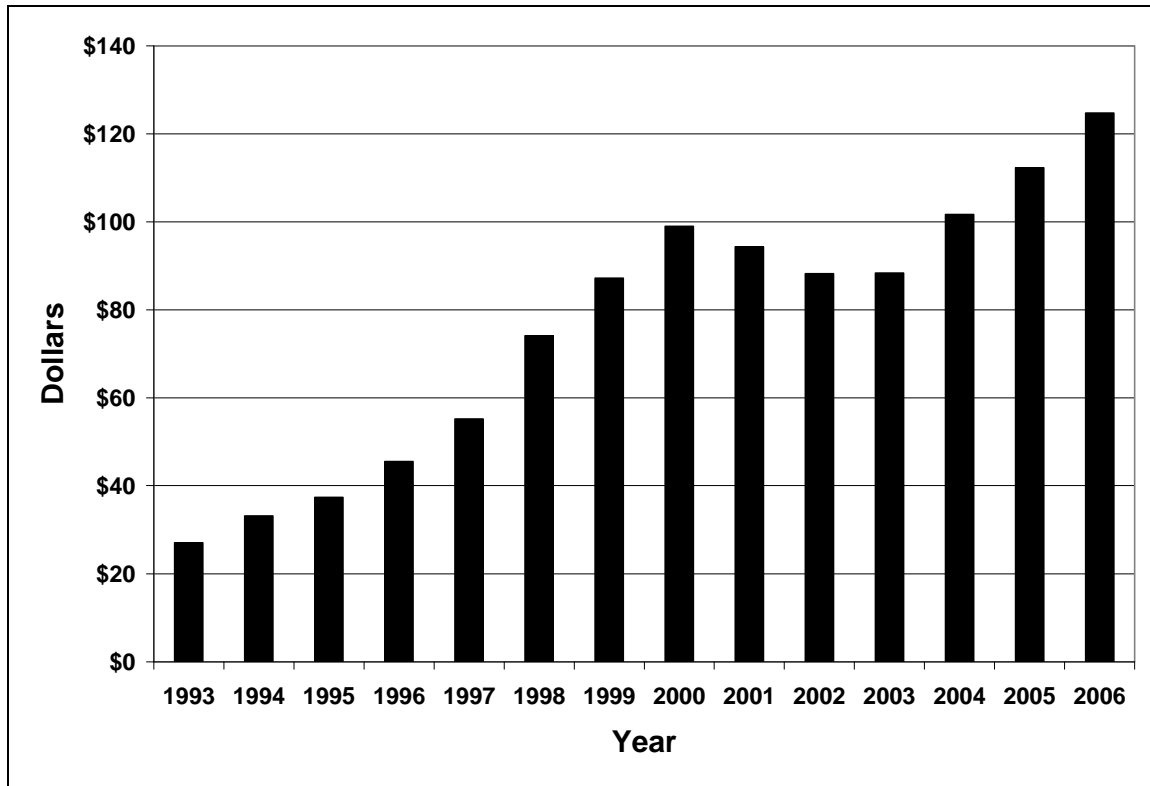
were introduced in 1997 (which are not deductible), IRA deductions fell from \$8.7 billion in 1997 to \$7.4 billion by 2001. After 2001, IRA deductions increased, reaching \$12.5 billion in 2006 (the last year for which tax data are publicly available).

Figure 2. Total IRA Deductions, 1993-2006 (billions of dollars)



Source: Internal Revenue Service, Statistics of Income Division, Individual Income Tax Returns, Publication 1304, various years.

On the other hand, certain IRA distributions are taxable, which will increase income tax revenues. Taxable IRA distributions amounted to \$27.1 billion in 1993 and grew to almost \$100 billion by 2000 (see **Figure 3**). After 2000, taxable IRA distributions fell slightly until 2003 and then increased, amounting to \$124.7 billion by 2006.

Figure 3. Total Taxable IRA Distributions, 1993-2006 (billions of dollars)

Source: Internal Revenue Service, Statistics of Income Division, Individual Income Tax Returns, Publication 1304, various years.

