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You Can Thank or Blame Richard Stanger for Writing 401(k)

By Richard Rubin and Margaret Collins - Feb 3, 2014

We've been looking for someone who was involved in actually writing section 401(k) of the U.S. tax code more than 35 years ago, read the e-mail to Richard Stanger. "Yes, that's me," he wrote back.

Stanger was a primary author of a little-noticed piece of a 1978 tax law. At the time, the 869-word insert was lost in the political heat of limits on tax-deductible three-martini lunches, lower capital gains rates and a bipartisan coalition that was rejecting President Jimmy Carter's proposals. Today, 401(k) is likely the most recognizable number in the Internal Revenue Code.

As the first 401(k) generation ages -- about 10,000 baby boomers turn 65 every day in the U.S. -- questions multiply about the adequacy of their finances. Just last week, President Barack Obama proposed a new retirement plan for Americans who don't have 401(k) plans at work as he warned that Social Security often isn't enough to rely on.

How 401(k) grew from an insignificant provision into a behemoth that transformed retirement savings and started an industry that holds $4 trillion in Americans' assets is a study in the sometimes unintended consequences of Washington action. Consider: The initial provision was estimated to have a "negligible effect upon budget receipts." Now, defined contribution plans are the fifth-biggest tax break for individuals, with an estimated revenue loss to the government of $61.4 billion in fiscal 2014.

'No Discussion'

"There was absolutely no discussion in '78 that if you do this, the world is going to change," said Daniel Halperin, then a senior Treasury official and now a Harvard Law School professor.

The tale of Richard Stanger, who said he hadn't been interviewed previously about his role, is also a story about accidental actors at historic moments. As Stanger himself says, if anyone had known how important 401(k) would become, the Joint Committee on Taxation never would have let him, a 28-year-old junior lawyer, write it.

Stanger is now 63, the same age as Americans worried about their retirement security. He was a three-year-old in Queens, New York, when the fight began over what would become 401(k).

Irving Trust Co. and other New York-based banks had set up profit-sharing plans in which taxes could be deferred. They were accepted by the IRS with formal rulings in 1956 and 1963. Those plans typically covered bonus payments, not a choice about deferring a portion of regular salary.

Law Student

By 1972, while Stanger was a law student at Temple University in Philadelphia, IRS officials became concerned about benefits going to top executives. They proposed regulations that would have required immediate taxation of money contributed into the plans in some cases, undercutting the whole concept.

Congress in 1974 then froze the status quo in place for existing plans, effectively promising to set permanent policy and deferring a final decision. This was part of the Employee Retirement Income Security Act, which came to be known as Erisa.

That created a situation where one set of rules applied to existing plans and there was no clear structure for setting up new plans.

Meanwhile, Stanger was graduating from law school and planning to focus on international taxation. Instead, he became a pension policy specialist after the firm he joined lost its expert to a job at the IRS and needed someone to learn that 1974 law. Stanger refers to himself as an “Erisa child.”

‘Leverage It’

“It slowly dawned on me that I was an expert on this -- and I should leverage it,” he said in an interview in his Manhattan office.

Three years later, at a conference in Chicago, Stanger ran into Mervin Wilf, his former law professor. Wilf mentioned a job opening in Washington he had heard about. As a result, Stanger started working in November 1977 at the Joint Committee on Taxation, the nonpartisan staff that helps Congress write tax legislation and estimates its cost.

In 1978, the Carter administration proposed a law to cut tax rates, add a credit to benefit middle-income taxpayers, limit deductions for business meals and raise taxes on some capital gains. At the time, the thresholds for tax brackets weren’t indexed for inflation, meaning that more people moved into higher brackets each year unless Congress acted.

A bipartisan coalition in Congress resisted the president’s plan and began assembling its own bill, pulling together ideas proposed by a variety of lawmakers.

1978 Act

The main goal of what became the Revenue Act of 1978 wasn’t retirement savings, said former Democratic Congressman Jim Jones of Oklahoma, who helped rally support for the plan.

The point, instead, was tax cuts for the middle class and lower levies on capital gains to spur business investment. The legislation countered Carter’s tax proposal to Congress, so Jones and Wisconsin Republican Bill Steiger solicited amendments from members on the House Ways and Means Committee to build bipartisan support, Jones said.

Jones said Republicans wanted a proposal that would provide incentives for individual retirement savings.

Representative Barber Conable, the top Republican on Ways and Means, suggested the add-on related to profit-sharing plans that became section 401(k), Jones said. Conable, who died in 2003, had been talking to businesses such as Xerox Corp. (XRX) and Eastman Kodak Co. that were major presences in his home region in upstate New York.

Defined-Benefit Plans

"I considered it not an expensive proposition from the standpoint of revenue loss, and a supplement to retirement that could catch on, but never be the dominant factor," said Jones, now chairman of ManattJones Global Strategies LLC in Washington. "At that particular time in life, it looked like defined-benefit plans would be the order of the day for years and years and years."

The Carter administration had concerns about the 401(k) provision, though decided to allow it to proceed, Halperin said.

"Would I like that decision back?" Halperin said. "I'm not so sure. But there are certainly times when I think it may have been a terrible mistake."

Conable's idea, which he had introduced as a bill, was passed along to the Joint Committee on Taxation -- and to Richard Stanger.

Stanger described his job as the provision's primary author, to come up with language, work with the drafters and coordinate with the Treasury Department.

Pencils, Paper

He would write with pencils and paper or dictate language into recorders, to be transcribed by stenographers. Then he would head over to a conference room in the Cannon House Office Building, across Independence Avenue from the Capitol, to meet with Ward Hussey, the top tax legislative drafter, and other officials to hash out the details of the wording.

