Recalibrating Retirement Spending and Saving

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The Role of Individual Retirement Accounts in US Retirement Planning

Sarah Holden and Brian Reid

The Individual Retirement Accounts (IRAs) are an important component of retirement savings in the USA, where the $4.2 trillion held in IRAs represented one-quarter of the $16.4 trillion of tax-deferred retirement saving (at year-end 2006; see Figure 5-1). IRAs have become an important pool of assets because of their key role in the retirement saving market (Brady and Holden 2007*a*, 2007*b*). Workers with earned income have the opportunity to make contributions to these accounts, and households can also use them to manage assets that they have transferred or rolled over from employer-sponsored retirement accounts such as 401(k) plan balances. In the US context, all IRAs provide investors with access to tax-advantaged saving; these tax incentives are intended to encourage individuals to use these accounts to save for retirement. At the same time, the tax advantages make IRAs an attractive vehicle for managing taxes in general. Federal laws and regulations place limits and restrictions on IRA contributions and on how individuals may take distributions from these accounts. Current tax law requires that individuals must begin taking distributions from their traditional IRAs at age $70^1/_2$, and generally the law imposes a 10 percent penalty on distributions taken prior to age $59^1/_2$.

This chapter examines how IRA holders manage these increasingly important retirement saving vehicles. Prior research has tended to report that people rarely tap into their IRA assets before retirement; they typically do so only as a last resort when faced with a financial shock. Further, the evidence has shown that people tend to postpone withdrawals from IRAs until required to do so by law. Our new results draw on data from the Federal Reserve Board's Survey of Consumer Finances (SCF), the Internal Revenue Service (IRS) Statistics of Income (SOI) Division data, and Investment Company Institute (ICI) household surveys of IRA owners. The findings confirm that few IRA owners take withdrawals prior to age $70^1/_2$ and withdrawals tend to be small. We also offer a multivariate analysis evaluating withdrawal patterns in more detail.

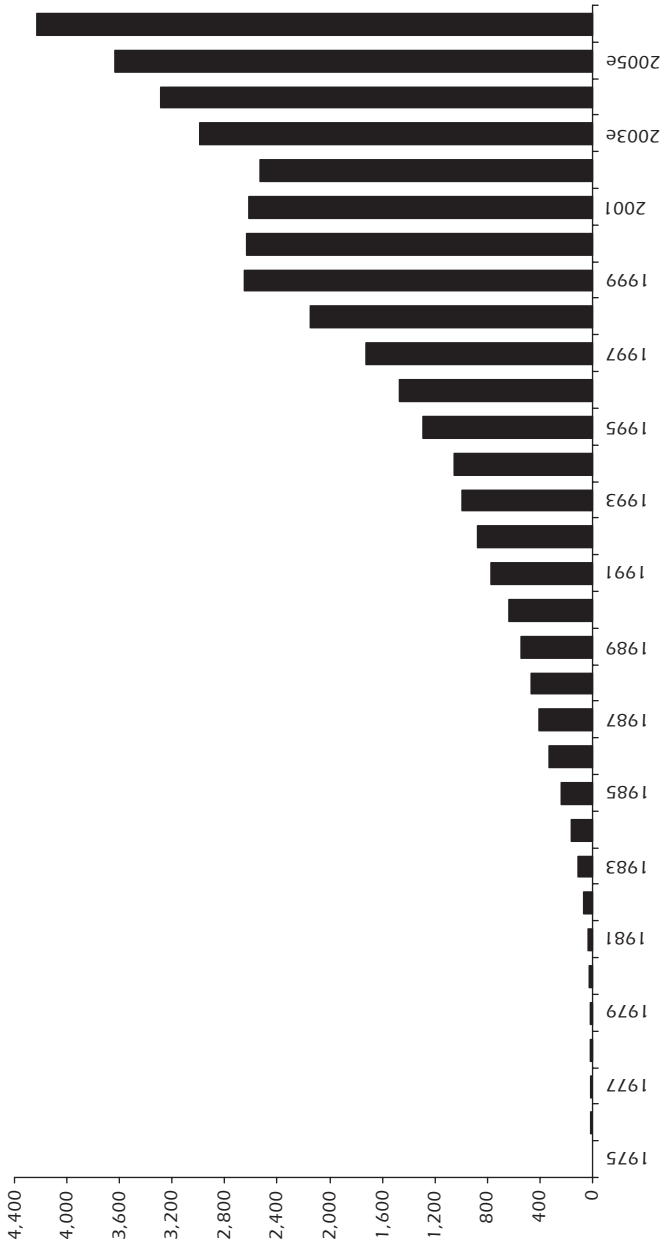

Figure 5-1. IRA assets, 1975–2006 (billions of nominal dollars). *Sources*: Investment Company Institute, IRS Statistics of Income Division, Federal Reserve Board, and American Council of Life Insurers. Derived from Brady and Holden (2007*a*). *Notes*: e = estimated, p = preliminary.

Prior Research

The long-term growth in account-based retirement saving has focused attention on how and whether households accumulate sufficient assets to fund retirement.[1] Previous research has studied the saving or accumulation phase of retirement planning,[2] but little analysis has been devoted to the withdrawal or distribution phase of these retirement accounts. Some analysts have examined the disposition of lump-sum distributions when workers change jobs and retire,[3] but few have looked at subsequent withdrawals from retirement accounts.

One reason there has been little comprehensive study of the withdrawal process is the limited availability of data, particularly with respect to IRAs. Nevertheless, some researchers have made headway on IRA withdrawal activity. For instance, Lin (2006) analyzes IRA withdrawal activity of HRS households; she shows that the probability of IRA withdrawals among older workers increases 3.6 percentage points within two years after an involuntary job loss. Using a panel of taxpayers from 1987 through 1996, Amromin and Smith (2003) study withdrawal activity among taxpayers younger than $59^1/_2$ and therefore, generally subject to the 10 percent penalty. They find that IRA withdrawals with penalty are more likely among households that experience adverse shocks (e.g., income shocks; demographic shocks, such as divorce; and lumpy consumption needs, such as education and housing). In addition, they find that the effect of adverse shocks is amplified for households with the lowest levels of financial wealth. They conclude that the empirical findings are consistent with the hypothesis that retirement assets are a financing resource of last resort. Bershadker and Smith (2006) analyze the same 10-year panel of taxpayers but examine the withdrawal activity of taxpayers aged 63–65 in 1987 and then follow them over the 10-year panel. About 40 percent of taxpayers were aged 63–69 when they first tapped their IRAs; 60 percent were aged 70 or older. These authors also study whether IRA-owning taxpayers started taking withdrawals prior to, near, or after retirement. They find that only 12 percent of IRA-owning taxpayers were 'early tappers,' taking distributions more than two years prior to retirement. Another 42 percent of IRA-owning taxpayers were 'on-time tappers,' first withdrawing from their accounts in the two-year window around retirement. The remaining 45 percent of IRA-owning taxpayers were 'late tappers', who waited until more than two years after retirement to tap into their IRAs.

In what follows, we build on this research by analyzing IRA withdrawal activity for a more recent time period using household survey and tax return information. This is informed by a brief history of IRAs, followed by IRA distribution rules and descriptive data on households who own IRAs. Next, we evaluate household surveys conducted by the ICI, which ask individuals to identify the reasons for their withdrawals. We also provide

results from a multivariate model that examines several factors affecting IRA withdrawal activity. Controlling on a variety of demographic and other characteristics helps us to identify factors that increase the probability of households withdrawing money from their IRAs before they are required to do so.

A Brief History of Individual Retirement Accounts

Saving for retirement in the USA has long been encouraged with tax-advantaged saving plans. Some are sponsored by employers, such as defined benefit and 401(k) plans, while others are individual-based such as IRAs. The laws governing these plans are dynamic and change over time.[4] In 1974, Congress enacted the Employee Retirement Income Security Act (ERISA) to protect and enhance Americans' retirement security by establishing comprehensive standards for employee benefit plans. ERISA also allowed the first form of IRA, known as a 'traditional' IRA. From the start, traditional IRAs were designed to serve two purposes: as contributory retirement plans, and as the recipients of rollovers from employer-sponsored retirement plans when workers change jobs or retire.

