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BACKGROUNDER

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Universal Savings Accounts Can Help All Americans Build Savings

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Abstract

Universal Savings Accounts (USAs) reduce taxes on savings and help families build their own financial security through a single, simple, and flexible savings account. USAs have proven successful around the world, supporting savers and giving them the flexibility to save for their own priorities. The USA proposal included in the Family Savings Act of 2018—part of "Tax Reform 2.0"—is a good first step toward simplifying the American savings system and removing tax disincentives to putting money away for future use. The current USA proposal is well designed, but too limited. The annual contribution limit should be set higher and roll over from year to year. Congress should also consider automatically increasing the contribution limit each year. This would allow USAs to incrementally become Americans' primary savings vehicle.

Key Points

- Universal Savings Accounts (USAs) reduce taxes on savings to help more American families build financial security. After-tax income can be deposited into a USA and invested, so that the savings generate tax-free earnings over time.
- USAs are like retirement savings accounts—without all the complicated rules. Savers can withdraw money whenever they want, for whatever they want.
- Existing complex rules and early withdrawal penalties on retirement savings negatively affect low-income households the most. USAs simplify saving, benefiting Americans of all income levels.
- USAs have proven successful in Canada, the U.K., and South Africa, where the accounts show that more flexible options are popular and can increase savings.
- USAs allow Americans at all income levels to save more of their own income with fewer Washington-imposed restrictions on where and when they can spend their own money.

Universal Savings Accounts (USAs) reduce taxes on savings for typical Americans and help families build their own financial security through a single, simple, and flexible account. On September 27, 2018, the House of Representatives passed, with bipartisan support, the Family Savings Act—one of three bills that comprise "Tax Reform 2.0."[1] Among other provisions, the Family Savings Act includes a USA.

The proposed USA allows taxpayers ages 18 and older to contribute up to $2,500 a year of after-tax income. Like private Roth-style retirement savings accounts, after-tax deposits into a USA can be invested to generate earnings over time. Unlike existing special-purpose savings accounts—401(k)s, individual retirement accounts (IRAs), 529 plans—USA holders are not bound by limits on when savings can be withdrawn or for what the funds must be used. All withdrawals from a USA are excluded from taxable income and are thus tax-free.

This paper, in its entirety, can be found at **http://report.heritage.org/bg3370**

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Although USAs are simple, the problems they help address are complex. The taxation of savings and investment in the U.S. is confusing, and the terminology is rarely intuitive. This *Backgrounder* serves as a primer on how qualified savings accounts help to alleviate the multiple taxation of personal savings and business investment. USAs are a new and simple savings account much like existing retirement and education savings accounts. USAs allow Americans at all income levels to save more of their own income with fewer Washington-imposed restrictions on where and when they can spend their own money.

History of USAs in the United States

Many different types of accounts have been described as USAs. In 1999, President Bill Clinton proposed a Universal Savings Account as a supplemental retirement account that included a refundable tax credit and government matching to encourage and subsidize additional saving.[2] President Clinton's proposal is distinct from the USAs under consideration today, as it was an addition to the formal retirement system.

The proposal most similar to the USA accounts discussed today, called a Lifetime Savings Account (LSA), was first included in President George W. Bush's fiscal year (FY) 2005 budget. President Bush proposed a series of simplifications to existing retirement accounts and a new LSA that would "allow an individual to earn a tax-free return on deposit amounts and withdraw the funds as needed without paying further taxes and without facing a withdrawal penalty."[3] Introduced in Congress by Representative Sam Johnson (R–TX) and Senator Craig Thomas (R–WY), the Lifetime Savings Account Act of 2005 (H.R. 1163, S. 545) allowed after-tax contributions of up to $5,000 a year, and excluded distributions from gross income.[4] Similar to LSAs, Representative Dave Brat (R–VA) and Senator Jeff Flake (R–AZ) introduced the Universal Savings Account Act in 2015 (H.R. 4094, S. 2320) and again in 2017 (H.R. 937, S. 232), with a $5,500 yearly contribution limit.[5]

The Family Savings Act of 2018 (H.R. 6757) includes the most recent proposal for a USA. Similar to the Brat–Flake proposal, taxpayers ages 18 and older could contribute up to $2,500 a year of after-tax income to their account. Any distributions from the account are excluded from taxable income, making them free of additional tax.

More far-reaching reforms to simplify and consolidate the myriad different private retirement accounts have also been described as USAs.[6] The IRS lists more than 16 different private retirement accounts, each with its own eligibility rules, income and contribution thresholds, early withdrawal penalties, and employer requirements.[7] In addition to retirement savings accounts, there are college and K–12 "529 plans" and Coverdale education savings accounts.[8] The multiple sets of rules that govern similar savings accounts should be streamlined to eliminate unnecessary complications that discourage use of the accounts.[9] However, for the purposes of this discussion, the term Universal Savings Account describes a new account *in addition* to the retirement and education accounts that currently exist.