The cost to the government of the tax-favored treatment of IRAs can be measured by the concept of tax expenditures. Tax expenditures are defined as “revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or a deferral of tax liability.”¹³ The Joint Committee on Taxation estimates that the tax expenditures of individual retirement plans will be \$16.3 billion in FY2008 and will amount to \$98.3 billion between 2008 and 2012.¹⁴

Savings Effects

Higher savings rates can lead to faster wealth and capital accumulation, which can boost future national income.¹⁵ An important question is whether or not the IRA tax incentives increase saving. The broadest measure of saving is national saving which consists of saving by households (personal saving), businesses, and the government through the budget surplus (public saving). IRA tax incentives (and many other retirement income tax incentives) can affect both personal

¹³ Congressional Budget and Impoundment Control Act of 1974 (P.L. 93-344).

¹⁴ Joint Committee on Taxation, “Estimates of Federal Tax Expenditures for Fiscal Years 2008-2012,” Oct. 31, 2008, table 2, p. 63.

¹⁵ Other factors also affect future income and living standards. Productivity growth, for example, directly raises future national income even without an increase in national saving.

and public saving. The tax expenditures for IRAs (discussed in the previous section) will lower public saving by reducing the budget surplus or increasing the budget deficit.

Conventional economic theory and empirical analysis do not offer unambiguous evidence that these tax incentives have increased personal or national saving.¹⁶ From a theoretical perspective, the effect of a tax reduction on savings is ambiguous because of offsetting income and substitution effects. The increased rate of return may cause individuals to substitute future consumption for current consumption and save more (a substitution effect), but, at the same time, the higher rate of return will allow individuals to save less and still obtain their target amount of savings (an income effect). The overall consequence for savings depends on the relative magnitude of these two effects. Empirical evidence on the relationship of the rate of return to the saving rate is mixed but indicates mostly small effects of uncertain direction. Recent evidence of the uncertainty of increasing savings with a higher rate of return is the juxtaposition of high returns in the stock market in the mid- to late 1990s with a dramatic reduction in the personal savings rate. This fall in the savings rate in the face of high returns provides some evidence that expanded tax incentives for IRAs will not be successful in increasing savings rates. The increasing individual contributions to IRAs may simply have resulted from shifting existing assets into IRAs or diverting savings, which would otherwise have occurred, into IRAs.

IRAs are unlikely to increase savings because most tax benefits were provided to individuals who contributed the maximum amount, which eliminates any substitution effect. For these individuals, the effect on savings is unambiguously negative, with one exception. In the case of the front-loaded deductible traditional IRA, savings could increase to offset part of the up-front tax deduction, but only if individuals recognize that their IRA accounts will involve a tax liability upon withdrawal. The share of IRAs that were new savings would depend on the tax rate—with a 28% tax rate, one would expect that 28% would be saved for this reason; with a 15% tax rate, 15% would be saved for this reason. This effect does not occur with a back-loaded Roth IRA or a nondeductible traditional IRA. Thus, conventional economic analysis suggests that private savings would be more likely to increase with a front-loaded rather than a back-loaded IRA.

Despite this conventional analysis, some economists have argued that IRA contributions were largely new savings. Theoretical arguments have been made that IRAs increase savings because of psychological, “mental accounting,” or advertising reasons. Individuals may need the attraction