Since 1974, Congress has changed the legal environment for IRAs many times, and it has also created new types of IRAs. Seeking to increase retirement plan coverage among small employers, the 1978 Revenue Act introduced the first employer-sponsored IRAs, known as Simplified Employee Pension (SEP) IRAs, which were later joined by Salary Reduction SEP IRAs (SAR-SEPs) in 1986, and then SIMPLE IRAs in 1996 (see Table 5-1).[5] To offer individuals a differently structured tax-deferred retirement savings vehicle, the Taxpayer Relief Act of 1997 introduced the Roth IRA, which is an IRA that accepts after-tax contributions but generally permits tax-free withdrawals (Internal Revenue Service 2006).

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Rules regarding contribution limits and deductibility eligibility also have changed over time, with observable impact on contributions flowing into traditional IRAs. For example, with the goal of bolstering retirement saving, the Economic Recovery Tax Act of 1981 (ERTA) raised the annual IRA contribution limit from the lesser of $1,500 or 15 percent of compensation, to the lesser of $2,000 or 100 percent of compensation. Previously, an individual with retirement plan coverage at work faced restricted eligibility to make deductible traditional IRA contributions, but now ERTA made traditional IRAs 'universal' by allowing any taxpayer under the age of $70\frac{1}{2}$ with earned income to make a tax-deductible contribution irrespective of retirement plan coverage at work. Deductible contributions to traditional IRAs increased sharply, rising from $4.8 billion in 1981 to $28.3 billion in 1982 (see Figure 5-2). During this time of simplified IRA rules and

TABLE 5-1 US Household Ownership of Individual Retirement Accounts (IRAs)

	Year Created	*Number of Households with Type of IRA, 2006*	*Percent of Households with Type of IRA, 2006*
Traditional IRA	1974 (Employee Retirement Income Security Act)	34.8 million	30.4
SEP IRA	1978 (Revenue Act)		
SAR-SEP IRA	1986 (Tax Reform Act)	7.9 million	6.9
SIMPLE IRA	1996 (Small Business Job Protection Act)		
Roth IRA	1997 (Taxpayer Relief Act)	14.4 million	12.6
Any IRA (total)		42.2 million	36.9

Source: Investment Company Institute (ICI 2007).

Note: Multiple responses included.

expanded eligibility, contributions rose and the number of individuals saving for retirement through IRAs increased, including those with lower incomes (Internal Revenue Service, Statistics of Income Division, 1989, 1984; Skinner 1992).

The Tax Reform Act of 1986 (TRA) eliminated universal deductibility eligibility, by re-establishing employer-sponsored retirement plan coverage as the basis for allowing tax-deductible contributions to traditional IRAs. In 1987, deductible contributions to traditional IRAs dropped to $14.1 billion, compared with $37.8 billion in 1986 (see Figure 5-2). Tax return data suggest that many taxpayers who remained eligible to make contributions stopped making them.[6] Deductible contributions to traditional IRAs edged downward over the ensuing years, decreasing after the introduction of Roth IRAs, and slipping further to $7.4 billion in 2001. The Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 provided a much-needed boost, although it did not remove the eligibility rules. EGTRRA increased traditional IRA contribution limits for the first time in 20 years and introduced catch-up contributions for workers aged 50 or older. Traditional IRA contributions increased a bit in response to the changes introduced by EGTRRA.[7]

By year-end 2006, IRA assets totaled $4.2 trillion, with traditional IRAs holding the bulk of IRA assets: $3.8 trillion or nearly 90 percent of the

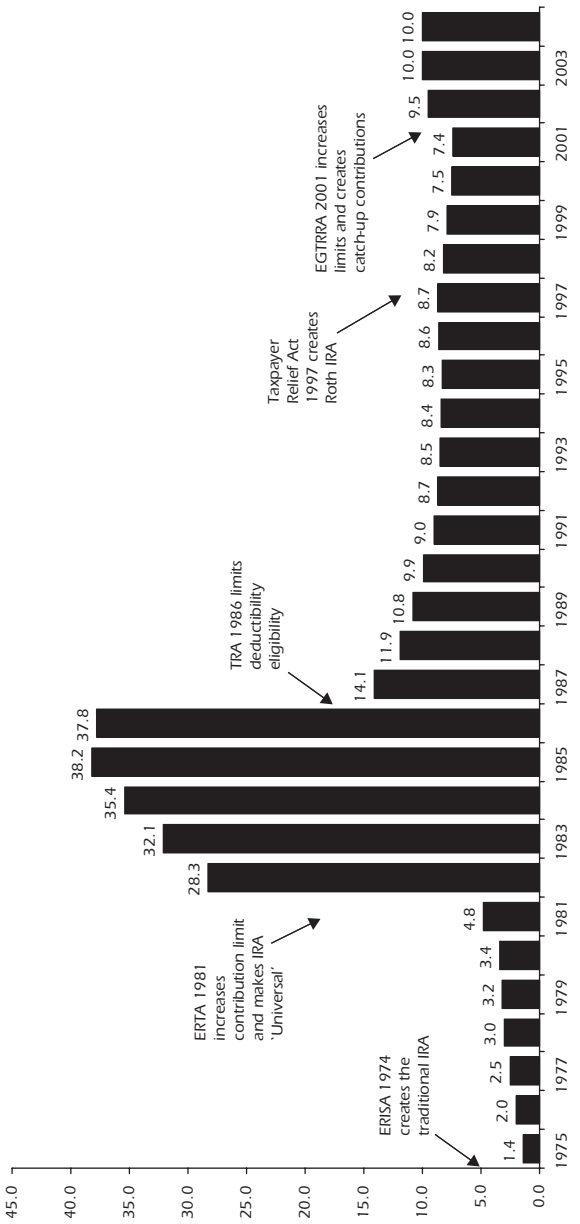

Figure 5-2. Deductible contributions* to traditional IRAs, 1975–2004 (billions of dollars). *Sources*: IRS Statistics of Income Division; Individual Income Tax Returns; Publication 1304, various years; and *SOI Bulletin*, various issues. *Note*: * Deductible IRA contributions reported on individual income tax returns (Form 1040).

TABLE 5-2 Most IRA Assets Are Held in Traditional IRAs (IRA assets by type, year-end, 1997–2006)

	Traditional[1]		*SEP and SAR-SEP*		*Roth*[2]		*SIMPLE*		*Total*
	Assets ($ billions)	*Share*[4] *(%)*	*Assets ($ billions)*	*Share*[4] *(%t)*	*Assets ($ billions)*	*Share*[4] *(%)*	*Assets ($ billions)*	*Share*[4] *(%)*	*Assets*[3] *($ billions)*
1997	1,642	95	85	5	—	—	1	(*)	1,728
1998	1,974	92	115	5	57	3	4	(*)	2,150
1999	2,423	91	143	5	76	3	9	(*)	2,651
2000	2,407	92	134	5	78	3	10	(*)	2,629
2001	2,395	91	131	5	79	3	14	1	2,619
2002	2,322	92	117	5	78	3	16	1	2,533
2003	2,719*e*	91	145*e*	5	106*p*	4	23*p*	1	2,993*e*
2004	2,962*e*	90	165*e*	5	127*e*	4	3*e*	1	3,284*p*
2005	3,260*e*	90	185*e*	5	145*e*	4	40*e*	1	3,632*e*
2006	3,784*e*	89	219*e*	5	178*e*	4	51*e*	1	4,232*e*

Sources: Investment Company Institute and IRS Statistics of Income Division, derived from Brady and Holden (2007).

Note: Components may not add to totals because of rounding.

[1] Traditional IRAs includes contributory and rollover IRAs.

[2] Roth IRAs includes contributory and conversion Roth IRAs.

[3] Total assets includes education IRAs, which were renamed Coverdell Education Savings Accounts (ESAs) in July 2001.

Share is the percent of total IRA assets.

(*) = less than 1/2%.

e = estimated *p* = preliminary.

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total (see Table 5-2). Despite having only been available since 1998, Roth IRAs represented 4 percent of all IRA assets, with $178 billion. Indeed, in each tax-year from 1999 through 2004, contributions to Roth IRAs have exceeded those to traditional IRAs.[8] Employer-sponsored IRAs (SEP, SAR-SEP, and SIMPLE) held the remaining 6 percent of IRA assets.

