Use of Individual Retirement Arrangements to Save for Retirement--Results From a Matched File of Tax Returns and Information Documents for Tax Year 2001

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With $2.6 trillion in assets at year-end 2001, Individual Retirement Arrangements (IRAs) had grown to represent nearly one-quarter of the $11.2 trillion in the U.S. retirement market (Figure 1). Defined contribution plan assets had risen to $2.7 trillion, with 401(k) plans holding an estimated $1.7 trillion, or 15 percent of the total retirement market, at year-end 2001. This year the Employee Retirement Income Security Act (ERISA) turns 30 years old. In 1974, when ERISA was passed, the total U.S. retirement market was only $367.5 billion in assets.[1] Thirty years later, U.S. households hold more than $12.1 trillion in retirement assets, with IRA assets exceeding $3.0 trillion.[2] This paper will focus mainly on one of these retirement vehicles—the one for which IRS files contain the most data. This retirement vehicle is the Individual Retirement Arrangement (or IRA).

By combining tax returns and information returns in one database, the Statistics of Income (SOI) Division has made it possible to study trends in contributions to IRAs, as well as the participation in other types of retirement plans, by individual taxpayers.[3] This paper will analyze the detailed SOI data for Tax Year 2001, paying particular attention to comparing taxpayers with IRA activity to the population of taxpayers who were eligible to participate in that Tax Year. In addition, this paper will show the interaction of IRA activity with employer-provided retirement plans.

ALL TAXPAYERS WITH IRAs

While the SOI has collected traditional IRA deductible contribution information for every tax year starting in 1975 (Figure 2), those contributions only tell a very small part of the IRA story. Detailed SOI data from the information Form 5498 reveal a more complete picture. For example, in 2001, while deductible contributions to all IRAs totaled $13.2 billion (including deductible contributions to traditional IRAs of $7.4 billion as shown in Figure 2), an additional $23.4 billion were contributed to IRAs on an after-tax (nondeductible) basis (Figure 3, column 4 minus column 6). More importantly, rollovers, primarily from qualified retirement plans increased IRA holdings by $187.1 billion in 2001. Pulling IRA assets down in 2001 were withdrawals and poor equity market returns, so that by year-end 2001, total IRA assets had edged down slightly to $2,619.4 billion. While much of this drop can be attributed to reduced returns on capital, it is also true that the level of IRA contributions rose by an anemic one-tenth of one percent compared with Tax Year 2000, with contributions to traditional and Roth IRAs actually dropping.[4]

When both traditional and Roth IRAs are considered, any individual with compensation under the age of 70 ½ could make a contribution to an IRA, up to a maximum of $2,000 (or total compensation, if less than $2,000) for Tax Year 2001. In making this computation, non-working married persons could count their spouses' earned incomes as their own for the purpose of making an IRA contribution.

Individuals age 70 ½ or older with earned incomes could not contribute to traditional IRAs, but they could still make payments to Roth IRAs, as long as they had incomes under $110,000 for single people (including unmarried heads of households); under $160,000 for married persons filing jointly (including recently widowed spouses with children); or under $10,000 for married persons filing separately.

The income concept used to determine eligibility was "modified adjusted gross income." This is basically adjusted gross income (or AGI)—the bottom line of page 1 of Form 1040, with a few items added back:

- Deductible IRA contribution(s);
- Student loan interest excluded from AGI;
- Excluded foreign earned income;
- Excluded foreign housing allowances;

[1] See Federal Reserve Board, *Flow of Funds Accounts*, table L.225, June 10, 2004 release.
[2] See Investment Company Institute (June 2004).
[3] See Sailer, Weber, and Gurka (2003).

[4] For Tax Year 2000 contribution details, see Sailer and Nutter (Spring 2004).

- Excluded bond interest;
- Employer-paid adoption expenses.

Overall, only 9.4 percent of those taxpayers eligible to make IRA contributions did so in 2001. When eligible taxpayers are classified by size of adjusted gross income (Figure 4), it turned out that less than 4 percent of eligible taxpayers with incomes under $25,000 actually made contributions. Participation rates gradually rose through the $200,000 under $500,000 class, where about 21 percent of eligible taxpayers contributed, and then declined again for the highest income classes.