The goals: create a structure for these kinds of plans and establish some safeguards, including a definition of "highly compensated" employees who weren't allowed to benefit unless others did, too.

Stanger wasn't the only author of section 401(k), just the technical expert charged with shaping it into its final form. The provision, changed and expanded in the years since, blessed the idea that employees could direct part of their salary into retirement accounts without paying taxes on it up front and established basic rules to prevent too much of the benefit from going to executives.

"That provision was an insignificant provision in a very large bill," said Bob Shapiro, who was chief of staff at the Joint Committee and Stanger's boss then. "It took on a life of its own afterwards."

Stanger worked on four provisions on benefits and pensions in 1978.

'Cleanest Pieces'

“The 401(k) was by far the smallest and took by far the least time,” he said. “I think it was one of the cleanest pieces of legislation ever enacted.”

The issue wasn’t the focus of much intense lobbying, at least not as much as the rest of the law.

That’s in part because people such as Carroll Savage had already done that work for much of the 1970s, helping prevent Congress from killing the plans in Erisa in 1974. They also built support for the idea that employees should be able to choose whether to accept compensation as salary or a deferred payment to be taxed only when they can actually spend it.

Savage, a Washington tax lawyer, represented Kodak and Xerox, he said. A partner at Ivins, Phillips & Barker, Savage said Kodak and Xerox were among the first non-banks to set up the plans.

The New York connection gave Savage some obvious allies: Conable and first-term Senator Daniel Patrick Moynihan, a New York Democrat.

Few Opposed

By the time section 401(k) was incorporated into the broader tax bill, there was little to no opposition.

“It’s just the inertia of getting things done in Congress when you’ve got a lot of busy people,” Savage said. “It really was just a question of moving the ball forward. I don’t think anybody spoke up negatively.”

Stanger was impressed with what he and his colleagues had wrought.

“I used to describe it -- and I still would -- as clean and elegant, with a lot of potential,” Stanger said of the 401(k) provision. “We had a phrase we used to use. We’d say, ’It sings,’ which meant it was well-drafted, well-constructed. And then we would say: ’But will it sail?’ We didn’t know.”

Did it ever.

The 401(k) law passed as old-fashioned pension plans were under attack. Public companies, required to account for their pension liabilities, were worried about their costs.

‘A Trend’

“Companies were really coming around to see the value of eliminating these liabilities,” Stanger said. “It was the beginning of a trend.”

The law took effect in January 1980. By the time the Treasury Department issued regulations in 1981, fully putting the law into action, Stanger had left the government.

That’s when people such as Ted Benna, then at the Johnson Cos., a benefit-consulting firm, stepped in. Benna realized the power of the 401(k) and helped to popularize it, which has left him with the title of “Father of the 401(k).”

“I realized I could go to these big companies and say, ’Instead of putting this money in after-tax, how would you like to do it pre-tax?’” Benna said in an interview.

The number of 401(k) plans grew to about 513,000 in 2011 from 17,000 in 1984, while active participants increased to 61 million from 7.5 million. In that time, defined-benefit pension plans fell to about 43,800 from about 165,700.

Not Enough

A concern is that 401(k)s haven't provided much of a retirement cushion. The median balance in 401(k) and individual retirement accounts for households headed by people ages 55 to 64 who had accounts at work was $120,000 in 2010, according to the Center for Retirement Research at Boston College.

In addition, some 401(k) plans have been the subject of lawsuits claiming that plans have excessive fees, limited investment choices or conflicts of interest.

The ascent of 401(k)s helped end the idea of a lifetime employment contract and was a catalyst for other movements that changed the nature of relationships between employees and companies. The risk and responsibility of saving for retirement shifted from employers to employees. Stanger said it led to a world in which workers, not companies, are responsible for planning their own career paths.

Xerox, Kodak

At the time, Savage said, he wondered whether other companies would start doing what Xerox and Kodak were.

"As the years have passed, I've watched the pension system, the traditional pension system, pretty much go down the tubes and watched 401(k)s pretty much take over the burden of providing retirement income and wondering whether I should feel guilty about that or proud," Savage said.

Ultimately, he said, some of that decline in pensions was inevitable and the 401(k) is there to pick up the slack.

Stanger is proud of his work and says 401(k)s were a good idea. He sees them as a rare positive economic force that came out of the late 1970s, a period when the country was suffering from unemployment and inflation.

"It really enables a lot of the flexibility and fluidity, movement, of resources and people and security and the ability to build pensions over multiple companies," Stanger said. "Defined benefit plans don't work very well for that."

After his three-year stint in the government ended, Stanger moved to the private sector, where he built a human resources consulting practice at PricewaterhouseCoopers LLP and then worked at IBM Corp. as a human resources vice president.

Will Wait

Stanger said he has "substantial" balances in 401(k) plans from both employers. He isn't required to tap into them until he reaches age 70 1/2, and he plans to wait until then and take the taxable distributions as slowly as possible.

As chief executive officer of StangerCarlson, a year-old human resources consulting business, he's thinking about when to hire employees and what retirement benefits to offer them. He plans to offer a 401(k) plan when he has workers instead of independent contractors. His priority: making sure there's a default investment option for his workers that is highly diversified.

“A lot of plans have hundreds of choices and most people can’t parse those hundreds of choices,” he said.

Stanger still shakes his head in amazement that the tax code section itself is so well-known by its number. In 1978, the plans were called cash or deferred arrangements.

“We thought that the acronym CODA would take off,” Stanger said. “But it didn’t.”

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