In addition to contributions and investment gains, asset transfers from employer-sponsored retirement plans have contributed significantly to the growth in traditional IRAs. When workers change jobs or retire, they are allowed to transfer (or roll over) in a lump sum the accumulations from their employer-sponsored retirement plans to IRAs to preserve the monies' tax-deferred status. Federal Reserve Board SCF data indicate that households identified about half of traditional IRA assets in 2004 as resulting from rollovers (Brady and Holden 2007*a*). In a 2005 survey of households owning IRAs conducted by ICI, 43 percent of households with traditional IRA assets indicated that their IRAs contained rollovers.[9] IRS-SOI data indicate rollovers into traditional IRAs were $204 billion in 2002 (see Table 5-3). These data highlight the long history of traditional IRAs as an accumulation vehicle, whether through contributions or rollovers. The IRS

TABLE 5-3 IRAs by Age of Taxpayer, Tax-Year 2002

	Total IRA Assets at Year-End 2001[a]		*Total Contributions*[b]		*Rollovers*		*Roth Conversions*		*Withdrawals*[c]		*Total IRA Assets at Year-End 2002*	
	Millions of Taxpayers (1)	*Billions of Dollars* (2)	*Millions of Taxpayers* (3)	*Billions of Dollars* (4)	*Millions of Taxpayers* (4)	*Billions of Dollars* (6)	*Millions of Taxpayers* (7)	*Billions of Dollars* (8)	*Millions of Taxpayers* (9)	*Billions of Dollars* (10)	*Millions of Taxpayers* (11)	*Billions of Dollars* (12)
All taxpayers, total	48.404	2,619.4	14.614	42.3	3.989	204.4	0.239	3.3	11.479	123.3	49.908	2,532.7
Under 20	0.266	1.1	0.199	0.3	—	—	0.002	0.0	0.027	0.2	0.341	1.1
20 under 25	0.745	2.0	0.572	0.9	0.061	0.2	0.017	0.1	0.063	0.2	0.968	2.6
25 under 30	1.770	8.1	0.995	1.8	0.208	1.0	0.014	0.0	0.173	0.6	2.036	8.4
30 under 35	3.055	27.1	1.425	3.3	0.346	4.0	0.024	0.1	0.323	1.6	3.348	28.7
35 under 40	4.146	63.9	1.617	4.3	0.398	7.5	0.026	0.2	0.441	2.8	4.409	61.0
40 under 45	5.233	133.4	1.928	5.5	0.458	10.9	0.023	0.4	0.446	4.7	5.539	123.9
45 under 50	6.122	215.7	2.095	6.6	0.478	18.0	0.030	0.4	0.538	6.0	6.256	202.0
50 under 55	6.108	292.2	2.095	7.1	0.451	28.5	0.033	0.4	0.588	8.6	6.269	291.9
55 under 60	5.649	363.8	1.786	6.3	0.552	40.1	0.024	0.6	0.624	12.7	5.818	394.9
60 under 65	4.802	426.3	1.213	3.9	0.448	49.6	0.027	0.5	1.035	18.1	4.865	447.0
65 under 70	3.740	386.6	0.549	1.8	0.290	23.0	0.014	0.4	1.048	19.0	3.712	362.8
70 under 75	3.164	421.0	0.113	0.4	0.182	14.0	0.006	0.1	2.757	26.0	3.007	370.6
75 under 80	2.290	202.4	0.020	0.1	0.081	5.2	0.0002	0.0	2.198	15.7	2.166	174.6
80 and over	1.315	75.7	0.006	0.03	0.037	2.4	—	—	1.219	7.2	1.174	63.3

Source: Derived from Bryant and Sailer (2006).

Note: Components may not add to totals because of rounding. All figures are estimates based on samples using a matched file of income tax returns, Forms 5498, and Forms 1099-R.

[a] The total IRA assets at year-end 2001 are at fair market value. The age classifications are based on each taxpayer's age at year-end 2002 for comparability across years.

[b] Includes deductible contributions reported on the Form 1040 and nondeductible contributions.

[c] Withdrawals are reported on Form 1099-R; does not include withdrawals for the purpose of rollovers to other IRA accounts if the transfer was made by the trustee; Roth conversions are shown separately.

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has tracked distributions or withdrawals from IRAs, as well. In 2002, total withdrawals from IRAs were $123 billion and predominantly made by older taxpayers.

Traditional IRA Distribution Rules

The topic of retirement income management is one of substantial interest of late; for instance, Mahaney and Carlson (2008) explore the timing of the take-up of Social Security benefits, and Sharpe, Scott, and Watson (2008) highlight the importance of earmarking certain assets to cover future income needs with a 'lockbox' spending strategy. Our work [Investment Company Institute (ICI) 2000*a*, 2000*b*] shows that most defined contribution plan balances are rolled over into IRAs at retirement, underscoring the importance of IRA payouts as a key component in households' retirement withdrawal activity.

These payouts are governed by a variety of rules stipulating how households may withdraw or take 'distributions' from their IRAs. A withdrawal from a traditional IRA plan, if taken by an individual younger than age $59^1/_2$, is generally subject to a 10 percent penalty on the taxable portion of the withdrawal (in addition to the federal, state, and local income tax that may be due). Taxpayers older than $59^1/_2$ but younger than $70^1/_2$ may take distributions from a traditional IRA without penalty, but they are not required to take distributions until age $70^1/_2$. In general, someone aged $70^1/_2$ or older will be required under tax law to take withdrawals from his or her traditional IRA, so that these monies which had been allowed to accumulate on a tax-deferred basis are mainly used to finance retirement (rather than have them flow to heirs at the retiree's death). The required minimum distribution (RMD) must then be taken annually in an amount tied to life expectancy tables published by the IRS.

Over the years, however, Congress has relaxed the use of IRA assets, making it easier for individuals to withdraw money in special situations, without incurring the additional penalty. For example, under the TRA of 1986, Congress added one such exemption, which allows the taxpayer to set up a substantially equal periodic payment (SEPP) plan and avoid the 10 percent penalty (see Figure 5-3).[10] Prior to TRA 1986, the main exception to the 10 percent penalty was triggered if the IRA owner died or became disabled. Other exemptions allowing for IRA withdrawals without penalty have been added: for instance, in 1996, Congress first allowed IRA owners to take distributions to pay for certain medical and health insurance expenses.[11] The Taxpayer Relief Act of 1997 exempted withdrawals used to pay for qualified higher education expenses or for a first-time home purchase (up to $10,000) from the penalty. In 1999, penalty-free

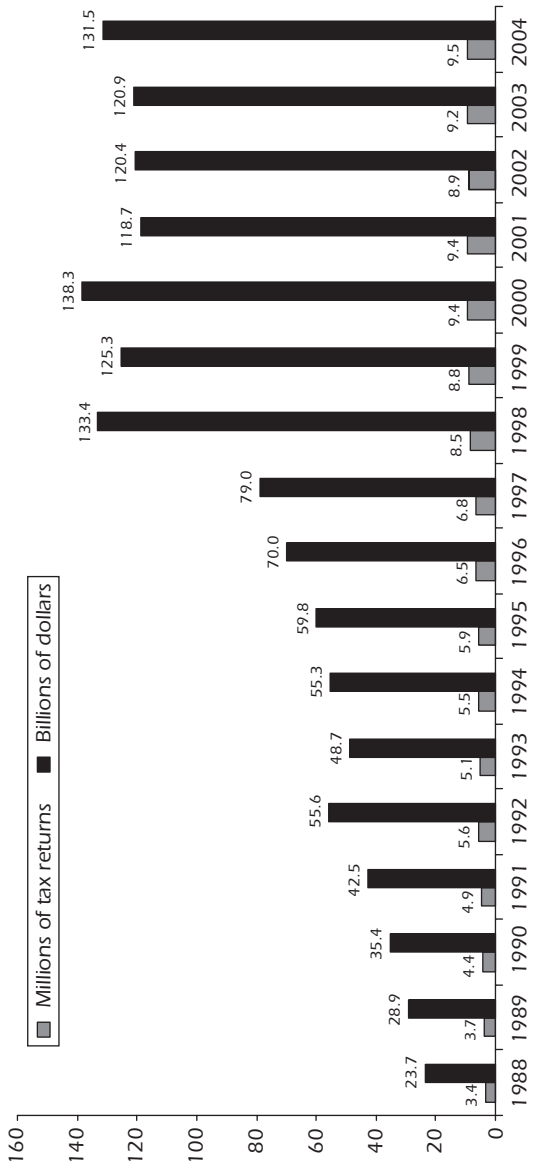

Figure 5-3. IRA distributions,* 1988–2004. *Sources*: IRS Statistics of Income Division; Individual Tax Returns; Publication 1304, various years; and Authors' Summary of Legislative Changes. *Notes*: *Total IRA distributions reported on Form 1040. Data include amounts converted to Roth IRAs.

distributions could be used to pay for an IRS levy on the IRA.[12] Recently, Congress permitted distributions for specific events (e.g., reservists called to active duty, hurricane damage) and placed time limits on when penalty-free withdrawals related to these events could occur.[13]

Characteristics of Traditional IRA Owners

Three different data sources are generally used to describe both the demographic and financial characteristics of households and individuals owning IRAs as well as the withdrawal behavior of traditional IRA owners.[14] Some of the data questions overlap, allowing comparisons, but many items are unique to a single datasource. The broad similarity of demographic and financial characteristics suggests that it is sensible to combine the separate results to glean a coherent story of traditional IRA ownership and withdrawal patterns.