When eligible taxpayers are classified by age group (Figure 5), the highest participation rate (over 14 percent) occurred for the 55- to 64-year-old group. Apparently, many taxpayers wait until a fairly advanced age to start making IRA contributions. Participation rates were much lower for taxpayers under 45 and over 70; the latter likely influenced by the age limitation on traditional IRA contributions.

In conclusion, when all types of IRA plans were considered, participation rates tended to rise as income levels rose. However, tax return information repeatedly shows that all income groups take advantage of deductible IRA contributions. Among tax returns with deductible traditional IRA contributions in 2001, 17.8 percent had AGI of less than $25,000; 32.4 percent had AGI between $25,000 and $50,000; 19.9 percent had AGI between $50,000 and $75,000; and 29.9 percent had AGI of $75,000 or more.[5]

TAXPAYERS WITH DEDUCTIBLE TRADITIONAL IRA CONTRIBUTIONS

The deductible traditional IRA allows eligible taxpayers to deduct the IRA contribution (up to $2,000), and exempts all proceeds from taxation until the money is withdrawn. The eligibility requirements for deductible IRAs are more stringent than those for nondeductible traditional IRAs or Roth IRAs.[6] For Tax Year 2001, the taxpayer eligible for deductible contributions

- Had to have compensation;
- Had to be under age 70 ½;
- Could not be taking the full $2,000 Roth IRA contribution;
- If covered by an employer-provided pension plan, had to have modified AGI of less than:
    - $43,000 if single or unmarried head of household;
    - $63,000 if married filing joint or a surviving spouse
    - $10,000 if married filing separately.

There was no income limit for taxpayers who were not covered by employer-provided pension plans, with one exception: if a married person filing jointly was not covered by a pension plan, but his or her spouse was, the non-covered spouse could not make a deductible IRA contribution if the couple's modified AGI was $160,000 or more.

In the charts showing taxpayer participation in deductible traditional IRA plans as a percentage of eligible taxpayers, data are shown separately for covered and non-covered taxpayers, since different rules apply to the two groups. Coverage by an employer-provided plan was determined either by the presence of contributions to a SEP or SIMPLE IRA on Form 5498, or a checkmark in the "Retirement Plan" box of Form W-2.

Overall, only 3.0 percent of eligible taxpayers took a traditional IRA deduction. When taxpayers were classified by coverage/non-coverage by an employer-provided pension, 2.4 percent of the covered and 3.2 percent of the non-covered taxpayers took the deduction. As shown in Figure 6, participation in this program varied considerably over various income levels, with 13 percent of taxpayers in the $200,000 under $2,000,000 class taking the IRA deduction. (The reason such a large income interval was chosen is that there was remarkably little difference in participation rates over this income range.) Obviously, at these income levels, only non-covered employees were eligible to take the IRA deduction.

As shown in Figure 7, the highest participation in deductible traditional IRAs is among those approaching retirement age. In the 55- to 64-year-old age group, 6.5 percent of eligible covered taxpayers took the deduction, as did 8.2 percent of eligible non-covered taxpayers. The highest age class ends at 70 ½ years, the maximum age at which one could qualify for the deductible traditional IRA contribution.

Figure 8 divides the taxpayer population as a whole (not just the eligible population) into six groups, based on participation in deductible traditional IRA plans. Only 2 percent of entire population took the deduction for Tax Year 2001. Fully 65 percent of all taxpayers were eligible to invest in deductible IRAs, but did not. Ineligible taxpayers included those with no compensation (12 percent of the population), covered taxpayers above the income limit (17 percent), those over age 70 ½ (2 percent) and those electing to make a full $2,000 Roth IRA contribution instead of a deductible IRA contribution (2 percent).

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[5] See Campbell and Parisi (Fall 2003).

[6] See Internal Revenue Service (2001) for details.