1. Protecting Family and Small Business Tax Cuts Act of 2018, H.R. 6760, 115th Cong.; American Innovation Act of 2018, H.R. 6756, 115th Cong., 2nd Sess.; and Family Savings Act of 2018, H.R. 6757, 115th Congress, 2nd Sess.
2. David John, "President Clinton's Flawed Universal Savings Account Program," Heritage Foundation *Executive Memorandum* No. 593, April 29, 1999, https://www.heritage.org/social-security/report/president-clintons-flawed-universal-savings-account-program, and news release, "Remarks of the President on Universal Savings Accounts," The White House, April 14, 1999, https://clintonwhitehouse4.archives.gov/WH/New/html/19990414-3020.html (accessed November 14, 2018).
3. "The Budget for Fiscal Year 2005: Promoting Prosperity, Expanding Opportunity," U.S. Government Publishing Office, p. 33, https://www.gpo.gov/fdsys/pkg/BUDGET-2005-BUD/pdf/BUDGET-2005-BUD-8.pdf (accessed November 19, 2018).
4. H.R. 1163, 109th Cong., 1st Sess., and S.545, 109th Cong., 1st Sess.
5. Universal Savings Account Act, S. 2320, 114th Cong., 1st Sess., and Universal Savings Account Act, S. 323, 115th Cong., 2nd Sess.
6. Erica York, "The Complicated Taxation of America's Retirement Accounts," Tax Foundation, May 22, 2018, https://taxfoundation.org/retirement-accounts-taxation/ (accessed November 14, 2018).
7. Internal Revenue Service, "Types of Retirement Plans," https://www.irs.gov/retirement-plans/plan-sponsor/types-of-retirement-plans (accessed July 11, 2018).
8. There are also various savings accounts for health care expenses, such as ABLE accounts for disability-related expenses, health savings accounts, and flexible spending accounts, that are entirely tax-free and for which deposits are tax-deductible and distributions for qualified expenses are not included in gross income.
9. Adam N. Michel, "Four Priorities for Tax Reform 2.0—and Seven Supporting Reforms," Heritage Foundation *Issue Brief* No. 4888 July 16, 2018, https://www.heritage.org/taxes/report/four-priorities-tax-reform-20-and-seven-supporting-reforms.

TABLE 1

Roth and Traditional Savings Accounts Face Same Tax Rate

	Tom Traditional 401(k)	**Rebecca** Roth 401(k)	**Dan** Savings outside qualified accounts
Pre-tax contribution	$5,000	$5,000	$5,000
Income tax paid on contribution	$0	$1,200	$1,200
Value of account, year 1	$5,000	$3,800	$3,800
Value of account, year 30	$40,800	$31,000	$31,000
Income tax paid on withdrawal	$9,800	$0	$4,000
After-tax value of savings	$31,000	$31,000	$27,000
Marginal effective tax rate	**24%**	**24%**	**34%**

NOTES: Values have been rounded to nearest hundred. Calculations are based on an income tax rate of 24 percent and capital gains rate of 15 percent, and assumed 7 percent continuously compounded rate of return for 30 years.
SOURCE: Author's calculations.

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Roth vs. Traditional: Two Treatments of Savings

While the USAs proposed in the Family Savings Act would only allow contributions made with after-tax income, contributions to a USA could theoretically also be made with pre-tax income in a structure similar to the current system used for retirement savings accounts. Most Americans are familiar with personal retirement accounts like employer-administered 401(k) accounts and IRAs. Retirement savings accounts essentially remove capital gains and dividends taxes from investment returns to household savings.[10]

Retirement savings accounts allow taxpayers to contribute tax-deferred income ("traditional" accounts) or after-tax income (Roth accounts). Income deposited into a traditional retirement savings accounts is deducted from taxable income so that income taxes are not due at the time the contribution is made.[11] Within retirement savings accounts, savers can purchase a wide range of stocks, bonds, mutual funds, and exchange-traded funds. Once a taxpayer reaches age 59½, withdrawals from the account are taxed as income. Contributions to Roth savings accounts are made after income taxes are paid, so distributions in retirement (after age 59½) are tax-free.

If the contribution and withdrawal are made while the taxpayer is in the same tax bracket, the tax rate on investment in Roth and traditional savings accounts is identical.