One datasource is the IRS-SOI division, which reports IRA data from a variety of tax and information forms. In addition to *SOI Bulletin* articles,[15] the IRS constructs a public-use data file that contains weighted information from individual tax returns (IRS Form 1040; these are appropriately blurred to protect taxpayer anonymity). A second datasource is the Federal Reserve Board's SCF (for discussion see Bucks, Kennickell, and Moore 2006). We also use household surveys conducted by the ICI to determine both the incidence of IRA ownership and the characteristics and activity of IRA owners (e.g., West and Leonard-Chambers 2006*a*, 2006*b*).

Both the ICI and SCF data have been previously used to trace households' IRA ownership. SCF data from 2004 indicate that half of US households had some sort of 'retirement account' (see Table 5-4; Bucks, Kennickell, and Moore 2006). Retirement accounts are defined to include IRAs; Keogh accounts; and 401(k), 403(b), thrift saving, and other employer-sponsored retirement accounts from current and previous jobs. Social Security and employer-sponsored defined benefit plans are not included in retirement accounts. Finer analysis shows that about one-quarter of households held traditional IRAs in 2004; this agrees with ICI household surveys that include a representative sample of all US households IRA ownership. In 2006, these data show that 30 percent of households had traditional IRAs by 2006 (see Table 5-1).

The incidence of traditional IRA ownership varies across financial and demographic characteristics. Although households across all income groups hold IRAs, only 5 percent of households in the lowest income quintile[16] have traditional IRAs, compared with 58 percent of households in the top income decile (see Table 5-4).[17] Traditional IRA ownership tends to increase with age of head of household: fewer than 10 percent

TABLE 5-4 Family Holdings of Retirement Account Assets and Traditional IRAs, 2004 (percent of families, by selected characteristics)

Family Characteristic	*Retirement Accounts*[a]	*Traditional IRAs*	*Traditional IRA Withdrawals*	*Traditional IRA Withdrawals Among Owners*
All families	49.7	24.1	4.3	18.0
≤70	52.5	23.2	1.5	6.6
70+	33.4	28.9	20.6	71.4
Income percentiles				
<20	10.2	5.2	1.6	30.8
20–39.9	30.2	12.4	4.7	38.2
40–59.9	53.0	22.9	6.1	26.5
60–79.9	70.1	31.0	5.2	16.7
80–89.9	81.5	39.3	3.4	8.5
90–100	88.5	58.4	4.9	8.3
Age of head (years)				
<35	40.2	9.3	0.8	8.0
35–44	55.9	18.2	0.8	4.4
45–54	57.7	28.1	0.6	2.2
55–64	63.1	39.7	2.5	6.4
65–74	43.2	34.5	15.7	45.6
75+	29.2	25.7	17.1	66.8
Head's education				
No high-school diploma	16.2	5.2	3.5	67.2
High-school diploma	43.7	18.7	4.4	23.4
Some college	47.8	18.6	3.2	17.3
College degree	68.9	38.8	5.2	13.4
Race or ethnicity of respondent				
White non-Hispanic	56.2	29.6	5.5	18.7
Nonwhite or Hispanic	32.9	9.6	1.2	12.4
Head's current work status				
Working for someone else	57.1	21.3	1.2	5.5
Self-employed	54.6	36.9	3.6	9.7
Retired	33.0	26.6	13.3	50.0
Other not working	24.9	14.4	1.1	7.7
Housing status				
Owner	60.2	31.7	5.8	18.2
Renter or other	26.2	7.0	1.1	16.3
Percentiles of net worth				
<25	14.1	1.4	0.1	8.1
25–49.9	43.2	10.3	1.0	9.8
50–74.9	61.9	29.5	6.4	21.6
75–89.9	77.7	46.9	9.3	19.9
90–100	82.5	67.3	10.6	15.8

Sources: Authors' tabulations from Survey of Consumer Finances; Bucks, Kennickell, and Moore (2006).

[a] Retirement accounts include IRAs; Keogh, 401(k), 403(b), and other retirement accounts from current and past employers.

TABLE 5-5 Age Composition of Traditional IRA Owners

	Households with Traditional IRAs in 2005: ICI Survey Data		*Taxpayers with Any IRAs in 2002: IRS SOI Form 5498 Data*		*Households with Traditional IRAs in 2004: SCF Data*	
	Percent of Households[a]	*Percent of Assets*[a,b]	*Percent of Taxpayers*	*Percent of Assets*	*Percent of Households*[b]	*Percent of Assets*
Age of head (years)	100.0	100.0	100.0	100.0	100.0	100.0
<40	13.1	4.4	22.2	4.0	15.2	4.2
40–49	24.1	25.7	23.6	12.9	19.1	14.3
50–59	28.4	28.0	24.2	27.1	27.4	26.6
60–69	15.7	28.0	17.2	32.0	19.5	30.7
70+	18.7	13.8	12.7	24.0	18.7	24.2

Sources: Investment Company Institute, Federal Reserve Board Survey of Consumer Finances, and IRS Statistics of Income Division, derived from Bryant and Sailer (2006).

[a] Number of respondents varies.

[b] Components do not add to 100% because of rounding.

of households younger than age 35 have traditional IRAs, but about 40 percent of preretiree households (aged 55–64) have traditional IRAs. Incidence of IRA ownership is a bit lower among retiree households, reflecting in part a cohort effect. The incidence of traditional IRA ownership also rises with educational achievement of the head of household. Five percent of households with no high-school diploma hold traditional IRAs. About one-in-five households with a high-school diploma has a traditional IRA, as do households with some college. Two-in-five households with at least a college degree hold traditional IRAs. In addition, incidence of traditional IRA ownership rises with net worth percentile.[18]

Using IRS-SOI data, Bryant and Sailer (2006) report that IRAs are held by people across a range of ages and incomes. The most recent IRS-SOI data available cover year-end 2002, at which point 70 percent of the 49.9 million taxpayers with IRAs (of any type) are younger than age 60 (see Table 5-5). Under the traditional IRA rules, they would generally not be eligible to take a withdrawal or distribution without penalty. Another 17 percent of taxpayers with IRAs are 60–69 years old, who generally would be eligible to make penalty-free withdrawals from their IRAs. The remaining 13 percent of taxpayers with IRAs at year-end 2002 are aged 70 or older. Under traditional IRA rules, these taxpayers would have to take out at least the RMD amount.

Surveys also show that households across a wide range of ages (and incomes) hold traditional IRAs. For example, ICI surveys indicate that nearly 20 percent of households with traditional IRAs are headed by

individuals aged 70 or older, as do the SCF data (see Table 5-5). The size of the IRA holdings also varies across household demographic and financial variables. The median traditional IRA holding tends to increase with income, net worth, and education level of households (see Table 5-6). Traditional IRA balances tend to increase with age, up to households in their late 60s and early 70s, but these tend to decline among older owners.