ALL TAXPAYERS WITH RETIREMENT PLAN ACCUMULATIONS

Taxpayers may accumulate assets for retirement through a variety of tax-advantaged programs. Figure 9 shows that fully 26 percent of the taxpayer population had assets invested in non-employer-sponsored IRAs. These assets (shown as traditional IRA or Roth IRA fair market value on Form 5498) were accumulated either through contributions to these plans, or through rollovers upon job change or retirement from employer-sponsored plans, such as those set up under Section 401(k) of the Internal Revenue Code. Among these 26 percent, 10 percent of the taxpayer population not only had assets invested in non-employer-sponsored IRAs, but were also participating in employer-sponsored plans, as evidenced by the presence of SEP or SIMPLE IRA contributions on Form 5498, or participation in employer-sponsored plans indicated on Form W-2.

Unfortunately, individuals' assets accumulated in employer-sponsored plans (such as 401(k)s) are not available from any documents in the Internal Revenue Service's record system. However, it seems safe to assume that the 9 percent of the population who had no IRA assets or current employer-sponsored plan coverage, but reported taxable pension income on their Forms 1040 had assets (or at least obligations) from employer-sponsored plans.

All told, IRS tax return and information forms show that in 2001, 60 percent of taxpayers had assets in and/or income from IRAs and/or employer-sponsored plans. Figure 9 shows 40 percent of the population neither receiving nor accumulating retirement assets. Of course, this number refers only to assets officially designated as retirement plans. Many of these individuals may be accumulating interest-bearing or dividend-paying assets, or other assets that can be sold at a future date to fund retirement.

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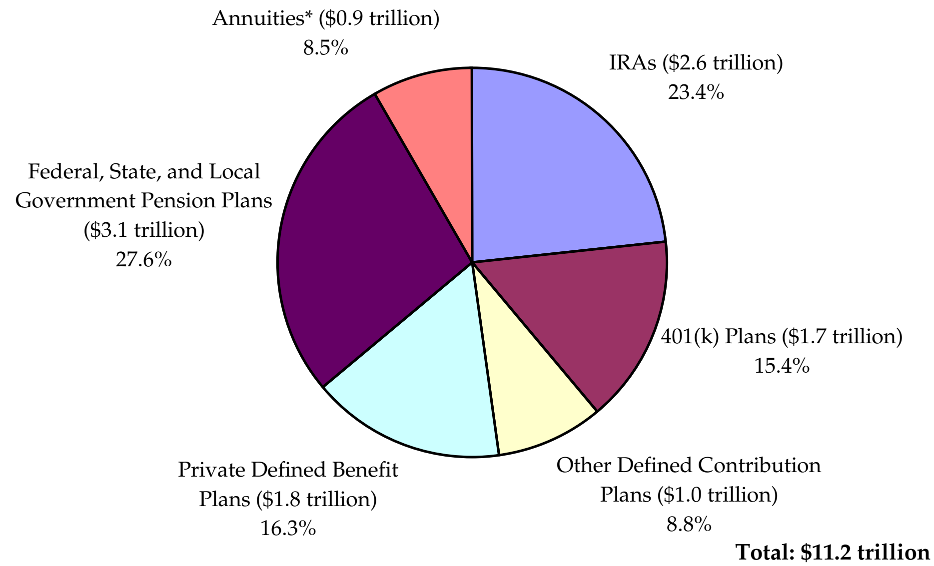
Note

The views in this paper are those of the authors and do not reflect those of the Investment Company Institute or its members, nor are they the official positions of the Internal Revenue Service. Any errors are solely the responsibility of the authors.