¹⁶ For a more complete discussion of the savings literature, see Jane G. Gravelle, *The Economic Effects of Taxing Capital Income* (Cambridge, MA: MIT Press, 1994), p. 27 for a discussion of the general empirical literature on savings and pp. 193-197 for a discussion of the empirical studies of IRAs. Subsequent to this survey, a paper by Orazio P. Attanasio and Thomas C. DeLeire, “The Effect of Individual Retirement Accounts on Household Consumption and National Savings,” *Economic Journal*, vol. 112 (July 2002), pp. 504-538, found little evidence that IRAs increased savings. For additional surveys see the three articles published in the *Journal of Economic Perspectives*, vol. 10, no. 3 (Fall 1996): R. Glenn Hubbard and Jonathan Skinner, “Assessing the Effectiveness of Savings Incentives,” (pp. 73-90); James M. Poterba, Steven F. Venti, and David A. Wise, “How Retirement Savings Programs Increase Saving,” (pp. 91-113); Eric M. Engen, William G. Gale, and John Karl Scholz, “The Illusory Effects of Savings Incentives on Saving,” (pp. 113-138). A working paper by Alun Thomas and Christopher Towe, “U.S. Private Saving and the Tax Treatment of IRA/401(k)s: A Re-examination Using Household Saving Data,” International Monetary Fund working paper 96/87, Aug. 1996, found that IRAs did not increase private household saving. A more recent study by Eric M. Engen and William G. Gale found that 401(k) plans, which are similar to IRAs in some ways, had a negligible to modest effect on savings. See “The Effects of 401(k) Plans on Household Wealth: Differences Across Earnings Groups,” National Bureau for Economic Research working paper 8032, Dec. 2000. See also Orazio P. Attanasio, James Banks, and Matthew Wakefield, “Effectiveness of Tax Incentives to Boost (Retirement) Savings: Theoretical Motivation and Empirical Evidence,” *OECD Economic Studies* No. 39, 2004/2, pp. 145-172, which presents evidence that retirement saving tax incentives induce very little new saving.

of a large initial tax break; they may need to set aside funds in accounts that are restricted to discipline themselves to maintain retirement funds; or they may need the impetus of an advertising campaign to remind them to save. There has also been some empirical evidence presented to suggest that IRAs increase savings. This evidence consists of (1) some simple observations that individuals who invested in IRAs did not reduce their non-IRA assets, and (2) a statistical estimate by Venti and Wise that showed that IRA contributions were primarily new savings.¹⁷

The fact that individuals with IRAs do not decrease their other assets does not prove that IRA contributions were new savings; it may simply mean that individuals who were planning to save in any case chose the tax-favored IRA mechanism. The Venti and Wise estimate has been criticized on theoretical grounds, and an empirical study by Gale and Scholz using similar data found no evidence of a savings effect.¹⁸ A study by Joines and Manegold comparing savings behavior of those newly eligible for IRAs and those already eligible for IRAs found no evidence of an overall effect on savings, although increases were found for some individuals and decreases for others; a study by Attanasio and DeLeire using this approach also found little evidence of an overall savings effect.¹⁹ And, while one must be careful in making observations from a single episode, there was no overall increase in the savings rate during the period that IRAs were universally available, despite large contributions into IRAs. Similarly, the household savings rate continued (and actually accelerated) its decline after the expansion of IRAs in 1997.

It is important to recognize that this debate on the effects of IRAs on savings concerned the effects of front-loaded deductible IRAs. Many of the arguments that suggest IRAs would increase savings do not apply to back-loaded Roth IRAs. For example, back-loaded IRAs do not involve the future tax liability that, in conventional analysis, should cause people to save for it.

Indeed, based on conventional economic theory, there are two reasons that the introduction of back-loaded Roth IRAs may decrease savings. First, those who are newly eligible for the benefits should, in theory, reduce their savings, because these individuals are higher-income individuals who are more likely to save at the limit. The closer substitutability of Roth IRAs with savings for other purposes would also increase the possibility that IRA contributions up to the limit could be made from existing savings. Secondly, those who are currently eligible for IRAs, who are switching funds from front-loaded traditional IRAs, or who are now choosing back-loaded Roth IRAs as a substitute for front-loaded ones should reduce their savings because they are reducing their future tax liabilities.

Also, many of the “psychological” arguments made for IRAs increasing savings do not apply to the back-loaded IRA. There is no large initial tax break associated with these provisions, and the funds are less likely to be locked up in the first few years because the penalty applying to early

¹⁷ This material has been presented by Steven Venti and David Wise in several papers; see for example, “Have IRAs Increased U.S. Savings?” *Quarterly Journal of Economics*, vol. 105, no. 3 (Aug. 1990), pp. 661-698.

¹⁸ See William G. Gale and John Karl Scholz, “IRAs and Household Savings,” *American Economic Review*, vol. 84 (Dec. 1994), pp. 1233-1260. A detailed explanation of the modeling problem with the Venti and Wise study is presented in Jane G. Gravelle, “Do Individual Retirement Accounts Increase Savings?” *Journal of Economic Perspectives*, Vol. 5 (Spring 1991), pp. 133-148.