Traditional IRA Withdrawal Activity

Policymakers have sometimes worried that individuals might tap their IRAs before retirement, and accordingly, federal law imposes a tax penalty for early withdrawals. In practice, older individuals do account for most of the IRA owners taking withdrawals, suggesting that the penalties for early withdrawals work to discourage individuals from withdrawing money from their IRAs before reaching retirement. For example, in 2002, the IRS-SOI data reveal that more than half (54 percent) of taxpayers with IRA withdrawals were aged 70 or older, 18 percent were 60–69 years old, with the remaining 28 percent of taxpayers taking withdrawals being aged 59 or younger (see Table 5-3). A pooled cross-sectional analysis of ICI surveys from 2000 to 2005 shows a similar concentration of older households among those taking withdrawals between 1999 and 2004; some 54 percent of households making withdrawals from their traditional IRAs were aged 70 or older, 21 percent were aged 59–69, and 25 percent were younger than 59 years old (see Table 5-7). The SCF data on households making withdrawals in 2003 also have a similar age distribution.

The concentration of withdrawals among older Americans reflects a much lower incidence of withdrawals among younger individuals. The SCF data indicate that about 7 percent of IRA-owning households headed by an individual aged 70 or younger made a withdrawal, while 71 percent of households headed by individuals older than 70 made withdrawals (see Table 5-4). Half of retired households with traditional IRAs made withdrawals. The finding that incidence of IRA withdrawals is much lower among households under age 70 is not isolated to this particular SCF survey. The pooled cross-sectional ICI household survey data show a similar incidence of withdrawal activity between 1999 and 2004. Seventeen percent of households holding traditional IRAs in each survey year had either withdrawn some of the money (14 percent) or liquidated their traditional IRA (3 percent) in the year prior to the survey (see Table 5-7). Only 6 percent of households headed by individuals younger than age 59 made withdrawals, while 18 percent of households aged 59–69 took withdrawals, and 57 percent of households aged 70 or older had withdrawals.

Consistent with earlier research findings that younger households are more likely to tap their IRAs following some financial need, ICI household

TABLE 5-6 Family Holdings of Retirement Account Assets and Traditional IRAs, 2004 (median amounts)[a]

Family Characteristic	*Retirement Accounts[b] ($)*	*Traditional IRAs ($)*	*Traditional IRA Withdrawals ($)*
All families	35,200	35,300	3,000
≤70	35,000	36,000	6,000
70+	42,000	33,000	2,200
Percentiles of income			
<20	5,000	9,500	2,400
20–39.9	10,000	17,000	1,500
40–59.9	17,000	18,000	2,000
60–79.9	32,000	25,000	3,700
80–89.9	71,000	55,000	7,000
90–100	184,000	100,000	23,100
Age of head (years)			
<35	11,000	10,000	2,500
35–44	28,000	22,000	5,000
45–54	55,500	40,000	5,000
55–64	83,000	52,000	6,000
65–74	80,000	75,000	3,700
75+	30,000	25,000	2,000
Head's education			
No high-school diploma	12,400	14,000	1,300
High-school diploma	20,000	20,000	1,700
Some college	21,000	28,000	4,000
College degree	64,800	50,000	6,800
Respondent's race or ethnicity			
White non-Hispanic	41,000	40,000	3,000
Nonwhite or Hispanic	16,000	15,000	3,000
Head's work status			
Working for someone else	30,000	30,000	3,500
Self-employed	60,000	50,000	6,000
Retired	46,000	42,000	3,000
Other not working	31,000	28,000	2,500
Housing status			
Owner	46,000	40,000	3,000
Renter or other	11,000	14,000	2,400
Percentiles of net worth			
<25	3,000	3,000	2,400
25–49.9	11,700	8,000	3,000
50–74.9	34,000	17,000	1,500
75–89.9	95,000	50,000	3,100
90–100	264,000	122,000	10,000

Sources: Authors' tabulations from Survey of Consumer Finances and Bucks, Kennickell, and Moore (2006).

[a] Median calculated among household engaged in the financial activity indicated.

[b] Retirement accounts include IRAs; Keogh, 401(k), 403(b); and other retirement accounts from current and past employers.

TABLE 5-7 Traditional IRA Withdrawal Activity by Age of Head of Household, 1999–2004 (percent of traditional IRA owners taking withdrawals)[a]

	Households with Traditional IRA Withdrawals	*Age of Head of Household (years)*		
		Under 59	*59–69*	*70 or Older*
Reason for withdrawal[b]				
Take required minimum distribution	46	10	12	75
Pay living expenses	18	24	34	9
Pay for health care	8	9	9	8
Reinvest the money[c]	9	10	11	7
Buy a home	5	9	6	2
Make a large purchase	8	9	16	5
Pay for education	4	11	3	1
Other	16	22	23	11
Age of head of household				
<59	25	100	0	0
59–69	21	0	100	0
70+	54	0	0	100
Amount withdrawn[d]				
<$2,500	31	29	15	39
$2,500–$4,999	15	15	11	17
$5,000–$9,999	18	20	21	16
$10,000–$24,999	20	19	29	16
$25,000–$49,999	9	7	14	7
$50,000+	7	10	10	5
Mean ($)	15,100	17,100	19,600	12,200
Median ($)	5,000	5,000	10,000	4,000
Full or partial withdrawal from traditional IRA				
Withdrew some, but not all money	85	67	86	93
Withdrew all money	15	33	14	7
Overview				
Percent of traditional IRA owners[a]	17	6	18	57
Withdrew some, but not all money	14	4	15	52
Withdrew all money	3	2	3	5

Source: Investment Company Institute, Annual Tracking Survey (2000–5).

Note: Number of respondents varies.

[a] Seventeen percent of households either still holding traditional IRAs in the year of the survey and having withdrawn some of the assets (14%) or having liquidated (3%) their traditional IRA during the year prior to the survey are counted as having withdrawals. The denominator includes households still holding traditional IRAs and those households whose withdrawals in the previous year closed their traditional IRAs. Results are pooled over 2000–5 survey years covering withdrawal activity in 1999–2004.

[b] Multiple responses included.

[c] Households indicating they were buying investments outside IRAs and/or buying another type of IRA.

[d] Components may not add to 100% because of rounding.

IRA survey responses find that about one-quarter of households with the head of household under age 59 cited the need to pay living expenses as a reason for tapping their IRAs, and 9 percent cited paying health-care expenses (see Table 5-7). Buying a home and paying for education were other reasons for tapping the IRA among younger households, both of which are permitted without penalty under certain circumstances. About 10 percent of households headed by individuals aged 69 or younger cited the rules for RMD as a reason for withdrawal, which on the surface looks anomalous. Younger households may cite RMD as a withdrawal reason because another individual in the household could be aged $70^1/_2$ or older or some of these individuals may have inherited IRAs with RMDs occurring.

In addition to being concerned that individuals will tap their IRAs early, policymakers also express concern that households will use their IRAs or other retirement savings to make large discretionary expenditures. There are many legitimate reasons that retired individuals may make a large purchase, such as consumer durables, which will assist them in smoothing consumption during retirement. However, few households indicate that they took the money 'to make a large purchase' (see Table 5-7). And among those households aged 70 or older taking withdrawals, RMD was the most cited reason with 75 percent of households headed by individuals aged 70 or older giving this reason for withdrawing.

IRA withdrawals in a given year tend to be relatively small—whether measured as a percent of aggregate assets or measured as an individual dollar amounts. Comparing annual total IRA distributions to the previous year's total assets shows that withdrawals have been modest and appear to have trended down despite the new penalty exceptions (see Figures 5-3 and 5-4). The pop-up in 1998 to 7.7 percent of assets reflects the large conversion of $39.3 billion into Roth IRAs.[19] Amounts withdrawn by individual households also tend to be modest. Tabulation of the (Internal Revenue Service, Statistics of Income Division IRS-SOI 2002) tax return data shows that 36 percent of tax returns with taxable IRA distributions had a distribution of less than $2,500 (see Table 5-8). Similarly, the pooled cross-sectional ICI household survey information finds that 31 percent of households with traditional IRA withdrawals had withdrawn less than $2,500. And, the SCF traditional IRA withdrawals were less than $2,500 in 44 percent of households with traditional IRA withdrawals.