An example: Tom and Rebecca are both 30 years old, in the 24 percent income tax bracket, and want to save $5,000 of pre-tax income this year. Tom deposits $5,000 directly into his traditional 401(k) and receives a corresponding income tax deduction, saving him $1,200 in taxes this year. Rebecca pays her 24 percent top marginal tax rate on her $5,000 and deposits $3,800 into a Roth 401(k). As shown in Table 1, if they both earn the same 7 percent rate of return, Tom will pay about $9,800 of tax on his investment when he retires. Rebecca's account balance is smaller than Tom's, but once Tom pays his tax, they are left

10. Taxes assessed at the business level still apply and reduce the return on investment.

11. Payroll taxes are still due on gross salary, before 401(k) contributions.

with the same after-tax savings and face the same marginal effective tax rate.[12]

Tom and Rebecca's similarly situated friend Dan also saved $5,000 of pre-tax income this year but did not deposit it in a retirement savings account. He has to pay income tax on his contribution and a 15 percent tax on his capital gain (the growth of his investment). His effective marginal tax rate is 34 percent.[13]

The U.S. income tax system increases Dan's tax rate on his income when he saves it, thus discouraging him from setting money aside for the future. Dan is likely to save less for retirement than Tom and Rebecca and consume more of his income in his 30s. When the tax system makes saving less attractive (compared to spending the money today), it can slow down capital formation and thus hamper gross domestic product (GDP) growth.

The U.S. income tax system systematically discourages savings and investment because it begins with the Haig–Simons definition of income: consumption plus change in net worth.[14] The income tax system double-taxes savers because tax is levied first when the income is earned and a second time on the growth of the savings. The growth of the savings is simply the compensation for waiting to use the income, so the system double-taxes savers compared to those who spend their income today. The lower tax rate on capital gains and dividends (top rate of 20 percent on long-term capital gains vs. 37 percent top marginal rate on income) and retirement savings accounts helps move the income tax toward a more neutral treatment of savings. A zero percent rate on capital gains and dividends would be closer to neutral.

Differences Between Roth and Traditional Accounts. In practice, there are important differences between the tax treatment of traditional and Roth-style savings accounts. When given the option between the two accounts, taxpayers who choose a Roth are essentially betting that their future tax rate will be higher than their current rate. This trade-off is different for different taxpayers and it changes over their lifetime.

Even if the accounts have the same after-tax value, some people may perceive the accounts differently. Behavioral economist Richard Thaler explained that traditional accounts with an up-front income tax deduction give "taxpayers an immediate reward for contributing."[15] This perceived front-loaded benefit may increase savings. Because tax is levied when sums are disbursed, people also tend to keep money in traditional accounts longer for fear of having to pay the inevitable tax.

On the other hand, Harvard economist John Beshears and co-authors show that people contribute more to Roth-style accounts when given the option.[16] Many savers have a set amount they want to save, and confusion over the pre-tax/post-tax distinction leads Roth savers to contribute more on an equivalent post-tax basis. In the example above, if Rebecca wanted to have the same $5,000 contribution to her Roth 401(k) she would have to save $6,579, paying $1,579 in taxes and depositing $5,000 in the account. As a result of saving more initially and paying the tax immediately, Rebecca would end up with over $40,800 in after-tax savings—$9,800 more than Tom. In the aggregate, the direction of the behavioral incentive is uncertain and does not justify one account style over another.

There are also important differences in the incentives for politicians and ease of administration. Some fear that contributing to a Roth account and paying taxes up-front could leave room for a future Congress to apply taxes to Roth earnings, eliminating the guarantee of tax-free withdrawals. This would revoke the current tax advantage.[17] The traditional tax-deferral

12. This is most simply illustrated by dividing each saver's taxes paid by their corresponding tax base.
13. The marginal effective tax rate is 1 minus the ratio between after tax and pre-tax return. This is a simplified example without accounting for discounting taxes in different time periods and other timing complications.
14. Robert Murray Haig, "The Concept of Income—Economic and Legal Aspects," in Robert Murray Haig, ed., *The Federal Income Tax* (New York: Columbia University Press, 1921), pp. 1–28, https://archive.org/details/cu31924020062935/page/n7 (accessed November 14, 2018).
15. Richard H. Thaler, "Psychology and Savings Policies," *The American Economic Review*, Vol. 84, No. 2 (May 1994), pp. 186–192, https://www.jstor.org/stable/2117826?seq=1#metadata_info_tab_contents (accessed November 15, 2018).
16. By one estimate, this Roth effect could increase savings by as much as 26 percent. John Beshears et al., "Does Front-Loading Taxation Increase Savings? Evidence from Roth 401(k) Introductions," Harvard Business School, August 24, 2014, http://www.hbs.edu/faculty/Publication%20Files/front-loading_taxation_b10a2f45-48ff-45ff-9547-99039cf8e9da.pdf (acessed November 15, 2018), and John N. Friedman, "Tax Policy and Retirement Savings," Brown University and National Bureau of Economic Research, November 30, 2015, https://eml.berkeley.edu/~burch/retirement_tax_policy_final.pdf (accessed November 15, 2018).
17. Deborah L. Jacobs, "Why—and How—Congress Should Curb Roth IRAs," Forbes, March 26, 2012, https://www.forbes.com/sites/deborahljacobs/2012/03/26/why-and-how-congress-should-curb-roth-iras/#3492273f17f8 (accessed November 15, 2018).

method may then be politically safer as it is more difficult to require that taxes be paid retroactively. Of course, there is fear over the fiscal outlook of the United States, with unsustainable debt potentially leading to significantly higher taxes in the future.