¹⁹ See Douglas H. Joines and James G. Manegold, “IRAs and Savings: Evidence from a Panel of Taxpayers,” Federal Reserve Bank of Kansas City Research working paper 91-05, Oct. 1991; Orazio P. Attanasio and Thomas C. DeLeire, “The Effect of Individual Retirement Accounts on Household Consumption and National Savings,” *Economic Journal*, vol. 112 (July 2002), pp. 504-538.

withdrawals is much smaller. In addition, funds are not as illiquid or tied up because of the possibility of withdrawing them penalty-free for special purposes, including medical expenses.

Overall, the existing body of economic theory and empirical research does not make a convincing case that the expansion of individual retirement accounts, particularly the back-loaded accounts which were included in the 1997 legislation, will increase savings.

Distributional Effects

Who benefitted from the expansion of IRAs? In general, any subsidy to savings tends to benefit higher-income individuals who are more likely to save. The benefits of IRAs for high-income individuals are limited, however, compared to many other savings incentives because of the dollar and income limits. Nevertheless, the benefits of IRAs when universally allowed tended to go to higher-income individuals. In 1986, 82% of IRA deductions were taken by the upper third of individuals filing tax returns (based on adjusted gross income); since these higher-income individuals had higher marginal tax rates, their share of the tax savings would also be larger.

In addition, when universal IRAs were available from 1981-1986, they were nevertheless not that popular. In 1986, only 15% of tax returns reported contributions to IRAs. Participation rates were lower in the bottom and middle of the income distribution: only 2% of taxpayers in the bottom third of tax returns and only 9% of individuals in the middle third contributed to IRAs. Participation rose with income: 33% of the upper third contributed, 54% of taxpayers in the top 10% contributed, and 70% of taxpayers in the top 1% contributed.

Ownership of IRAs has increased substantially since 1986, however. In 2004, the Investment Company Institute estimates that 40% of U.S. households owned an IRA.²⁰ Not surprisingly, households that own IRAs have higher income and more wealth than households not owning IRAs. Although there are income limits on the deductibility of IRA contributions, a disproportionate share of the tax benefits accrue to upper-income taxpayers. In 2003, tax returns reporting \$75,000 or more in adjusted gross income accounted for 23.5% of all taxable returns. While only 4.5% of these higher-income returns reported a tax-deductible IRA contribution, they accounted for 40% of all reported deductible IRA contributions.

Overall, as one might expect, the expansion of IRAs tends to benefit higher-income individuals, although the benefits are constrained for very-high-income individuals because of the contribution and income limits. An expansion in contribution limits (as occurred in 2003) would be more focused, however, on higher-income individuals who are more likely to be contributing at the limit and more likely to take full advantage of higher limits.

Administrative Issues

The more types of IRAs that are available, the larger the administrative costs associated with them. With the introduction of back-loaded Roth accounts in 1997, three types of IRAs now exist: the front-loaded that have been available since 1974 (and universally available in 1981-1986), the

²⁰ Sarah Holden, Kathy Ireland, Vicky Leonard-Chambers, and Michael Bogden, "The Individual Retirement Account at Age 30: A Retrospective," *ICI Perspective*, vol. 11, no. 1 (Feb. 2005).

non-deductible tax-deferred accounts, and the back-loaded Roth accounts. Treatment on withdrawal will also be more complex, since some are fully taxable, some partially taxable, and some not taxable at all.

Another administrative complexity that arises is the possibility of penalty-free withdrawals prior to retirement for special purposes. These special purposes include using the distribution for unreimbursed medical expenses, buying or building a first home, and higher-education expenses. Each special purpose has separate conditions placed on the distribution. For example, the first-time-homebuyer early distribution is limited to \$10,000, and the medical expenses early distribution can occur only if unreimbursed medical expenses exceed 7.5% of adjusted gross income.²¹

Policy Implications of Traditional and Roth IRAs

Many individuals now have a choice between a front-loaded deductible traditional IRA and a back-loaded Roth IRA. An earlier section discussed the relative tax benefits of the alternatives to the individual. This section discusses the relative advantages and disadvantages to these different approaches in achieving national policy objectives. These objectives include reducing the federal budget deficit and federal debt, increasing national savings, and increasing retirement savings.

