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A Road Map for Universal Savings Accounts in America

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KEY TAKEAWAYS

A powerful tool to reduce wealth inequality, Universal Savings Accounts (USAs) would empower middle-class Americans to save more and build wealth.

This simple, tax-free saving account allows placing up to $10,000 each year into investments of their choosing—dramatically expanding stock ownership in America.

Congress and the President should use any "tax cuts 2.0" plan to reduce taxes on savings and promote financial stability for Americans through USAs.

Recent news reports indicate that the White House is looking closely at the idea of Universal Savings Accounts (USAs) as a centerpiece for President Donald Trump's middle-class tax cut 2.0.[1]

USAs would reduce tax penalties on savings for lower- and middle-income families, which are currently double-taxed–once when the money is earned, and a second time when the savings earn interest, capital gains, dividends, etc.[2] USA funds could be used for any purpose: medical expenses, childcare, education and college tuition, or start-up capital for a new business, to name a few. Most economists agree that the personal savings rate for Americans is too low. The virtue of USAs would be to add an extra layer of financial security for tens of millions of Americans—and thus make them less dependent on government assistance.

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The returns to saving—interest, dividends, and capital gains—are tax disadvantaged, hit by multiple layers of investment taxes. This penalty for saving keeps many Americans from accessing the benefits of compound interest and self-sufficiency. Investment earnings are the compensation for waiting to spend the income, thus the current system double-taxes savers, compared to those who spend their income today. When the tax system makes saving less attractive, it can slow down capital formation and thus hamper income and gross domestic product growth.

These new USA accounts would allow all adult taxpayers to invest up to $10,000 a year. Much like individual retirement accounts and 401ks, these accounts would protect workers' invested wages from double taxation. USA holders would *never* be assessed a penalty for withdrawing their own money.

Benefits for the Middle Class, Low Income, and Millennials

Existing special-purpose savings accounts help protect Americans from the savings penalty—but only if they are saving for certain enshrined activities used most often by people with stable incomes. These existing accounts include penalties for using the money for things other than the designated use and include other complicated rules that reduce uptake. The current system of accounts discourages saving among Americans who are reticent to lock up their extra income until retirement. Especially for young and lower-income savers, uncertainty about the future and the complexity of retirement account rules lower participation and shrink contributions. USAs can encourage saving in new populations by making the process of saving less complex and more attractive after-tax.

Following the introduction of accounts similar to USAs in the U.K. and Canada, moderate-income households were the most responsive.[3] 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.[4] In Canada, 55 percent of account holders earned less than Canadian $55,000 (around U.S. $41,000), and someone earning between Canadian $50,000 and $55,000 was *equally likely* to contribute to his or her account as someone earning more than $250,000.[5] In Canada, young people take the most advantage of these accounts, with people in their 20s contributing at some of the highest rates.[6] In the U.K., 50 percent of account holders earned less than £20,000 (around U.S. $26,000).[7]

Critics of USAs point out that many tax filers have a low enough income that they currently do not have to pay capital gains or dividends taxes.[8] The zero-percent tax bracket applies to single taxpayers with adjusted gross income of up to $39,375, or $78,750 for married couples filing jointly in 2020.

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 she is ready to spend the savings, it is much more likely that she will be in a higher tax bracket. USAs are also a structural reform to protect future savers from proposals to tax capital gains at wage tax rates, which would substantially increase the burden of investment taxes on lower-income families.

A Road Map for USAs in America

A limited USA, allowing contributions of up to $2,500 a year, passed the House of Representatives in 2018 with bipartisan support as part of the Family Savings Act.[9] The next proposal for USAs should expand the annual benefit and include as few restrictions as possible.

The USA proposal in the Family Savings Act is a Roth-style account that accepts contributions after income and payroll taxes have been paid. USAs could also be set up in the traditional style, in which the contribution is deducted from taxable income, grows tax-free, and taxes are paid at withdrawal. These two treatments are economically equivalent. Traditional-style accounts may be more familiar to taxpayers, but due to the timing of tax payments, after-tax accounts also have smaller budget-window revenue impacts, which could make them easier to implement.

Here is how the program would work. Each individual taxpayer would be able to place up to $10,000 annually into a personally owned wealth account. Like current retirement accounts, investors would have a wide range of investment options. Like existing accounts, if the USA account holders do not want to pick individual stocks, they would have the option to invest in privately managed index funds with low management fees.

