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Tax Reform: Promoting Retirement Security

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My name is Todd McCracken and I am the president of the National Small Business Association (NSBA), America's oldest small-business advocacy organization. On behalf of the 150,000 small businesses the NSBA represents, I am pleased to provide our perspective on promoting retirement security through tax reform.

The NSBA strongly believes that the present tax system is irretrievably broken and constitutes a major impediment to the economic health and international competitiveness of American businesses of all sizes. To promote economic growth, job creation, capital formation, and international competitiveness, fundamental tax reform is required.

We would like to offer a brief statement on how the tax code is impeding retirement security. The two primary reasons are (1) that the current administrative burden imposed on small businesses considering implementing a retirement savings plan is too high and (2) the tax system is biased against savings.

Retirement Plans Under Current Law

When a small business owner is considering his or her retirement needs and those of his employees he must consider simplified employee pensions (SEPs), salary reduction simplified employee pensions, SIMPLE IRA plans, SIMPLE 401(k) plans, regular 401(k)s, profit-sharing plans, money purchase pension plan, Keogh plans, defined benefit plans, defined contribution plans, and employee stock ownership plans. Most of those plans are qualified plans subject to the minimum coverage requirements, minimum vesting standards, the actual deferral percentage test, the non-discrimination requirements, and the top heavy plan requirements.

If your eyes have glazed over, you would not be alone. The problem is that if a small business owner fails to figure all of this out and gets it wrong, then the entire plan may become subject to immediate taxation and penalty. Is it any wonder that many small businesses owners decide not to get involved in this morass? I think not.

This is not the forum for getting into a detailed critique of the current rules governing retirement savings. The bottom line is that it should not be this difficult for a small business owner to provide for his or her retirement and that of the business' employees. This can be accomplished under current law by radically changing and simplifying the defined contribution plan rules. Or it can be solved in the context of fundamental tax reform by eliminating the double taxation of savings.²

Congress should prioritize dramatic simplification of the law in the area of retirement savings. Congress may want to consider merging simplified employee pensions (SEPs), salary reduction simplified employee pensions, SIMPLE IRA plans, SIMPLE 401(k) plans and Keogh plans into a unified small business defined contribution pension plan. Some ideas for how this might be done include a reasonably large deduction (for example, up to 25 percent of salary) and

² The FairTax, the Flat Tax, a business transfer tax or a consumed income tax (sometimes called an expenditure tax, inflow-outflow tax or cash-flow tax) would all accomplish this result.

uniform simple, comprehensible non-discrimination rules. Moreover, employers should be permitted to elect to automatically enroll their employees (as under current law).

The Inadequacy of Savings in the United States

The Congress needs to act to improve the retirement savings climate in the U.S. U.S. retirement savings are inadequate. The median IRA balance is \$20,444.³ The median 401(k) plan balance is \$17,794.⁴ Median household financial assets owned declined from \$31,300 to \$29,600 from 2007 to 2009 and has probably not improved materially.⁵ The median equity in primary residences has declined nearly 33 percent to \$64,000.⁶ These levels of savings are only enough to generate a few hundred dollars a month of annuity income. In other words, most Americans have entirely inadequate retirement savings.

The FairTax

There are a many ways to improve the tax system. To improve on the current system doesn't take a lot. But NSBA regards the FairTax (S. 13, H.R. 25) as the best fundamental tax reform proposal. It would have a dramatic positive impact on economic growth, job creation, real wages, investment and international competitiveness. It would treat all savings as if they were invested in a Roth IRA. A summary of why the FairTax deserves support:

1. The FairTax would be simple and dramatically reduce compliance costs that have a disproportionate negative impact on small firms. The resources currently used to comply with the present tax system can be better used growing businesses, creating new products, conducting research and development, purchasing productivity enhancing equipment or reducing prices to customers. Retirement plans could be based on business' and employees' needs not the complex morass in the tax law. Because the cost of maintain retirement or other savings plans would decline dramatically, it is probable that more employers would offer savings plans.
2. Consumption rather than income would be taxed. Savings would all be treated Roth IRA treatment and savings rates should increase substantially.
3. The FairTax would be neutral toward savings and investment and reduce the user cost of capital substantially. The capital stock would therefore grow. Productivity, innovation and real wages would increase.

³ Craig Copeland, "IRA Balances and Contributions: An Overview of the EBRI IRA Database," Employee Benefit Research Institute Issue Brief, September 2010, No. 346, p. 9.

⁴ Jack VanDerhei, Sarah Holden and Luis Alonso, "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2009," Employee Benefit Research Institute Issue Brief, November 2010, No. 350, p. 10.

⁵ Jesse Bricker, Brian Bucks, Arthur Kennickell, Traci Mach and Kevin Moore, "Surveying the Aftermath of the Storm: Changes in Family Finances from 2007 to 2009," Board of Governors of the Federal Reserve System, March 2011, p.27.

⁶ Ibid., p. 27. Figures derived from primary residence assets and liabilities data.

4. The FairTax has much lower marginal tax rates than the current tax system and has virtually the lowest possible marginal tax rate consistent with a neutral tax treatment of savings and investment.⁷ It would dramatically reduce the tax disincentive to work, save and invest. The double taxation of corporate income (i.e. dividends and individual capital gains that are a function of retained corporate earnings) would be eliminated.
5. Entrepreneurial risk-taking and innovation would increase because more investment capital would be available and the tax on capital gains would be zero.
6. The U.S. would attract capital from throughout the planet. Investment in the U.S. whether by Americans or foreigners would not be taxed. The U.S. would, in effect, become the largest tax haven in the world. The “giant sucking sound” you would hear, to paraphrase Ross Perot’s memorable metaphor, would be the U.S. attracting capital from throughout the world. Having adequate capital is important for all businesses but particularly important for small and start-up businesses.
7. For the first time, the tax system would impose the same tax burden on foreign produced goods and U.S. produced goods. The FairTax would eliminate the current origin principle system that places U.S. based firms at such a large disadvantage. This is because the FairTax is a destination principle tax (i.e. it is, in effect, border adjusted).

⁷ The only reason it does not have the lowest possible rate theoretically possible is the rebate that prevents the poor from paying any federal income or payroll tax and reduces middle class effective tax rates substantially.