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Multivariate Model of IRA Distribution Activity

The previous section has suggested that the current tax and penalty structures seem to discourage individuals from tapping their IRAs prior to retirement. Next, we set up and test a multivariate model to assess the

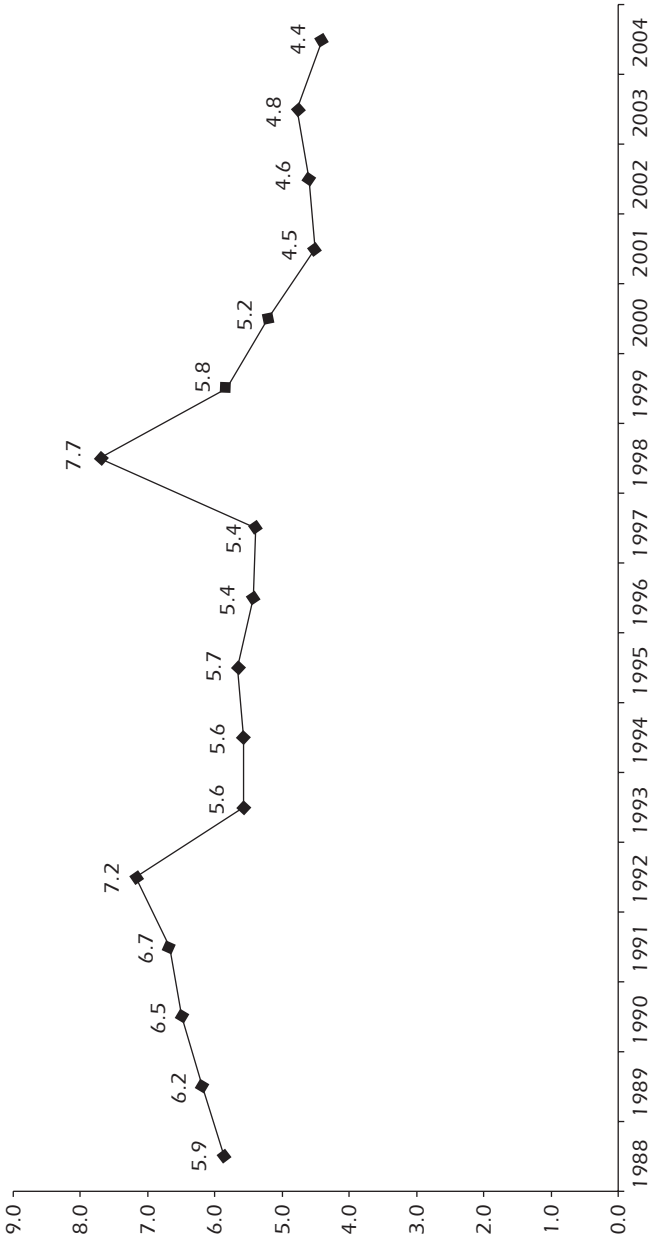

Figure 5-4. Total IRA distributions* as a percent of previous year's total IRA assets (1988–2004). *Sources*: IRS Statistics of Income Division; Individual Tax Returns; Publication 1304, various years; Investment Company Institute; Federal Reserve Board; and American Council of Life Insurers. *Notes*: *Total IRA distributions reported on Form 1040. Data include amounts converted to Roth IRAs.

TABLE 5-8 Traditional IRA Withdrawals Tend to Be Small (percent of traditional IRA owners taking withdrawals)

	Traditional IRA Withdrawals: ICI 1999–2004[a] *(percent of households)*[c]	*Taxable IRA Distributions:*[b] *SOI Form 1040 Data for 2002 (percent of tax returns)*[c]	*Traditional IRA Withdrawals: SCF Data for 2003 (percent of households)*[c]
Amount withdrawn			
<$2,500	31	36	44
$2,500–$4,999	15	19	12
$5,000–$9,999	18	17	18
$10,000–$24,999	20	17	15
$25,000–$49,999	9	7	6
$50,000+	7	4	5
Mean[c] ($)	15,100	10,700	10,500
Median[c] ($)	5,000	4,200	3,000

Source: Investment Company Institute, Annual Tracking Survey (2000–5); Tabulation of IRS Statistics of Income Form 1040 Public-Use File Data, 2002; and Tabulation of Federal Reserve Board 2004 Survey of Consumer Finances.

[a] Results are pooled over 2000–5 survey years covering withdrawal activity in 1999–2004.

[b] Taxable IRA distributions reported on the Form 1040 include conversions to Roth IRAs.

[c] The ICI and SCF tabulations are computed for households taking traditional IRA withdrawals. The SOI tabulations are computed for tax returns with taxable IRA distributions.

effectiveness of current tax incentive and penalty structures to encourage individuals to use their IRAs as a retirement savings vehicle rather than simply a tax-deferred savings pool. The IRA withdrawal decision is modeled as a two-step process whereby in step 1 the household decides to take a distribution/withdrawal or not, and in step 2, it decides how much to withdraw. Accordingly, we use a sample-selection (Heckman's two-step) model to capture the probability of taking the withdrawal and the subsequent amount taken if it is positive. The penalty structures included in the tax code serve as a guide for determining the variables included in the first step of the estimation process. In particular, withdrawals prior to age $59^1/_2$ generally are subject to a 10 percent penalty on the taxable portion of the withdrawal, with two exceptions being when the proceeds are used to pay health expenses or a first-time home purchase. If these policies are effective, we would expect that being younger than 60, being in good health, and not having a home mortgage would all reduce the probability of taking a withdrawal from an IRA.

Table 5-9 lists the variables used for the first-step Probit analysis: household income; an indicator for the head of household being aged 60 or

TABLE 5-9 Variables for SCF Traditional IRA Withdrawal Analysis

	Type of Variable	*Percentage of Traditional IRA Owning Households*[a]
Income		
Household income	Continuous	
Age		
Possible penalty (Age ≤60)	Dummy; if ≤60, then = 1	78.5
Education of head of household		
No high-school diploma	Dummy	2.1
High-school diploma	Dummy; omitted category	21.4
Some college	Dummy	14.2
College degree[b]	Dummy	62.4
Race or ethnicity of respondent		
White non-Hispanic/nonwhite or Hispanic	Dummy; if nonwhite or Hispanic, then = 1	12.7
Health status of head of household		
Healthy/not healthy[c]	Dummy; if not healthy, then = 1	13.1
Current work status of head of household		
Working for someone else	Dummy; omitted category	62.1
Self-employed	Dummy	20.5
Retired[d]	Dummy	14.3
Other not working[e]	Dummy	3.2
Housing status		
Owns home with mortgage	Dummy	65.4
Owns home with no mortgage	Dummy; omitted category	25.4
Renter or other	Dummy	9.2
Financial assets		
Amount held in traditional IRA(s)	Continuous	
Amount held in nonretirement Financial assets	Continuous	

Source: Authors' tabulation from Federal Reserve Board Survey of Consumer Finances, 2004.

[a] Sample drawn from 2004 Survey of Consumer Finances consisting of households owning traditional IRAs with head of household aged 70 or younger.

[b] College degree includes two-year programs, any college degree, and graduate degrees.

[c] Self-assessed health variable. If respondent indicated 'excellent' or 'good' health, then classified as 'healthy.' If the respondent indicated 'fair' or 'poor' health, then classified as 'not healthy.'

[d] Retired includes retired and disabled, which includes students and homemakers and those aged 65 and older and not working.

[e] Other not working includes mainly those under 65 and out of the labor force.

younger ('possible penalty'); head's education level; respondent's race or ethnicity; head's self-assessed health status and current work status; housing status (in particular, also accounting for the presence of a mortgage); and household financial assets (amounts held in traditional IRAs and financial assets outside of tax-deferred retirement accounts). The multivariate analysis uses the 2004 SCF household survey data-set. As noted above, individuals responding to this survey are similar to those observed in the ICI household surveys and the IRS-SOI tax return and taxpayer data. Because the Internal Revenue Code (IRC) rules require IRA owners to make withdrawals after age $70^1/_2$, this analysis uses a limited sample of traditional IRA-owning households whose head of household is not aged $70^1/_2$ or older.