From a budgetary standpoint, the short-run estimated cost of the front-loaded deductible traditional IRA will better reflect the eventual long-run budgetary costs of IRAs than does the back-loaded Roth IRA. Roth IRAs have probably made it harder to meet long-run budgetary goals because the budget cost is incurred in the future as the nontaxed account earnings grow and budget targets do not take into account the out-year costs (that is, the costs beyond the five- or 10-year budget window). This issue can be important if the long-term objective is balancing the budget or generating surpluses. Achieving this goal can be compromised if the costs of IRAs are rising. In addition, if distributional tables are based on cash flow measures, as in the case of the Joint Tax Committee distributional estimates, a more realistic picture of the contribution of IRA provisions to the total distributional effect of the tax package will emerge with the front-loaded IRA.

The deductible traditional IRA is more likely to result in more private savings than the Roth IRA, from the perspective of either conventional economic theory or the “psychological” theories advanced by some. In fact, Roth IRAs may not have contributed to private savings. Of course, a traditional IRA also has a revenue cost which offsets any positive private savings effect. The ultimate impact of traditional IRAs on national saving depends on the relative magnitudes of the revenue costs and the private saving effect.

While the IRA tax incentives may not have appreciably increased national savings, they have probably increased retirement savings by individuals.²² The severe penalties for early withdrawals increase the likelihood these funds will be available at retirement. The increase in retirement savings is becoming more important as the old-style defined benefit pension plans are either

²¹ The tax rules are explained in the 100-page guide for preparing 2004 tax returns. See Internal Revenue Service, *Individual Retirement Arrangements (IRAs)*, Publication 590, 2005.

²² See Employee Benefit Research Institute, “Universal IRAs and Deductible Employee Contributions,” EBRI Issue Brief #1 (Jan. 1982), at <http://www.ebri.org/publications/ib>, visited Nov. 14, 2005.

eliminated or replaced by less generous and riskier defined contribution plans such as 401(k) plans.

There are, however, some policy advantages of Roth IRAs. The Roth IRA avoids one planning problem associated with deductible traditional IRAs: individuals may fail to recognize the tax burden associated with accumulated IRA assets. If this is the case, the deductible IRA would leave them with less after-tax assets in retirement than they had planned, a problem that would not arise with the Roth IRA, where no taxes are paid at retirement. Another possible advantage of Roth IRAs is that the effective tax rate is always known (zero), unlike the front-loaded IRA where the effective tax rate depends on the tax rate today vs. the tax rate in retirement.

Recent Proposals

In the FY2009 budget proposal, the President proposed consolidating the traditional and Roth IRAs into a single Retirement Savings Account (RSA). The RSA would be modeled on the Roth IRA. The annual contribution limit would be \$5,000, which would be indexed to inflation. Individuals may contribute up to the maximum amount regardless of their adjusted gross income. Contributions would not be tax deductible, but investment earnings would accumulate tax free and qualified distributions would not be taxable. Nonqualified distributions exceeding the value of contributions would be subject to regular income taxes and a 10% penalty tax. The President also proposed creating Lifetime Savings Accounts (LSAs) with an annual contribution limit of \$5,000, which would be similar to RSAs but could be withdrawn penalty-free at any time. This proposal was also contained in the FY2006 budget proposal, the FY2007 budget proposal, and FY2008 budget proposal, although in the latter case the limit was reduced to \$2,000.

The President's Advisory Panel on Federal Tax Reform proposed similar changes. This plan would create Save for Retirement Accounts (SRAs) to replace traditional and Roth IRAs. Contributions up to \$10,000 annually could be made regardless of adjusted gross income. The contribution limit would be indexed to inflation. Contributions would not be tax deductible but investment earnings would accumulate tax free. Early distribution exceeding the value of contributions would be subject to regular and penalty taxes.