There is little evidence, however, that a future Congress that wants to raise taxes on savers will overlook tax-deferred accounts. Roth accounts have "untaxed gains," but traditional accounts will tend to be systematically larger since they have yet to be taxed. There are always new and innovative ways to increase taxes, and the Roth/traditional distinction is unlikely to deter future revenue-seeking tax writers.

After-tax Roth-style accounts benefit from the administrative simplicity of not having to track deposits once the tax is paid. Traditional tax-deferred accounts necessitate more intrusive and burdensome reporting and compliance rules to track the value of investments as the account balance is drawn down. If the taxes are paid before contributions to the accounts are made, there is no need for further government involvement.

USAs Boost Savings

The introduction of a USA gives more Americans access to the savings benefits that are currently only available for retirement and education savings. USAs simply make the lower tax rates on saving more accessible to a larger number of people for a larger number of reasons. When taxes on savings go down and when restrictions on what people can use their savings for go down, households and individuals save more.

Retirement savings accounts show that, when given the option to save without the income tax penalty, households save more. Harvard economist Daniel Benjamin estimates that roughly 50 percent of 401(k) balances represent new private savings.[18] Economists Glenn Hubbard and Jonathan Skinner find that a "conservative estimate of the effect of IRAs on personal saving" shows that 26 cents of every dollar of IRA contributions represents new savings. They suspect the true effect "is actually somewhat larger."[19] Other studies have found similarly large effects of lower taxes on capital gains and dividends.[20]

Skeptics point to some studies that find only small increases to household saving.[21] For example, Harvard economist Raj Chetty and co-authors found that after a 1999 tax reform, only 1 percent of the change in retirement account contributions were actually changes to total savings—indicating that most savings account contributions may simply be transfers of existing savings from taxable to non-taxable accounts.[22] Other studies, including estimates from the Brookings Institution, also found that retirement savings accounts have small short-run effects on savings.[23] Regardless of the magnitude of the savings response, lower taxes on saving mean people are left with more money because the government takes less of it.

Even the small increases in savings compound over time. The Brookings study showed that over the course of 30 years or more, the retirement savings accounts raise savings between 3 percent and 17 percent, which represents a "substantial cumulative

18. Daniel J. Benjamin, "Does 401(k) Eligibility Increase Saving? Evidence from Propensity Score Subclassification," Journal of Public Economics, Vol. 87 (2003), pp. 1259–1290, https://pdfs.semanticscholar.org/bb24/812845012f56b908170f6634dc679d8a0f6c.pdf (accessed November 19, 2018).

19. R. Glenn Hubbard and Jonathan S. Skinner, "Assessing the Effectiveness of Saving Incentives," Journal of Economic Perspectives, Vol, 10, No. 4 (Fall 1996), p. 80, https://pubs.aeaweb.org/doi/pdf/10.1257%2Fjep.10.4.73 (accessed November 15, 2018).

20. Raj Chetty and Emmanuel Saez estimate that the tax cut caused total regular dividend payouts to rise by 20 percent within 1.5 years of the 2003 reform and "made the capital market reshuffle funds out of lower-growth firms…toward other ventures with greater expected value." Jesse Edgerton tempers these results in his 2010 paper. Raj Chetty and Emmanuel Saez, "The Effects of the 2003 Dividend Tax Cut on Corporate Behavior: Interpreting the Evidence," University California–Berkley, undated, https://eml.berkeley.edu/~saez/chetty-saezAEA06.pdf (accessed November 15, 2018), and Jesse Edgerton, "Effects of the 2003 Dividend Tax Cut: Evidence from Real Estate Investment Trusts," Federal Reserve Board, 2010, https://www.federalreserve.gov/pubs/feds/2010/201034/201034pap.pdf (accessed November 15, 2018).

21. Brendan Duke, "Universal Savings Account Proposal in New Republican Tax Bill Is Ill-Conceived," Center on Budget and Policy Priorities, September 19, 2018, https://www.cbpp.org/research/federal-tax/universal-savings-account-proposal-in-new-republican-tax-bill-is-ill-conceived (accessed November 15, 2018), and Raj Chetty et al., "Active vs. Passive Decisions and Crowd-Out in Retirement Savings Accounts: Evidence from Denmark," The Quarterly Journal of Economics, Vol. 129, No. 3 (2014), pp. 1141–1219.

22. Chetty et al., "Active vs. Passive Decisions and Crowd-Out in Retirement Savings Accounts: Evidence from Denmark."

23. Eric M. Engen, William G. Gale, and John Karl Scholz, "Do Saving Incentives Work?" Brookings Papers on Economic Activity No. 1 (1994), pp. 85–180, https://www.jstor.org/stable/pdf/2534631.pdf (accessed November 15, 2018), and Orazio P. Attanasio and Thomas DeLeire, "The Effect of Individual Retirement Accounts on Household Consumption and National Saving," The Economic Journal, Vol. 112, No. 481 (July 2002), pp. 504–538, https://www.albany.edu/~mj770/530/AD-saving.pdf (accessed November 15, 2018).

impact on the capital stock."[24] A larger capital stock—the sum of investment less depreciation over time—increases the size of the economy and increases per capita GDP.