Table 5-10 reports the estimation results of the Probit analysis. First, we address variables suggested by the tax code, namely, being under age 60 ('possible penalty'), and, therefore, generally subject to the 10 percent penalty, decreases the probability of a withdrawal. The penalty exemption encompasses some medical and home purchase amounts; being in poor health or having a home mortgage increases the likelihood that a household makes a traditional IRA withdrawal. The health variable might also reflect a negative shock to the household and, consistent with Amromin and Smith (2003) and Lin (2006), could be interpreted as financial need increasing the likelihood of a withdrawal. Employment status also affects the probability of withdrawal, with those whose head of household is retired are more likely to tap their IRAs. If the head of the household has less than a high-school education, the probability of withdrawal is increased. With respect to the amount held in traditional IRAs, households with more IRA assets are less likely to take a withdrawal than households with fewer IRA assets, up to $11,000 in traditional IRA assets. Households with more than $11,000 in their traditional IRAs are more likely to withdraw the more they have in their IRAs.

The second stage of the analysis examines the factors that determine the amount of the withdrawal, in levels and as a percentage of the IRA assets held prior to the withdrawal.[20] The second stage of the estimation is based on a model that certain factors that affect the decision to make the withdrawal do not play a role in the amount of the withdrawal. Since the 10 percent penalty for early withdrawal generally applies regardless of the amount withdrawn, and the exceptions for health expenses and buying a first home are relatively generous, we assume that the amount of the withdrawal is not affected by the penalty or these two primary exceptions to the penalty. We also assume that race/ethnicity and education level do not affect the amount of the withdrawal once the decision to withdraw has been made. The variables included in the regression that explores the factors that affect the amount of the withdrawal are the age of the head of the household, their household income, their employment status,

TABLE 5-10 Probit Estimation of the Probability that Traditional IRA-Owning Household Made a Withdrawal

Variable Name		*Coefficient*	*Standard Error*	*Predicted and Marginal Effects Evaluated at Means of Independent Variables (%)*
Predicted probability of withdrawal at means				2.0
	Constant/Intercept	2.577	1.702	
Income	ln(Household income)	−0.125	0.081	−0.06(+10)
Age	No penalty predicted (reference)			6.1
	Possible penalty (Age ≤60)	−0.675***	0.165	−4.8
Head's education	No high-school diploma	0.775*	0.401	+7.3
	High-school diploma predicted (reference)			1.7
	Some college	0.164	0.243	+0.8
	College degree[b]	0.035	0.201	+0.2
Respondent race or ethnicity	White non-Hispanic predicted (reference)			1.9
	Nonwhite or Hispanic	0.287	0.208	+1.8
Head's health status	Healthy[c] predicted (reference)			1.8
	Not healthy[c]	0.365**	0.182	+2.4
Head's work status	Working for someone else predicted (reference)			1.7
	Self-employed	−0.002	0.173	−0.01
	Retired[d]	0.512**	0.208	+3.6
	Other not working[e]	0.333	0.403	+2.0

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Housing status	Owns home with mortgage	0.427**	0.172	+1.9
	Owns home with no mortgage predicted (reference)			1.0
	Renter or other	0.026	0.330	0.1
Financial assets	ln[Amount held in traditional IRA(s)]	−0.519*	0.280	+0.04(+10)
	ln[Traditional IRA(s)] squared	0.028**	0.013	
	ln(Amount held in nonretirement financial Assets)	−0.032	0.140	−0.03(+10)
	ln(Nonretirement financial assets) squared	−0.001	0.007	
	Observations	1,366		

Source: Authors' analysis of Federal Reserve Board Survey of Consumer Finances, 2004.

Notes: *: Significant at the 10% level, **: Significant at the 5% level, ***: Significant at the 1% level.

[a] Sample drawn from 2004 Survey of Consumer Finances consisting of households owning traditional IRAs with head of household aged 70 or younger.

[b] College degree includes two-year programs, any college degree, and graduate degrees.

[c] Self-assessed health variable. If respondent indicated 'excellent' or 'good' health, then classified as 'healthy.' If the respondent indicated 'fair' or 'poor' health, then classified as 'not healthy.'

[d] Retired includes retired and disabled, which includes students and homemakers and those aged 65 and older and not working.

[e] Other not working includes mainly those under 65 and out of the labor force.

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their IRA assets, and their financial assets held outside of their tax-deferred retirement accounts.

Results from the conditional second stage (including only households headed by individuals under age 70) do not indicate any of the factors are significant in explaining the amount withdrawn other than age and nonretirement financial assets. Among those taking withdrawals, the amount of the withdrawal increases with age until the head of the household reaches his or her mid-forties and then declines as his or her age increases (see Table 5-11). Households withdraw more from their IRAs the more they have in nonretirement financial assets, but the square of this variable is only significant at the 10 percent level. We also explore how these same factors affect the share or percentage households withdraw from their traditional IRA accounts. Only age has a significant effect on the share of the IRA account that households withdraw. Households increase the share of their traditional IRA withdrawn until the head of household reaches his or her mid-forties, after which the share declines.

All told, these results suggest that the current tax and penalty structures seem to provide incentives for individuals to use their IRAs as a dedicated pool of retirement saving by discouraging early withdrawals. However, once a household decides to take a withdrawal, the amount of the withdrawal is only related to age. Given that these accounts are important repositories for rollovers from employer-sponsored retirement plans, including 401(k) assets, the tax incentives for using IRAs seem to encourage people to consider them as retirement financing vehicles. While there is some leakage from these accounts, the leakage in large part seems in line with the exceptions that Congress has put in place.

Conclusions

The IRAs are a substantial and growing component of US retirement assets. Since their inception, federal law has provided tax incentives for individuals to use IRAs and tax penalties to discourage tapping of these accounts prior to retirement. This chapter tackles the question of whether these incentives are encouraging individuals to use their IRAs for retirement purposes. After a brief history of IRAs and an analysis of aggregate IRA data, we evaluate detailed information on IRA owners and their withdrawal activity. Our evidence indicates that few households tap their IRAs prior to retirement, even in the wake of several years of the loosening of withdrawal restrictions. In fact, RMDs are cited as the main reason for taking withdrawals. Overall it appears that most households are managing their withdrawal behavior in a manner consistent with policy motivations for these accounts.

TABLE 5-11 Heckman IRA Withdrawal Regression Results

	Dependent Variable: ln (withdrawal amount)		*Dependent Variable: ln (percentage of account withdrawn)*	
	Coefficient	*St. Error*	*Coefficient*	*St. Eerror*
Constant/Intercept	0.591	3.864	−4.073	2.963
ln(Household income)	−0.039	0.172	0.060	0.131
Age of head of household (years)	0.280**	0.112	0.185**	0.085
Age-squared	−0.003***	0.001	−0.002**	0.001
Working for someone else (omitted category)				
Self-employed	0.123	0.429	−0.065	0.339
Retired[b]	0.542	0.514	0.350	0.403
Other not working[c]	−0.302	0.883	−0.196	0.669
ln (amount held in traditional IRA)	0.834	0.727	0.381	0.530
ln [traditional IRA(s)] squared	−0.013	0.033	−0.034	0.024
ln (Amount held in nonretirement financial assets)	−0.682	0.483	−0.316	0.344
ln(Nonretirement financial assets) squared	0.038*	0.020	0.020	0.014
Mills Lambda	−0.710	0.543	−0.642	0.411

Source: Authors' analysis of Federal Reserve Board Survey of Consumer Finances, 2004.

Notes: *: Significant at the 10% level, **: Significant at the 5% level, ***: Significant at the 1% level.

[a] Sample drawn from 2004 Survey of Consumer Finances consisting of households owning traditional IRAs with head of household aged 70 or younger.

[b] Retired includes retired and disabled, which includes students and homemakers and those aged 65 and older and not working.

[c] Other not working includes mainly those under the age of 65 and out of the labor force.

Au: Please provide the citation of footnote 1 in the table body of Table 11.

The views expressed in this chapter are those of the authors and do not necessarily reflect those of the ICI or its members. The authors thank Michael Bogdan for data tabulations.

Appendix

This appendix provides a brief description of each data-set used in the analysis; the data are drawn from public and proprietary data sources.

Survey of Consumer Finances

The SCF is a triennial interview survey of US families sponsored by the Board of Governors of the Federal Reserve System and the US Department of Treasury. The sample design for the survey is driven by the need to measure a broad range of financial characteristics. The sample design has two parts: (*a*) a standard geographically based random sample and (*b*) a specially constructed oversampling of wealthy families. Weights are used to combine the two samples to represent the full population of US families. The 2004 SCF interviewed 4,522 families, which represent 112.1 million families. Data available on the Board's website are suitably altered to protect the privacy of individual respondents. Bucks, Kennickell, and Moore (2006) provide a comprehensive discussion of the SCF sampling and weighting procedures. Data, code book, and Federal Reserve Board analysis related to the SCF are available at the Board's website at www.federalreserve.gov/pubs/oss/oss2/2004/scf2004home.html.