The Advisory Panel also proposed the creation of Save for Family Accounts (SFAs) to replace existing education and medical savings accounts. This proposal would allow every taxpayer to contribute up to \$10,000 each year to an SFA on an after-tax basis. The earnings would accumulate tax free in the same way as in the current Roth IRA. Tax-free withdrawals would be allowed at anytime for qualified educational and medical costs, or to purchase a primary residence. In addition, taxpayers would be able to withdraw up to \$1,000 tax free each year for any purpose. Nonqualified distributions in excess of the \$1,000 limit would be subject to income taxes and a 10% penalty tax, similar to the penalty paid on nonqualified distributions from the current Roth IRA.

For the same reasons that apply to Roth IRAs, none of these proposals would appreciably increase national saving. Furthermore, it is unlikely that these proposals would appreciably increase retirement saving. The LSA and SFA are probably more attractive savings vehicles for workers than the retirement savings accounts (RSAs and SRAs) because they have the same tax advantages as the retirement accounts, but can be accessed penalty-free before retirement. Since less than a third of U.S. families report that retirement is the most important reason for saving, it

seems likely most workers would save in the nonretirement accounts before saving in the retirement accounts.²³

With no income limits on owning any of these accounts, it also seems likely that a considerable amount of existing savings would be transferred to these accounts. Consequently, tax expenditures would increase, especially beyond the typical budget five- or 10-year horizon. This could dramatically increase future budget pressures. The Congressional Budget Office estimated that the President's FY2008 savings proposal would reduce federal revenues by about \$3 billion between 2008 and 2017.²⁴ Revenues would initially rise as funds are moved from tax-deductible accounts to RSAs and LSAs. After 2010, however, revenues would fall somewhat as withdrawals from RSAs and LSAs go untaxed. Another study projects that the long-run revenue costs could reach \$30 to \$50 billion per year.²⁵

Although 60% of U.S. families saved in 2000, there are income disparities: 30% of the poorest 20% of families saved while over 80% of the richest 10% of families saved.²⁶ These proposals would predominantly benefit higher-income individuals and families who are the ones likely to save.

Conclusions

The initial purpose of IRAs in 1974 was to extend the tax advantages allowed to employees with pension plans to individuals with no pension coverage. The major focus of IRAs today is generally to encourage savings, especially for retirement. If the main objective of individual retirement accounts is to encourage private and national savings, the analysis in this study suggests that this objective has not been achieved. Moreover, the back-loaded Roth approach is less likely to induce savings than the traditional form of IRAs. However, IRAs have undoubtedly increased longer-term saving for retirement. But, the ability to withdraw amounts for purposes other than retirement somewhat dilutes this focus on preparing for retirement. The recent and planned expansions in the IRA limit may make the provisions more likely to provide a marginal incentive, but will also direct the benefits towards higher-income individuals.

IRAs have often been differentiated from other tax benefits for capital income as the plan focused on moderate income or middle class individuals. The IRA has been successful to the extent that more of the benefits are targeted to moderate-income individuals than is the case for many other tax benefits for capital (e.g., capital gains tax reductions). Nevertheless, data on participation and usage of IRAs suggest that the benefits still accrue primarily to higher-income individuals.

Based on conventional economic theory and the aforementioned empirical evidence on savings effects, the RSA and LSA proposals of the Bush Administration, which are back-loaded Roth-

²³ Ana M. Aizcorbe, Arthur B. Kennickell, and Kevin B. Moore, "Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances," *Federal Reserve Bulletin*, vol. 89 (Jan. 2003), pp. 1-32.

²⁴ Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for Fiscal Year 2008*, Mar. 2007, p. 11.

²⁵ See CRS Report RL32228, *Proposed Savings Accounts: Economic and Budgetary Effects*, by Jane G. Gravelle and Maxim Shvedov.

²⁶ Ana M. Aizcorbe, Arthur B. Kennickell, and Kevin B. Moore, "Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances," *Federal Reserve Bulletin*, vol. 89 (Jan. 2003), pp. 1-32.

style savings accounts, appear unlikely to significantly affect national saving and could exacerbate future budgetary pressures. Furthermore, since these proposals are not limited to lower-income individuals and families, the benefits would primarily accrue to higher-income individuals.