Could a USA Reduce Savings Rates? Some have claimed that a USA could hurt savings rates, especially among low-income and middle-income households. If the introduction of a USA allows people to shift their savings out of retirement accounts, they could then spend their savings before retirement, leaving them less prepared for the future, the reasoning goes.[25] Evidence from international experiences with USAs shows the opposite effect.

USAs in Canada, called Tax-Free Savings Accounts (TFSAs), do not crowd out existing tax-preferred retirement savings. Using data from a survey of financial security, University of Ottawa economist Adam Lavecchi found that TFSA contributions come from existing tax-disadvantaged savings or new savings, not existing tax-deferred retirement accounts.[26] Furthermore, in the U.K., low-income savers using a USA earning between £9,500 and £20,000 (about $12,000 and $26,000) reported a 23 percent increase in savings that would not have otherwise been saved or invested.[27]

There is little evidence that tax-advantaged savings accounts decrease savings. Most of the literature shows the opposite effect; saving increases when people can use accounts that remove the income tax's penalty on saving. USAs increase savings.

USAs Simplify Saving

USAs help people save in two important ways: (1) Reducing double taxation increases the attractiveness of putting money away for the future, and (2) USAs simplify the rules that govern savings accounts. USAs prevent retirement account leakage, fix complicated taxes on unrealized gains, allow people to self-insure against future costs, and incentivize the private sector to help people save more.

USAs Support Retirement Saving. Retirement savings accounts are the primary private saving vehicle for most Americans. When people need emergency money, they often withdraw or borrow from their retirement account. Retirement experts call this "leakage." By one estimate, leakage reduces wealth in U.S. retirement accounts by about 25 percent.[28]

Exacerbating this problem are the taxes and regulatory hurdles that are designed to increase the cost of accessing retirement savings early. Many savers must withdraw additional money just to cover the 10 percent tax penalty for withdrawing money before age 59½.[29]

Savers are penalized if they improperly access their savings before retirement. USAs fix this problem by allowing a less-restrictive savings option for those who need it.[30] USAs have:

- **Fewer rules, more savings.** The current system discourages saving among Americans who are reticent to lock up their savings until retirement. Especially for young savers, uncertainty about their future and complexity of retirement account rules lowers participation in retirement accounts and the amount contributed. USAs can encourage savings in new populations by making the process of saving less complex.

24. Jonathan McCarthy and Han N. Pham, "The Impact of Individual Retirement Accounts on Savings," Current Issues in Economics and Finance, Vol. 1, No. 6 (September 1995), https://pdfs.semanticscholar.org/79b4/d9adb16a6c0400ded555da863d903806d649.pdf (accessed November 15, 2018), and Hubbard and Skinner, "Assessing the Effectiveness of Saving Incentives" p. 80.
25. Duke, "Universal Savings Account Proposal in New Republican Tax Bill Is Ill-Conceived."
26. Adam M. Lavecchia, "Tax-Free Savings Accounts: Who Uses Them and How?" University of Ottawa Working Paper No. 1802E, January 2018, https://pdfs.semanticscholar.org/14cf/ae18f13215d1f010fdca8b2736de945381fd.pdf?_ga=2.148039733.320791662.1540238802-401782580.1540238802 (accessed November 15, 2018).
27. Organization for Economic Cooperation and Development, "Encouraging Savings Through Tax-Preferred Accounts," OECD Tax Policy Study No. 15, 2007, https://www.oecd-ilibrary.org/taxation/encouraging-savings-through-tax-preferred-accounts_9789264031364-en (accessed November 15, 2018).
28. Anne Tergesen, "The $210 Billion Risk in Your 401(k)," The Wall Street Journal, October 10, 2018, https://www.wsj.com/articles/defaults-on-401-k-loans-dent-retirement-wealth-1539192648 (accessed November 15, 2018).
29. Each plan has different rules that allow certain qualified early distributions. Internal Revenue Service, "Plan Feature Comparison Chart: Choose a Retirement Plan," Tax Exempt and Government Entities, https://www.irs.gov/pub/irs-pdf/p4484.pdf (accessed November 19, 2018).
30. Chris Edwards, "Universal Savings Accounts Can Fix 401(k) Leakage," Cato at Liberty blog, October 12, 2018, https://www.cato.org/blog/universal-savings-accounts-can-fix-401k-leakage (accessed November 15, 2018).

- **Lower taxes on unrealized gains.** Mutual funds that realize a gain by selling assets typically distribute that gain to the fund's investors once a year. Even if the gain is reinvested into the fund, taxpayers are liable for capital gains taxes on their share of the distributed profit. Thus, a taxpayer can have a positive tax liability on income that is still held in the fund. If the saver buys in to the fund right before the gains are distributed, he could owe tax on gains realized before he made the purchase.[31] The complexity of this tax system entirely falls away for investments held in a USA, because the gains are not taxed.