Statistics of Income Division

The IRS-SOI Division publishes a series of tabulations based on Form 5498 and individual income tax returns (Form 1040). In addition, the IRS-SOI division makes available an SOI public-use tax file. Focusing on the former, Bryant and Sailer (2006) present the most recent Form 5498 tabulations published by the IRS-SOI division. Sailer, Weber, and Gurka (2003) explain the tax and information returns used to tabulate the data. Basically, the additional data from the information returns (such as IRA data reported on Form 5498) are linked to the individual tax return files, which are a representative sample of tax returns in the USA. Parisi and Hollenbeck (2004, 2005, 2006) report recent aggregate results from the individual tax returns. Turning to the IRS public-use tax file, this information is drawn from US federal individual income tax returns; the 2002 public-use tax file contains 131,307 records, weighted to represent statistical information for the 130.1 million federal individual income tax returns (Form 1040, Form 1040A, and Form 1040EZ) filed for tax-year 2002. The file is designed for making national-level estimates, and the data-set consists of detailed information taken from SOI sample records (the 'microdata file'). Individual names, Social Security numbers, and other personal identifying factors have been omitted. To preserve the character of the microdata file, while also protecting the identity of individuals, the public-use tax file is based on a subsample (less than one-third) of the microdata file and blurs some of the individual return items. Thus, individual records in the public-use tax file may or may not contain data from just one tax return, and never

contain the full item content of any one tax return. The data in the public-use file do not provide access to individual taxpayer records.

Investment Company Institute Tracking and IRA Surveys

This chapter also relies on data tabulations from two ongoing ICI household surveys: the Annual Tracking Survey and the IRA Owner Survey. The first relies on an annual survey of 3,000 randomly selected US households to determine the incidence of mutual fund ownership and IRA ownership (among other things). This chapter makes use of the IRA ownership incidence. The survey's standard error for the total sample is ±1.8 percentage points at the 95 percent confidence level. The second datasource is the ICI IRA Owner Survey. West and Leonard-Chambers (2006*a*, 2006*b*) present results from the 2005 survey which interviewed 595 randomly selected households owning IRAs [including traditional, Roth, SEP, SAR-SEP, and SIMPLE IRAs; Coverdell education savings accounts (ESAs), formerly called Education IRAs were not included]. The standard error is ±4.0 percentage points at the 95 percent confidence level.

Notes

[1] At year-end 1985, defined contribution plan and IRA assets comprised 32 percent of the $2.3 trillion US retirement market. By year-end 2006, defined contribution plan and IRA assets accounted for 51 percent of the $16.4 trillion US retirement market (Brady and Holden 2007*b*). In addition, some employees have an individual account in an employer-sponsored defined benefit plan (mainly in cash balance plans) and many can opt to receive a lump-sum distribution from their company defined benefit plans.

[2] See, for instance, Copeland (2007); Love, Smith, and McNair (2007); Poterba, Venti, and Wise (2007); Blitzstein, Mitchell, and Utkus (2006); Holden, Brady, and Hadley (2006); VanDerhei, Copeland, and Salisbury (2006); Holden et al. (2005); Holden and VanDerhei (2005, 2002*a*, 2002*b*); and Mitchell and Utkus (2004).

[3] For example, see Copeland (2005); Investment Company Institute (ICI) (2000*a*, 2000*b*); Sabelhaus (2000); Burman, Coe, and Gale (1999); Purcell (1999); Sabelhaus and Weiner (1999); Poterba, Venti, and Wise (1999, 1995); and Chang (1996).

[4] For more discussion, see Holden et al. (2005) and Holden, Brady, and Hadley (2006).

[5] The TRAof 1986 created SAR-SEP IRAs, but the Small Business Job Protection Act of 1996 halted further creation of new SAR-SEP IRAs.

[6] For example, see Joint Economic Committee (2004), which indicates that analysis of the IRS-SOI data suggests that the presence of income limits reduces participation rates at all income levels. Hrung (2004) cites literature analyzing the role that taxpayer confusion plays in the reduction in contribution activity. In addition,

Burnham (2003) finds that some lower-income individuals who are covered by employer-sponsored plans contribute to their IRAs as if they were constrained by the same contribution limits as higher-income individuals when they are not (analyzing 1997 IRS-SOI data). Smith (2002) finds lower participation rates among taxpayers in the phase-out ranges, which he suggests may be due to the complexity of calculating a partial deduction and/or the expectation of being above the income range in the future. Furthermore, some research suggests that a reduction in the promotion of IRAs after universality was removed also had an impact (see Hrung 2004 for additional references).

[7] Bryant and Sailer (2006) find that 53 percent of taxpayers making contributions in 2002 took advantage of the higher limits. West and Leonard-Chambers (2006*a*) report that a rising share of eligible households is making catch-up contributions over time.

[8] Contributions to Roth IRAs in 1999 were $10.7 billion compared with total contributions of $10.3 billion to traditional IRAs that year. In 2002, contributions to Roth IRAs were $13.2 billion, while total contributions to traditional IRAs were $12.4 billion (Bryant and Sailer 2006; Brady and Holden 2007*a*, 2007*b*).

[9] West and Leonard-Chambers (2006*a*) also found that IRAs with rollovers had higher average traditional IRA balances.

[10] TRA 1986 conformed the withdrawal restrictions for various tax-deferred arrangements (e.g., qualified plans, IRAs, 403(b) arrangements) and included the exception for SEPPs for any age, including owners younger than $59^1/_2$ years of age. The taxpayer would seek to qualify under IRC §72(t), which was made effective for distributions in tax years after 1986.

[11] The exemptions for health insurance premiums and medical expenses came under the Health Insurance Portability and Accountability Act of 1996 (HIPAA). The penalty is not assessed on distributions equal to or less than any qualified medical expenses in excess of 7.5 percent of adjusted gross income, or if to pay for health insurance premiums if the IRA owner is unemployed. See IRS, *Publication 590* for a complete description of the current rules.

[12] This exemption was part of the IRS Restructuring and Reform Act of 1998.

[13] For example, reservists who were called into active duty after September 11, 2001 and before December 31, 2007 and who took distributions from their IRA after being called into active duty could do so and not be subject to the penalty. Also, if a taxpayer's home was located in a disaster area resulting from hurricanes Katrina, Rita, or Wilma and the distribution was made before January 1, 2007 and the taxpayer sustained economic loss because of the hurricane, they are allowed to take up to $100,000 without incurring the penalty.

[14] A data appendix provides additional details on datasources used.

[15] These are described in Bryant and Sailer (2006) and Parisi and Hollenbeck (2006) among other publications.

[16] The income percentile breaks are those for the national SCF sample. As explained by Bucks, Kennickell, and Moore (2006), the income levels delineating the percentiles in 2004 were as follows: less than 20 percent ($18,900); 20–39.9 percent ($33,900); 40–59.9 percent ($53,600); 60–79.9 percent ($89,300); and 80–89.9 percent ($129,400).

[17] Households with IRA withdrawals are distributed across the income groups: 3.4 percent of households with IRA withdrawals are in the bottom income quintile (nationwide) of households; 6.4 percent are in the second income quintile; 17.5 percent are in the third income quintile; 26.8 percent are in the fourth income quintile; 18.9 percent are in the second-highest income decile; and 27.0 percent are in the top income decile.

[18] The net worth percentile breaks are those for the national SCF sample. As explained in Bucks, Kennickell, and Moore (2006), the net worth levels that delineate the percentiles in 2004 are: less than 25 percent ($13,300); 25–49.9 percent ($93,100); 50–74.9 percent ($328,500); and 75–89.9 percent ($831,600).

[19] See Campbell, Parisi, and Balkovic (2000). In 1998, the first year in which Roth IRAs were available, eligible taxpayers could spread the income tax owed on the conversion amount over four years, which boosted conversion activity in that year.

[20] IRA assets prior to the withdrawal are estimated by adding the withdrawal amount to the current year-end assets to approximate the IRA balance before the withdrawal was taken.

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