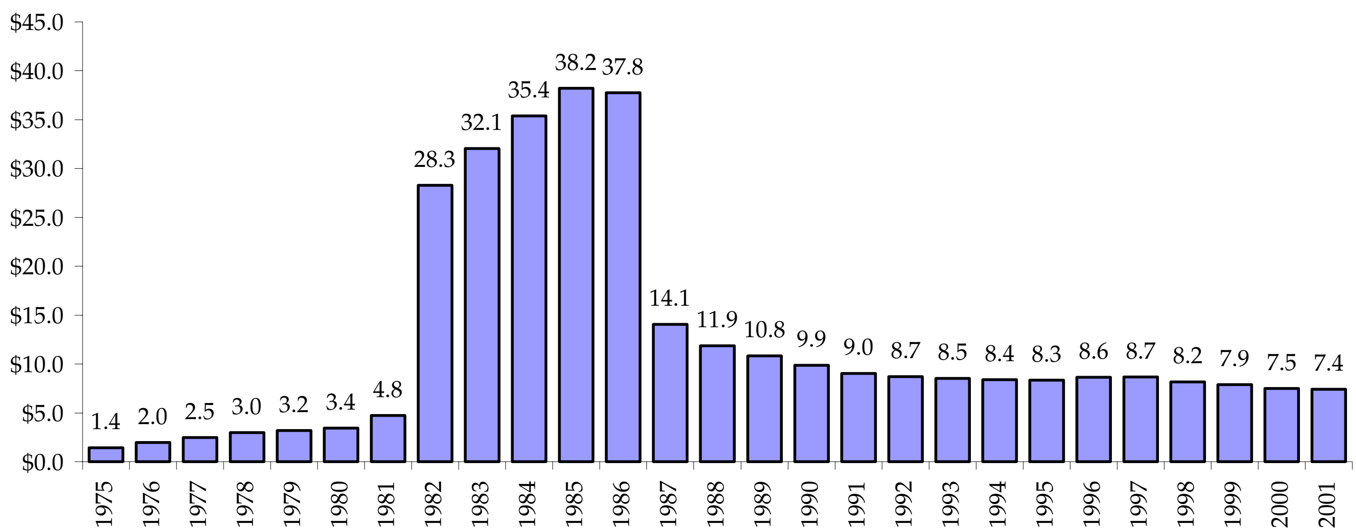
Figure 1
U.S. Retirement Market, 2001



*Does not include annuities held in IRAs, 403(b) plans, 457 plans, or private pension plans.

Sources: Investment Company Institute, Internal Revenue Service, Statistics of Income Division, and Federal Reserve Board

Figure 2
Deductible IRA Contributions to Traditional IRAs,* 1975–2001
(billions of dollars)



*Deductible IRA contributions reported on individual income tax returns (Form 1040).

Source: IRS, Statistics of Income Division, *Individual Income Tax Returns, Publication 1304* , various years, and *SOI Bulletin.*

Figure 3. Individual Retirement Arrangement (IRA) Plans by type, Tax Year 2001

Type of plan	Beginning of year FMV		Total contributions		Deductible on Form 1040		Rollovers	
	Number of Taxpayers	Amount	Number of Taxpayers	Amount	Number of Taxpayers	Amount	Number of Taxpayers	Amount
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Total	46,270,141	2,629,309,067	15,987,806	36,524,664	4,504,937	13,167,381	3,602,806	187,080,603
Traditional IRA Plans	38,076,500	2,407,022,354	5,583,757	9,825,898	3,718,917	7,406,866	3,602,806	187,080,603
SEP Plans	3,313,204	134,047,902	1,786,931	10,071,870	642,053	4,991,601	n/a	n/a
SIMPLE Plans	1,568,426	10,351,751	1,728,736	5,468,896	143,966	768,913	n/a	n/a
Roth IRA Plans	9,485,189	77,579,420	6,806,294	11,116,124	n/a	n/a	n/a	n/a
Education IRA Plans 3/	241,238	307,640	82,088	41,876	n/a	n/a	n/a	n/a

