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This letter is in response to the request for input from the public to the Senate Finance Committee for ideas on reforming the tax code. It is being sent to two committee working groups, individual@finance.senate.gov and savings@finance.senate.gov, since I believe it relates to both individual income tax and savings and investment.

SUMMARY

Over the last 20 years, as more and more people became covered by 401K Plans, IRA's, and other retirement plans, and as investments in those plans have risen, many people, even those who might be considered middle and upper middle income people, have amassed a significant amount of money. When they do retire, this money becomes income taxable as it is withdrawn (excluding Roth IRA's), and estate taxable. When the person and his/her spouse die, much of remaining retirement savings may be wiped out in income and estate taxes.

In an effort to make Social Security more solvent, much has been discussed regarding raising Social Security taxes or the retirement age, or reducing benefits, yet nothing regarding enticements to totally opt-out of benefits.

The following outline proposes that income and estate tax benefits be given in exchange for opting out of Social Security benefits at retirement. Hopefully these enticements will result not only in this generation, but subsequent generations, of people who do not need Social Security and can afford to forego it. And, the longer these benefits are passed to future heirs, the longer Social Security strengthens with minimal real impact to the deficit. Critical to the success of this proposal, however, is not allowing the elimination of contributions to Social Security by this class of people. While the following may sound complicated, this is clearly a complicated problem.

DETAILED PROPOSAL

- Up to age 50, all workers and their employers will contribute to Social Security just as they do today.

- From age 50 to the then legal retirement age, any worker whose combined assets in retirement plans such as 401K's, IRA's and other retirement plans is in excess of a certain amount, say 1 million dollars for discussion purposes, may opt out of Social Security benefits if he or she desires. From the point at which the worker opts out he/she will make no further contribution via FICA, however, his/her employer will continue to make the full contribution (self-employed people will pay half their prior, total amount, that is they will pay their "company's" full contribution). Should the amount in retirement plans fall below, let us say, $500,000 prior to reaching retirement age, the worker will go back under the Social Security safety net, but under reduced benefits. This point is proposed as a further enticement to opt out of Social Security benefits.

- Since spouses may not have saved equal amounts in retirement funds, a provision can be made that both spouses may opt out if the total in all retirement funds for both is, let us say, 2 million dollars. Many lower income / retirement asset spouses may opt to remain under Social Security while their partner opts out as a form of some safety net protection.

- Upon opting out, the money in these funds, and any subsequent earnings and contributions in these funds, is declared to be income and estate tax free, and will, upon reaching retirement age, be moved into a separate Tax Free Retirement Account. Should someone who had opted out fall below the safety net base, all such assets would lose this status. Since Roth IRA's were funded with after tax moneys, those accounts converted to this new status, would result in income tax deductions, with carryover capability to future years.

- When someone dies, before or after reaching retirement age, all tax free assets would go to beneficiaries estate tax free for their subsequent retirement under the same rules as outlined here.

- Just as today, however, any access to these retirement funds prior to retirement age, by the original retiree or subsequent beneficiaries, would result in income tax and a penalty.

- The hope is that people with adequate finances would use up non-tax free assets for their retirement first because more would continue to grow tax free and be available for tax free inheritance.

- With the right scenarios, people who can afford to retire on their own will have contributed to Social Security from age 20, on average, to 50 or longer. Their employers will contribute fully right to retirement. And, eventually, the retiree will be no burden whatsoever on Social Security.

- There will be lost income and estate tax revenue to the federal government, however, this is out many years in the future and will not increase the current deficit since the Social Security benefit liability will have been lowered. More importantly, it would be an investment in the secure retirement of future generations without the need for Social Security.

- There are downsides to this proposal, such as what happens to those without the safety net of Social Security who either spend all of their retirement savings or lose it in poor investments, the unknown of how many people would participate in such a plan, and many more details which must be addressed. However, assuming a reasonable number of people opt for this proposal, the burden on Social Security could reduce significantly over a few generations.

Granted those who can take advantage of this proposal will likely be upper middle income and upper income earners, but these are the ones who contribute the most to Social Security, and would collect the most. So, these higher contributors pay for let's say 30 to 40 years, never collect a dime from Social Security, set an example of self-sufficiency to others, and, hopefully, leave remaining assets to the next generation to do the same. I believe, over 2 to 3 generations, a significant number of people will come off Social Security, leaving much more for those who truly need it. And, at least in theory, this proposal should be supportable by both Republicans and Democrats. Republicans will see less people dependent on the government and a philosophy of individual responsibility. Democrats will see a bigger pool of money for those most needy of Social Security.

A further consideration is the effect on the economy overall from IRA Required Minimum Distributions (RMD's), and the resulting income tax, once a person reaches 70½:

- The largest point of the baby boom generation is reaching retirement, with many having relied on investments to fuel the growth of their retirement plans

- Distributions, due to either need or RMD's, will result in tax liabilities, which may then force the sale of at least some of these investments.

- A poorer next generation is waiting to inherit from the baby boomers, who are living longer and spending some of these assets on health/elder care expenses, but whose estates will be further hit by estate taxes. They won't have the money to purchase all of those investments being sold.

- The net effect will likely be a negative impact to stock and bond markets, the extent of which will likely impact the overall economy very negatively. This does not paint a pretty picture.