Simpler Rules than Insurance. Many forms of insurance are simply complicated Roth-style USAs provided by an intermediary with strings attached. Consider a "home warranty" that will replace broken or aging appliances, up to some limit. By paying a monthly insurance bill, people are essentially paying down the cost of future repairs. In the meantime, the insurance company invests the money so they can pay for a replacement refrigerator in the future. The insurance payout is tax-free, but the insurance company generally keeps a large part of the gain. A saver, on the other hand, could put the money she would have paid in insurance premiums into a USA. The invested amounts will earn a return that accrues to her, not the insurance company. If the saver encounters an unexpected cost, she can withdraw some of her funds to cover the expense. Often, insurance is used to cushion future uncertainty, but in many cases, insurance policies serve other purposes.[32] A USA is like a self-insurance program, but with a USA the taxpayer is allowed to keep the investment growth.

The Private Sector Encourages Savings. In Canada, the private-sector providers of USA-style accounts help to promote the accounts and have an incentive to help savers meet their saving goals. Because the accounts would be privately managed, banks all across America would compete for the new business. Ryan Bourne and Chris Edwards explain that "Canadian news media and financial institutions have extensively marketed the accounts, which has helped promote a culture of saving."[33]

USAs Help Low-Income Families

Complex rules and early withdrawal penalties on retirement saving most negatively affect low-income households. The complexity discourages less-sophisticated savers from using the accounts at all, and taxes on early withdrawals are largely paid by the lowest-income Americans.

Following the introduction of USAs in the U.K. and Canada, moderate-income households were the most responsive. Low-income and moderate-income savers represent over 50 percent of account holders in both countries, and contributions as a percentage of income are highest for low-income earners.[34] Special-purpose savings accounts with complicated rules discourage low-income savers from participating. USAs expand access by helping low-income savers overcome concerns about liquidity—the ease of accessing savings.

Tax penalties for improperly accessing special-purpose accounts fall most heavily on the lowest-income participants. Research from the Internal Revenue Service found that the lowest-income group in their study was 31 percent "more likely than other income groups to take a net taxable withdrawal when they experience an income shock."[35] A study by the Urban Institute similarly found that the likelihood of early withdrawal "is highest among the youngest adults, those without college degrees, blacks, and those with the lowest income and assets."[36] This problem could be ameliorated by the introduction of USAs.[37]

31. Tom Herman, "Mutual-Fund Investors, Beware: There's a Tax Trap Waiting for You," The Wall Street Journal, October 21, 2018, https://www.wsj.com/articles/mutual-fund-investors-beware-theres-a-tax-trap-waiting-for-you-1540174141 (accessed November 15, 2018).
32. Many forms of life insurance, for example, are used primarily for tax planning to avoid double taxation on estates.
33. Ryan Bourne and Chris Edwards, "Tax Reform and Savings: Lessons from Canada and the United Kingdom," Cato Institute Tax & Budget Bulletin No. 77, May 1, 2017, https://object.cato.org/sites/cato.org/files/pubs/pdf/tbb-77-update-2.pdf (accessed November 15, 2018).
34. Organization for Economic Cooperation and Development, "Encouraging Savings Through Tax-Preferred Accounts," p. 37.
35. Robert Argento, Victoria L. Bryant, and John Sabelhaus, "Early Withdrawals from Retirement Accounts During the Great Recession," Internal Revenue Service, November 2013, https://www.irs.gov/pub/irs-soi/14rpearlywithdrawalretirement.pdf (accessed November 15, 2018).
36. Barbara A. Burtrica, Shelia R. Zedlewski, and Philip Issa, "Understanding Early Withdrawals from Retirement Accounts," Urban Institute Retirement Policy Discussion Paper No. 10-02, May 2010, http://beta.accesstofinancialsecurity.org/sites/default/files/UnderstandingEarlyWithdrawalsfromRetirementAccounts_UrbanInstitute_1.pdf (accessed November 15, 2018).
37. Bourne and Edwards, "Tax Reform and Savings: Lessons from Canada and the United Kingdom."

Critics of USAs rightly point out that a majority of tax filers have a low-enough income that they currently do not have to pay capital gains or dividends taxes.[38] The zero percent tax bracket applies to single taxpayers with adjusted gross income of up to $38,600, or $77,200 for married couples filing jointly in 2018.[39] This static analysis of the percentage of taxpayers below the 15 percent capital gains tax threshold is misleading. Incomes tend to rise significantly over a person's lifetime, so a saver today may not have to pay capital gains taxes, but once he is ready to spend the savings, it is much more likely that he will be in a higher tax bracket.