Type of plan	Roth conversions		Withdrawals 1/		Other changes 2/	End of year FMV	
	Number of Taxpayers	Amount	Number of Taxpayers	Amount	Amount	Number of Taxpayers	Amount
	(9)	(10)	(11)	(12)	(13)	(14)	(15)
Total	0	0	9,185,958	104,527,365	-129,010,549	48,404,401	2,619,376,420
Traditional IRA Plans	255,062	-3,052,037	8,553,004	98,690,314	-107,320,567	39,283,457	2,394,865,938
SEP Plans	n/a	n/a	342,199	4,452,660	-8,305,687	3,523,805	131,361,424
SIMPLE Plans	n/a	n/a	98,049	471,710	-1,756,655	1,959,748	13,592,282
Roth IRA Plans	255,062	3,052,037	370,077	875,818	-5,874,730	11,026,390	79,349,804
Education IRA Plans 3/	n/a	n/a	73,919	36,863	-105,681	206,655	206,972

Note: Except as noted, all data are from matched forms 1040 and 5498; all figures are estimates based on samples--amounts in thousands of dollars.

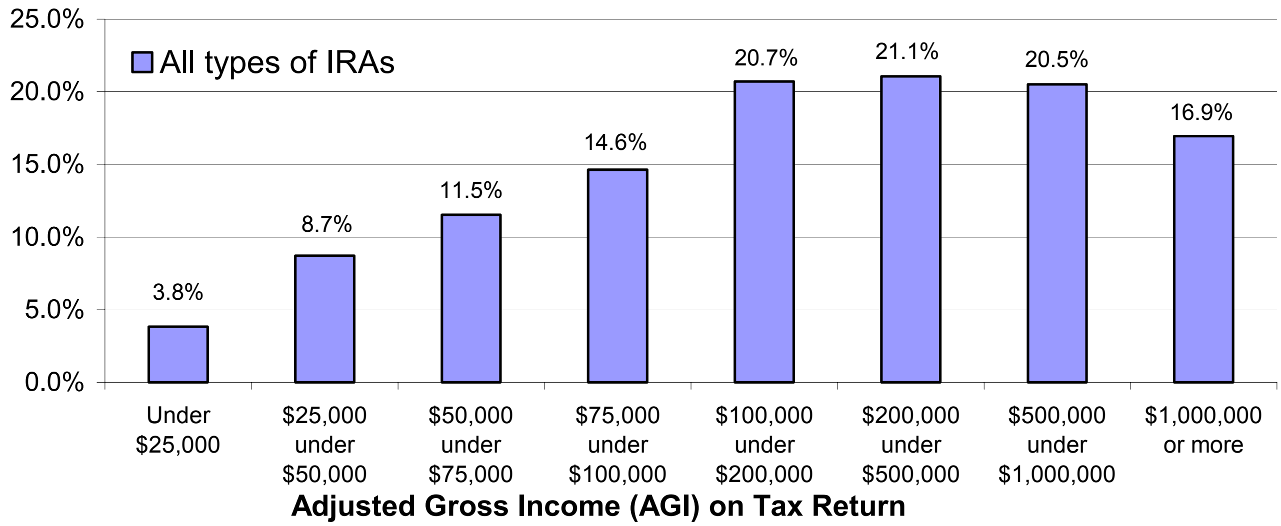
1/ Withdrawals are reported on Form 1099-R; excludes withdrawals for the purpose of rollovers to other IRA accounts, or Roth IRA conversions.

2/ Residual of change in fair market value minus all the enumerated changes.

3/ Education IRAs were renamed Coverdell Education Savings Accounts (ESAs) in July 2001; excludes Ed-IRAs owned by non-filing dependents.