Appendix. A History of IRA Proposals

Individual retirement accounts of the traditional type (front-loaded) were first allowed in 1974 (up to \$1500 or 15% of earnings), in order to extend some of the tax benefits of employer pension plans to those whose employers did not have such plans. IRAs were made universally available in 1981 (and the limits increased to \$2000) as a general savings incentive.

In 1986, IRAs were restricted for higher-income individuals already covered by employer pension plans, as part of the general base broadening needed to reach the distributional and revenue neutrality goals of the Tax Reform Act of 1986. Those covered by employer plans with incomes less than \$50,000 for married individuals and \$35,000 for single individuals were not eligible. There was a \$10,000 phase-out range (i.e. \$40,000 to \$50,000) where partial benefits were allowed. Deductible contributions were limited to \$2,000 or total earnings, whichever was less; contributions could also be made for a non-working spouse (but total contributions for a married couple could not exceed total earnings). Individuals above the income limits could make nondeductible contributions and take advantage of tax deferral on investment earnings.

In the 101st Congress (1989-1990) several proposals to restore IRA benefits were made: the Super IRA, the IRA-Plus, and the Family Savings Account (FSA).

The Super-IRA proposal, suggested by Senator Bentsen and approved by the Senate Finance Committee in 1989 (S. 1750), would have allowed one half of IRA contributions to be deducted and would have eliminated penalties for “special purpose” withdrawals (for first time home purchase, education, and catastrophic medical expenses). The IRA proposal was advanced as an alternative to the capital gains tax benefits proposed on the House side.

The IRA-Plus proposal (S. 1771), sponsored by Senators Packwood, Roth, and others, proposed an IRA with the tax benefits granted in a different fashion from the traditional IRA. Rather than allowing a deduction for contributions and taxing all withdrawals similar to the treatment of a pension, this approach simply eliminated the tax on earnings, like a tax-exempt bond. (This type of IRA is commonly referred to as a back-loaded IRA.) The IRA-Plus would also be limited to a \$2,000 contribution per year. Amounts in current IRAs could have been rolled over and would not have been subject to tax on earnings (only on original contributions); there were also special purpose withdrawals with a five-year holding period.

The Administration’s proposal in 1990 for Family Savings Accounts (FSAs) also used a back-loaded approach with contributions allowed up to \$2500. No tax would have been imposed on withdrawals if held for seven years, and no penalty (only a tax on earnings) if held for three years. There was also no penalty if funds were withdrawn to purchase a home. Those with incomes below \$60,000, \$100,000, and \$120,000 (single, head of household, joint) would have been eligible.

In 1991, S. 612 (Senators Bentsen, Roth, and others) would have restored deductible IRAs, and also allowed an option for a nondeductible or back-loaded “special IRA.” No tax would have been applied if funds had been held for five years and no penalties would have applied if used for “special purpose withdrawals.”

In 1992 the President proposed a new IRA termed a FIRA (Flexible Individual Retirement Account) which would have allowed individuals to establish back-loaded individual retirement accounts in amounts up to \$2,500 (\$5,000 for joint returns) with the same income limits as

proposed in the 101st Congress. No penalty would have been applied for funds held for seven years.

Also in 1992, the House passed a limited provision (in H.R. 4210) to allow penalty-free withdrawals from existing IRAs for “special purposes.” The Senate Finance Committee proposed, for the same bill, an option to choose between back-loaded IRAs and front-loaded ones, with a five-year period for the back-loaded plans to be tax free and allowing “special purpose” withdrawals. This provision was included in conference, but the bill was vetoed by the President for unrelated reasons. A similar proposal was included in H.R. 11 (the urban aid bill) but only allowed IRAs to be expanded to those earning \$120,000 for married couples and \$80,000 for individuals (this was a Senate floor amendment that modified a Finance Committee provision). That bill was also vetoed by the President for other reasons.

The Contract with America and the 1995 budget reconciliation proposal included proposed IRA expansions similar to the 1997 proposals (discussed below), but this package was not adopted. The Health Insurance Portability and Accountability Act of 1996 allowed penalty-free withdrawals from IRAs for medical costs.

