Improved Tax Treatment of Saving Included in Year-End Federal Spending Deal

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This week, Congress forged an agreement to fund the federal government through an omnibus spending package that runs through September 2023. This package will include legislation that improves the tax treatment of saving, building on previous proposals introduced in the Senate and the House that change incentives to save and simplify the tax treatment of saving.

The previous proposals included the Senate Enhancing American Retirement Now (EARN) Act and the House Securing a Strong Retirement Act (SECURE 2.0), which were reconciled between the chambers prior to inclusion in the omnibus federal spending package.

These proposed reforms to retirement savings accounts in the omnibus federal spending package include the following major changes:

- Increases the required minimum distribution (RMD) age from 72 to 73 starting on January 1, 2023, and then to 75 beginning on January 1, 2033
- Requires many new 401(k)-style retirement plans to automatically enroll workers (automatic opt-in) with automatic contributions ranging from 3 to 10 percent starting in 2025
- Expands catch-up contributions for people aged 50 and over to 401(k) retirement accounts, raising the catch-up amount to $7,500 in 2023 and raising the maximum catch-up amount to $11,250 for those aged 60 to 63 starting in 2025
- Allows for employer emergency savings accounts alongside retirement accounts, which lets employees save up to $2,500 in Roth-style accounts for emergency savings
- Expands the saver's credit by providing a 50 percent credit on savings up to $2,000 (for a maximum value of $1,000), which will be provided regardless of income tax liability starting in 2027
- Eliminates required distributions for Roth 401(k)s starting in 2024

- Standardizes rollover forms to enhance the portability of existing retirement accounts
- Allows for tax- and penalty-free rollovers worth up to $35,000 from 529 education savings plans into IRAs
- Provides more transparency for lump sum buyout offers
- Sets new limits on syndicated conservation easements

The proposal for emergency savings accounts is based on the Emergency Savings Act of 2022, offered by Sens. Cory Booker (D-NJ) and Todd Young (R-IN), which would give employers the option of establishing workplace emergency savings accounts for employees of up to $2,500 in contributions. The accounts would be treated on a Roth basis, meaning contributions would be made after-tax and withdrawals and any growth could be used tax-free at any time. Emergency savings accounts would help reduce the incentive to take a loan against or liquidate retirement accounts, which are also often subject to penalties for early withdrawals.

The changes within the retirement tax package share a common goal of improving incentives for households to save during a time when inflation is impacting their finances. The tax system currently encourages saving in a disjointed and complicated fashion, requiring households to understand the variety of rules and restrictions associated with different saving opportunities.

While the changes introduced in the omnibus federal spending package improve the tax treatment of saving, policymakers can build on these changes in the future by streamlining the number of savings vehicles, further simplifying rules related to withdrawals and contributions, and, short of moving to taxing consumption, indexing taxes on the returns to saving (such as capital gains taxes) to inflation.

The proposals currently fall short of ensuring all saving is treated neutrally but would improve incentives to save and make important simplifications to the current retirement account system.