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Tax-deferred Saving Accounts: Heterogeneity and Policy Reforms∗

Anson T. Y. Ho †

Abstract

Tax-deferred saving accounts (TDA) are systematically used in many countries. In the United States, households’ access to TDA exhibits substantial heterogeneity: 401(k) has a higher contribution limit than IRA, but only 50% of workers are eligibility for it. I developed an overlapping-generations model that captures the tax benefits of TDA and the heterogeneity in 401(k) eligibility to investigate the quantitative impacts of TDA on the aggregate economy and their implications on policy reforms. Experiment results show that IRA already provides sufficient tax benefits for most households. The effects of providing universal 401(k) are relatively insignificant because households who can benefit from 401(k) already have access to it. On the other hand, raising the TDA contribution limit allows high-income households to increase their use of TDA and results in stronger effects on the economy. When households’ use of TDA is considered, the U.S. income tax system is less distortionary and the welfare gain from a consumption tax reform is reduced by more than half.

JEL classification: H24, E21, E64.

Keywords: Tax-deferred Accounts; Household Savings; Retirement; Tax Reform.

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