In 1997, the President proposed to increase the adjusted gross income limits for the current IRAs to \$100,000 for married couples (with a phase out beginning at \$80,000), and to \$70,000 for individuals (with a phase out beginning at \$50,000). Part of this expansion would have occurred in 1997-1999 (a joint phase out between \$70,000 and \$90,000 and a single phase-out between \$45,000 and \$65,000). Such a proposal would have extended individual retirement account eligibility to the vast majority of taxpayers. Taxpayers would have had the option of choosing instead special, nondeductible IRAs, with no taxes applying if the funds are held in the account for at least five years. The 10% penalty would not have been due for withdrawals during that period for post-secondary education, first-home purchase, or unemployment spells of 12 weeks or more. Existing deductible IRAs could have been rolled over into nondeductible accounts with the payment of tax on withdrawals.

The House-proposed revisions were generally the same as those proposed in the House Republican Contract With America and included in the 1995 budget reconciliation proposal, and as those reported out of the Ways and Means Committee. This change would have allowed individuals to contribute up to \$2,000 to a nondeductible or “back-loaded” IRA regardless of income, termed the American Dream Savings (ADS) account. The back-loaded IRA did not provide a tax deduction up front, and did not impose taxes on qualified withdrawals. The \$2,000 would have been indexed for inflation after 1998. This provision would have been in addition to deductible IRAs (but would have replaced the current nondeductible accounts); earnings on withdrawals would not have been be taxed if held for at least five years and used for qualified purposes: withdrawals after age 59½, left in the estate, attributable to being disabled, or withdrawn for down payment on a first home.

A 10% early withdrawal penalty would have continued to apply to nonqualified withdrawals, but withdrawals to pay for higher-education expenses would not have been subject to the penalty tax. No minimum distribution requirements would have applied. Taxes and penalties would not have applied until the original contribution was recovered, and all IRAs would be aggregated for this purpose.

Amounts in current IRAs could have been withdrawn and placed into the nondeductible IRAs without penalty prior to 1999. Amounts rolled over must have been included in income in equal increments over four years.

The Senate 1997 version would have raised the income limits on deductible IRAs from \$50,000 to \$60,000 for single returns and \$80,000 to \$100,000 for joint returns by 2004. These limits would have been phased in: \$30,000 to \$40,000 for single and \$50,000 to \$60,000 for joint in 1998-1989; \$35,000 to \$45,000 for single and \$60,000 to \$70,000 for joint 2000-2001; \$40,000 to \$50,000 for single and \$70,000 to \$80,000 for joint in 2002-2003. Individuals whose spouses were participants in an employer plan would have been eligible regardless of the income limit.

This proposal would also have introduced back-loaded accounts as a substitute for nondeductible accounts; individuals would have had to reduce the contributions to these accounts by the amounts deductible from front-loaded accounts. These accounts were called IRA Plus accounts. The rules regarding withdrawals and penalties were similar to those in the House bill, except that withdrawals without penalty were also allowed for long-term unemployment. There were no income limits for back-loaded IRAs.

The final bill followed the Senate version, with some alterations to the phase outs. The provision allowing exemption from withdrawal penalties for long-term unemployment was dropped.

The Senate version of Taxpayer Refund and Relief Act of 1999 would have increased contribution limits to \$5,000, increased income limits for deductible IRAs, and eliminated income limits for Roth IRAs. The House bill's provisions were much more limited: Roth IRA limits would have been increased. The final bill more closely followed the Senate version, although the income limits for Roth IRAs were to have been increased with no change for deductible IRAs. The President vetoed the tax cut because of its large revenue cost. Several bills including IRA provisions saw some legislative action in 2000, but not one was enacted.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) gradually increases the contribution limits to IRAs. IRA limits increased to \$3,000 in 2002-2004, to \$4,000 in 2005-2007 and \$5,000 in 2008. The limits will then be indexed for inflation in \$500 increments. Limits for catch-up contributions by individuals over 50 years of age were \$500 in 2002-2005 and will be \$1,000 in 2006. A nonrefundable tax credit for contributions to a qualified retirement plan including IRAs beginning at 50%, but phasing down, is allowed for lower-income individuals. Many of the provisions in EGTRRA will expire in 2010, but the Pension Protection Act of 2006 made those expansions permanent.

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