Taxpayers should be able to withdraw their money for any reason, at any time, and spend it without limitations. The accounts should also be eligible to invest in as broad a bucket of assets as possible and be able to accept contributions from employers or other taxpayers. The lack of restrictions, combined with a wide range of investment options, are crucial to the success of USAs. Restrictions on when the income can be used would likely depress uptake among lower-income Americans who are more likely to need emergency funds.

Lawmakers would also be wise to avoid income limits that cap access to the accounts for higher-income taxpayers. Income limits reduce the number of savers who feel the marginal impact of the tax break. Thus, income limits diminish some of the predicted economic benefit. Some commentators have suggested modest income limits. If restrictions are added, they should be structured to become less restrictive over time.

USAs Can Reduce Income Inequality

One major benefit of USAs is they would dramatically increase stock ownership in America—potentially adding tens of millions of Americans to the investor class. When the stock market rises, as it has at an average annual real pace of about 7 percent, more Americans would directly benefit from that growth.

For example, if a worker who just turned 65 had put $4,000 into a USA each year starting when she was 24, she would have about $1 million in that account.[10] If a similar young person was able to put $10,000 a year in these accounts, he would have well over $2 million. Not everyone will want to leave his or her money in the market until retirement, but no one should miss out on the benefits of investment growth even for a few years.

USAs are not meant to replace retirement, education, or health savings accounts; they supplement these systems. In Canada, contributions to USAs are shown to come from existing tax-disadvantaged savings or new savings, not existing tax-deferred retirement accounts.[11] Some in the retirement industry worry that people might save less for retirement, but real-world examples show that USAs do not crowd out retirement savings. Instead, they *expand* it by providing an on-ramp to the existing savings system for those who are currently locked out.

The existing savings system includes tax penalties for improperly accessing special-purpose accounts. Intended to stop "leakage" from retirement accounts, these fees fall most heavily on the low-income, young, and minority participants.[12] In addition to lowering saving among more vulnerable Americans, withdrawal penalties and required holding periods are an additional tax on hardship—often forcing people to dip further into their savings to pay the fines. USAs without withdrawal restrictions are the best way to encourage new saving for the most Americans.

USAs should also not be confused with existing health savings accounts (HSAs) or past proposals that included savers credits and government matching programs. Unlike USAs, HSAs are entirely tax-free, including being free from income and payroll taxes when funds are used for their designated purpose: qualifying medical expenses.

Lawmakers may also be tempted to use tax credits or other incentives to increase saving in USAs. Policy should remove disincentives to save—but stop short of subsidizing saving. Pushing young and lower-income taxpayers to save more than they deem appropriate leaves less money for other priorities and could lead to unintended consequences, such as increased borrowing.[13]

A related benefit from USAs would be to re-instill in America a savings culture. Existing government programs crowd out private savings, transforming wealth accumulation by individuals into unfunded government promises, contributing to wealth inequality and financial instability. USAs would be both financial safety nets for all sorts of contingencies that can financially strain families *and* a way to build personal wealth when times are good. The goal is to allow families to have the "rainy day" funds in their own accounts to deal with a crisis, rather than depending on government. The entitlement mentality would be replaced with a savings-and-wealth mentality.

Tax Cuts 2.0

The majority of the provisions in the Tax Cuts and Jobs Act expire at the end of 2025, when taxes increase for most Americans. In addition to making these cuts permanent, Congress and the President should include USAs as part of any tax cuts package. USAs are about more than creating personal savings, but they will also help boost domestic investment and economic growth. USAs pair sound economic incentives with a strong political appeal.

The budgetary impact of USAs could be offset by reforms that reduce corporate subsidies in the tax code, like those for green energy, or cut wasteful and poorly targeted direct spending in other areas of the budget.[14] Comprehensive tax reform should strive to be deficit-neutral, as large deficits make the long-term certainty of taxes staying low less likely.

Democrats in Congress have made income and wealth inequality their top issue of concern, and these accounts would do more to narrow the gap between rich and poor, while also fueling a stronger economy than any proposal we have heard from Congress or the presidential candidates.

Conclusion

Families could tap their USAs, without penalty, to pay for emergency medical expenses, school tuition, starting a new business, or buying a home. The plan would add to national savings and self-sufficiency, not subtract from it—as most government programs do.

USAs can also be easily targeted to lower- and middle-income Americans, thus negating misguided and misleading claims of "tax cuts for the rich." Because these accounts are voluntary, families that do not wish to participate because of short-term financial stress would not have to. Our hope is that the accounts would allow tens of millions of Americans see the benefits of saving money, owning stock, and tapping the power of compound interest.

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