The rules and penalties on retirement savings accounts are only a small barrier for affluent Americans. The barrier primarily discourages low-income and middle-income Americans from saving for fear of locking up precious resources for multiple decades. Those who do contribute to a retirement account and subsequently lose a job or have another negative income shock, are penalized if they improperly access their savings. A USA gives the option of tax-preferred saving, currently used primarily by more affluent Americans, to those who may be reticent to put savings away for several decades and who face uncertainty about future income flows.

International Experience with USAs

USAs have proven successful around the world. Canada, the U.K., and South Africa have programs that are ideal models for U.S. implementation and that show the success of more flexible savings options. All three examples are simple Roth-style accounts that are widely popular with savers of all income levels.

United Kingdom Individual Savings Accounts. The U.K. offers Individual Savings Accounts (ISAs) that allow annual after-tax contributions of up to £20,000 (around U.S. $26,000) a year with no income or lifetime contribution limits; withdrawals are tax-free and can be made any time for any reason. The accounts are popular and widely used. Forty-three percent of British adults hold an account and 55 percent of account holders contributed in 2016.[40] In a review of ISAs, Ryan Bourne and Chris Edwards find that the accounts "are popular with people at all income levels," and "relative to their incomes, lower earners hold more in their ISAs than higher earners."[41] In 2016, 52 percent of ISA holders earned less than £20,000.[42]

Canadian Tax-Free Savings Accounts. Canada also has a version of USAs called Tax-Free Savings Accounts (TFSAs). Introduced in 2009, TFSAs supplement existing retirement savings accounts and allow Canadian $5,500 (around U.S. $4,200) of yearly after-tax contributions in 2018. Yearly contribution limits can be rolled over to future years, so an eligible person who opens an account in 2018 could contribute up to $57,500 Canadian (around U.S. $43,000) in the year he opens the account.[43] Withdrawals are tax-free and can be made any time, for any reason. In 2015, 40 percent of all Canadian households contributed to a TFSA.[44] In that same year, 53 percent of account holders earned less than Canadian $50,000 (around U.S. $38,000).[45]

South African Tax-Free Savings Accounts. In 2015, South Africa introduced new Tax-Free Savings Accounts (TFSAs) to help boost non-retirement savings. The after-tax accounts have a R33,000 (around

38. Duke, "Universal Savings Account Proposal in New Republican Tax Bill Is Ill-Conceived."
39. 2018 long-term capital gains tax brackets, 0 percent if adjusted gross income is $38,600 or less (single), $77,200 (joint); 15 percent for those below $425,801 (single), $479,001 (joint), and a top rate of 20 percent.
40. HM Revenue & Customs, "Individual Savings Account (ISA) Statistics," August 2018, data for 2015 to 2016, Table 9.8, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/737394/Full_Statistics_Release_August_2018.pdf (accessed November 15, 2018).
41. Bourne and Edwards, "Tax Reform and Savings: Lessons from Canada and the United Kingdom."
42. HM Revenue & Customs, "Individual Savings Account (ISA) Statistics," Table 9.7.
43. Government of Canada, "Tax-Free Savings Account (TFSA), Guide for Individuals," Contribution limits: 2009–2012, $5,000; 2013–2014 and 2016–2018, $5,000; 2015, $10,000, https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/rc4466/tax-free-savings-account-tfsa-guide-individuals.html (accessed November 19, 2018).
44. Government of Canada, "Household Contribution Rates for Selected Registered Savings Accounts, Census of Population, 2016," September 13, 2018, https://www12.statcan.gc.ca/census-recensement/2016/as-sa/98-200-x/2016013/98-200-x2016013-eng.pdf (accessed November 15, 2018).
45. Canada Revenue Agency, "Tax-Free Savings Account 2017 Statistics (2015 contribution year) Table 1C: TFSA Holders by Total Income Class," https://www.canada.ca/content/dam/cra-arc/migration/cra-arc/gncy/stts/tfsa-celi/2015/tbl01c-eng.pdf (accessed November 19, 2018).

U.S. $2,300) annual contribution limit and a R500,000 (around U.S. $35,000) lifetime contribution limit.[46] Since their creation in 2015, about 460,000 accounts have been opened and, according to one industry expert, first-time savers opened more than 13 percent of accounts.[47] Although there are limited English-language resources on South African TFSAs, they seem to be gaining popularity, as one survey found that the number of accounts opened in the second year they were available almost doubled the number opened in the first year.[48]

Revenue Effects

The revenue impact of USAs depends on the size of the yearly contribution limit and the rate of use by savers. The Joint Committee on Taxation estimates that the $2,500-a-year USA proposed in the Family Savings Act would lower federal revenue by $8.6 billion over 10 years, not accounting for any economic growth.[49] At the other extreme, an unlimited USA would be equivalent to eliminating all capital gains and dividends taxes, which the Tax Foundation estimates would reduce revenues by $1,683 billion over 10 years, or $979 billion when accounting for the 2.7 percent larger economy due to more investment.[50]

There is also a significant revenue difference between Roth and traditional accounts due to the timing of tax collection. Because Congress budgets and scores the revenue impact of bills over 10 years, traditional accounts will appear to lose more revenue because taxpayers take the deduction up-front and do not pay taxes until years later. On the other hand, Roth accounts understate the reduced revenue in the 10-year window because the lost capital gains tax revenue tends to be further in the future.