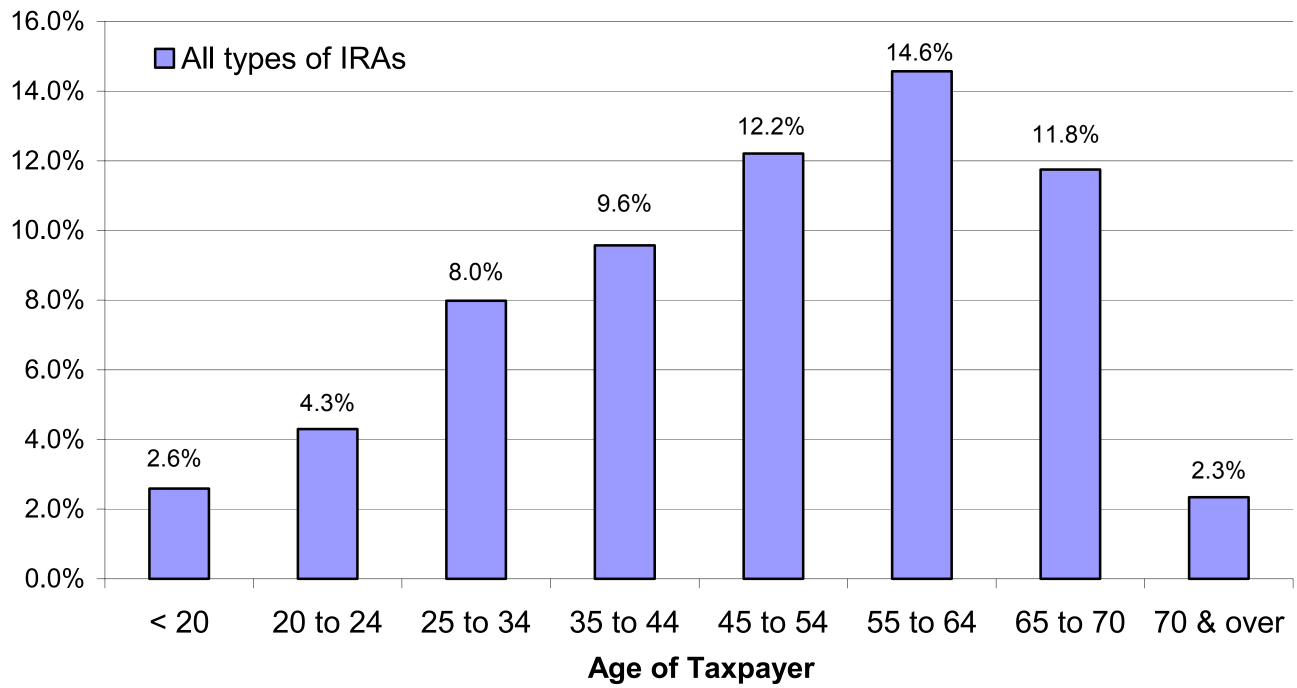
Source: Matched file of income tax returns, Forms 5498, and 1099-R for Tax Year 2001

Figure 4: Percent of Eligible Taxpayers Contributing to Any Type of IRA Plan by Size of AGI, Tax Year 2001



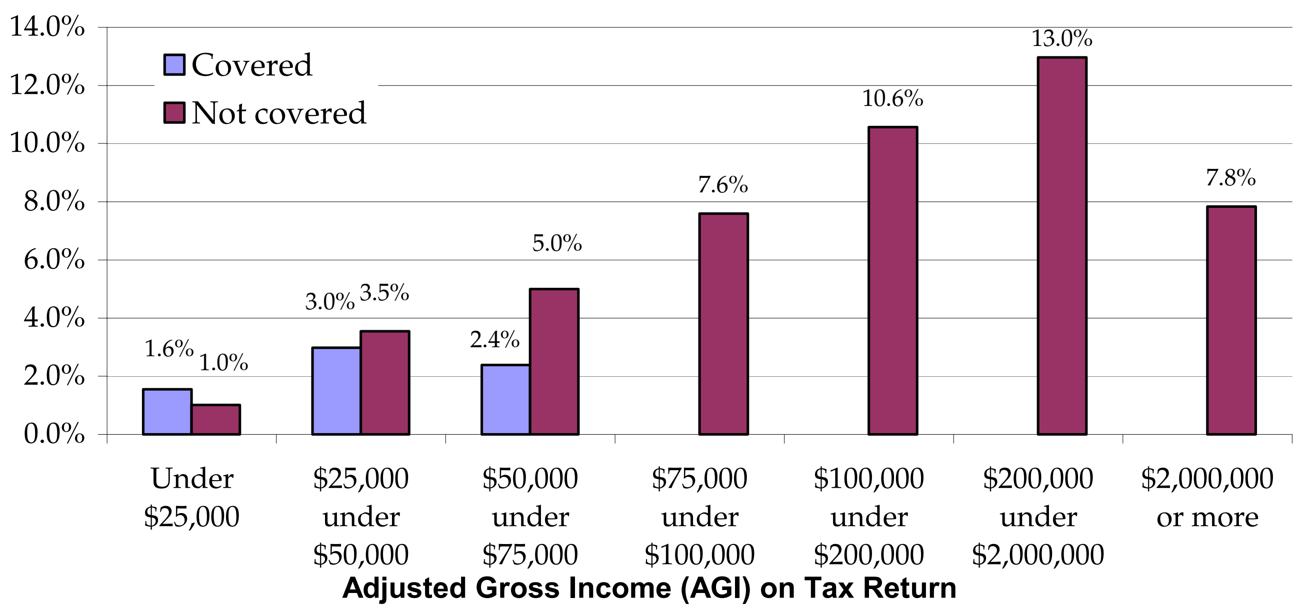
Source: Matched file of income tax returns, Forms 5498, and 1099-R for Tax Year 2001