Over the complete lifecycle of a savings account, the government would likely earn slightly more revenue from traditional accounts. The government tends to have a lower discount rate than individuals do, so waiting to collect the revenue is less costly for the government, especially if the investment gain includes a supernormal return (above the normal return for delaying current consumption).[51]

The $8.6 billion revenue reduction from the small USA included in the Family Savings Act is less than the 10-year cost of the U.S. tax credit program for clean-fuel burning vehicles and refueling properties. A revenue-neutral USA with a $10,000 annual limit, about four times more generous than the current proposal, could be added to the tax code by also eliminating the current biodiesel tax credit.[52] Eliminating these or other tax credits would replace narrowly targeted tax benefits for special interests with broad-based benefits for all Americans.

Recommendations for Congress

USAs lower taxes on saving and help families build their own financial security through a single, simple, and flexible account. Congress should capitalize on the bipartisan support for helping Americans save more of their own money by passing the largest and most user-friendly USA possible. Congress should:

- **Create a USA.** After-tax savings accounts have proven successful at supporting savers and giving them the flexibility to save for their own priorities. The USA proposal included in the Family Savings Act is a good first step toward simplifying the American savings system and removing tax disincentives to saving.

46. South African Research Service, "Tax Free Investments," June 25, 2018, http://www.sars.gov.za/TaxTypes/PIT/Pages/Tax%20Free%20Investments.aspx (accessed November 15, 2018).
47. Amanda Visser, "The Ins and Outs of Tax-Free Savings," Press Reader, February 1, 2018, https://www.pressreader.com/south-africa/finweek-english-edition/20180201/281702615140277 (accessed November 15, 2018).
48. Intellidex, "A Study of Tax-Free Savings Account Takeup in South Africa," July 2017, SaveTaxFree.co.za, http://www.intellidex.co.za/wp-content/uploads/2017/07/TFSA-Survey-Report-2017-Live-Version-FINAL.pdf (accessed November 15, 2018).
49. Joint Committee on Taxation, "Estimated Revenue Effects of H.R. 6757, The 'Family Savings Act Of 2018,' as Amended, Scheduled for Consideration by the House Of Representatives on September 27, 2018," JCX-80-18, https://www.jct.gov/publications.html?func=startdown&id=5147 (accessed November 19, 2018).
50. Tax Foundation, "Options For Reforming America's Tax Code," 2016, https://files.taxfoundation.org/20170130145208/TF_Options_for_Reforming_Americas_Tax_Code.pdf (accessed November 19, 2018).
51. York, "The Complicated Taxation of America's Retirement Accounts."
52. The Heritage Foundation, "Reduce Spending Through the Tax Code," Blueprint for Balance, June 11, 2018, https://www.heritage.org/blueprint-balance/blueprint-balance/reduce-spending-through-the-tax-code.

- **Stick with the Roth.** The USA proposal in the Family Savings Act is well designed. The Roth-style, after-tax account is administratively simple and protects the privacy of savers. Once the deposit has been taxed, there should be no reason for the IRS to track the investments. The smaller revenue impacts of after-tax accounts also make them politically easier to implement in the 10-year budget window.

- **Allow larger accounts.** A contribution limit of $2,500 a year is much too low. If the accounts must have a contribution limit, the threshold should start at $10,000 a year, or more. People's lives are full of ups and down, and they should be able to save if they have a good year—putting money away when times are good in order to provide in times of need. Under the currently proposed limit of $2,500, parents could save every year for the first 18 years of their child's life and still have saved less than one year's tuition at many private colleges.

- **Raise the limit every year.** The yearly unused contribution limit should be rolled over to future years, similar to the Canadian system. Congress also should consider allowing the contribution limit to increase by $5,000 each year, or a multiple of the inflation rate, so that the account limit grows faster than inflation. This would allow USAs incrementally to become Americans' primary savings vehicle.

USAs Benefit All Americans

Universal Savings Accounts reduce taxes on savings for typical Americans and help families build their own financial security through a single, simple, and flexible account. Unlike existing special-purpose savings accounts, USA holders would not be bound by limits on when savings can be withdrawn or for what the funds must be used. USAs address the problems with the taxation of savings and investment in the U.S., the rules of which are confusing, and which reduce overall saving and investing. As individuals would contribute post-tax earnings, all withdrawals from a USA would be excluded from taxable income and any gains accrued would thus be tax-free. USAs allow Americans at all income levels to save more of their own income with fewer Washington-imposed restrictions on where and when they can spend their own money. USAs are an excellent idea whose time has come. Congress should pursue USAs for the benefit of all Americans.

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