Figure 5: Percent of Eligible Taxpayers Making IRA Contributions by Age, Tax Year 2001



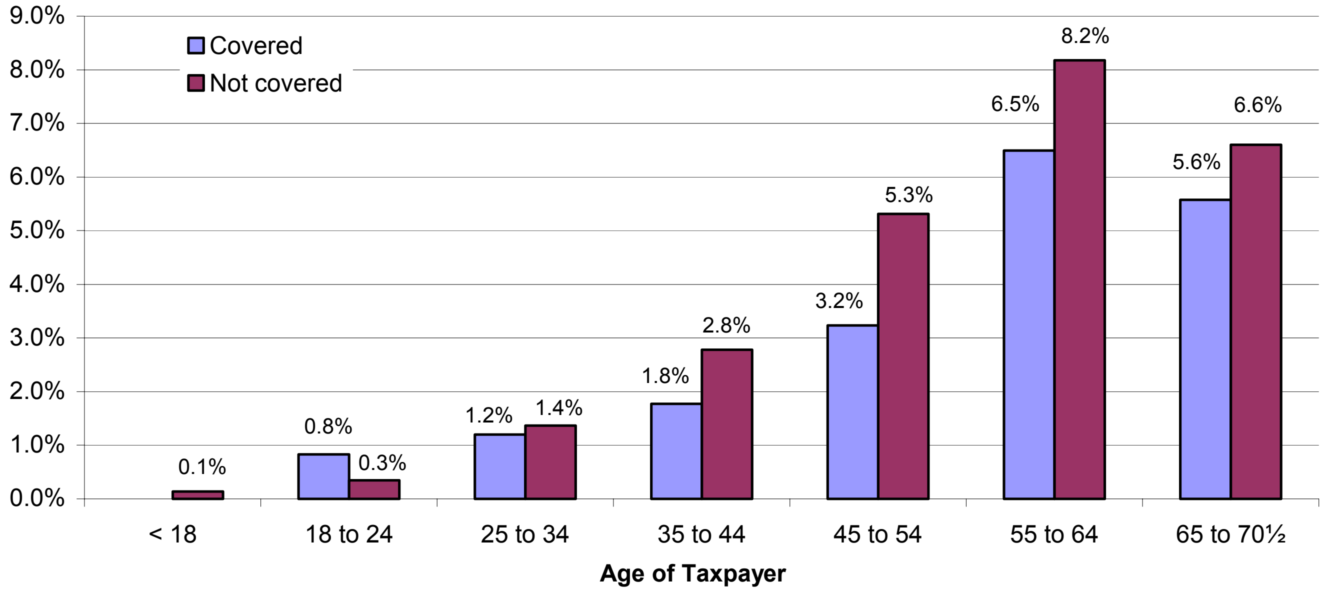
Source: Matched file of income tax returns, Forms 5498, and 1099-R for Tax Year 2001

Figure 6: Percent of Eligible Taxpayers Taking Traditional IRA Deduction by AGI and Employer-Provided Retirement Plan Coverage, Tax Year 2001



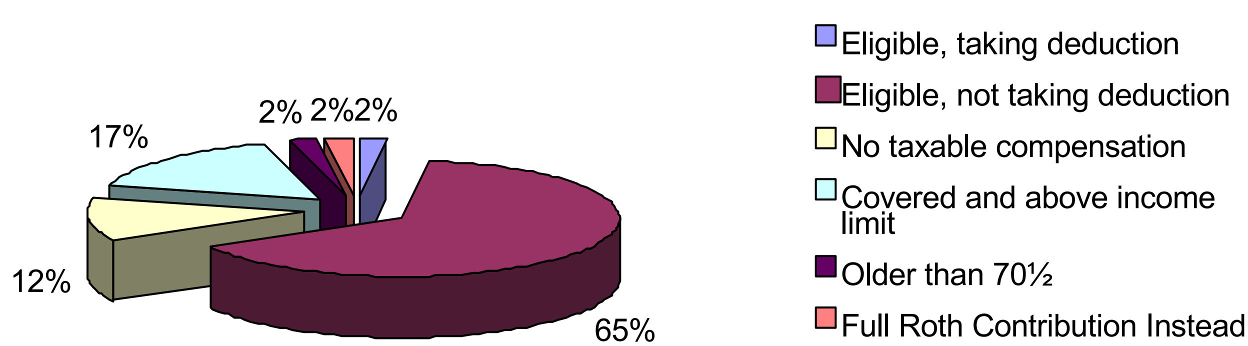
Source: Matched file of income tax returns. Forms 5498. and 1099-R for Tax Year 2001

Figure 7: Percent of Eligible Taxpayers Taking Traditional IRA Deductions by Age and Employer-Provided Retirement Plan Coverage, Tax Year 2001



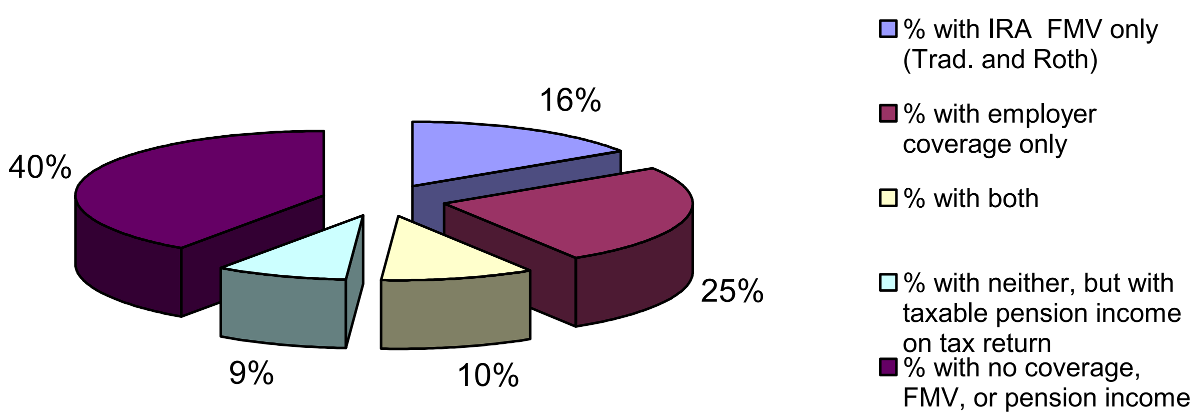
Source: Matched file of income tax returns, Forms 5498, and 1099-R for Tax Year 2001

Figure 8: Percent of All Taxpayers by Eligibility for IRA Deductions, Tax Year 2001



Source: Matched file of income tax returns, Forms 5498, and 1099-R for Tax Year 2001

Figure 9: Percent of All Taxpayers by Type of Retirement Plan Participation, Tax Year 2001



Source: Matched file of income tax returns, Forms 5498, and 1099-R for Tax Year 2001