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### Re-Valuing Household Wealth

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Poterba (2004) makes the compelling argument that the face value of 401(k)s, IRAs, and other “tax deferred assets” (or TDAs) cannot be directly valued together with other components of household wealth such as houses, stocks, and bonds. The rationale is that TDAs carry a substantial deferred tax liability on withdrawal. Thus, an IRA valued at \$1,000 can yield considerably less than this when the asset is “cashed out.” As Poterba notes, “...deferred taxes ... can make a dollar held inside a retirement saving account worth less at retirement than a dollar held in a similar asset outside such an account... [p. 490]”.

Poterba was mainly concerned with the issue of whether the (post-tax) rate of return is higher with a TDA or directly investing in stocks and bonds. The motivation here is quite different. It is to compare time trends in wealth with and without netting out the tax liability implicit in such TDAs.

I propose two measures. The first is the conventional definition of household wealth in which assets such as DTAs are valued at their face value. The second is the cash withdrawal value (CWV). To convert TDAs to a cash value, it is necessary to subtract out the accumulated taxes due on these instruments. Since cash withdrawals out of these assets are taxed as “ordinary income,” the taxes due may be substantial.

The empirical analysis covers years 1983 to 2016 based on data from the Federal Reserve Board’s Survey of Consumer Finances. It will be conducted for both conventional net worth, NW, and augmented wealth, AW, the sum of net worth, defined benefit pension wealth, and Social Security wealth, SSW. The reason for looking at AW is that both defined benefit pension and Social Security benefits, like TDAs, are taxed on receipt. The NBER TAXSIM calculator is used to estimate federal income taxes.

Several major issues are addressed. First, how do time trends in mean and median wealth differ between NW and CWV? Wealth values will, of course, be lower for CWV than NW. Moreover, because defined contribution pension wealth, DCW, has been rising sharply as a share of NW, growth in mean and median CWV should be lower than NW. This difference will, of course, also depend on what happened to marginal tax rates over time. Second, how does the level and time trend in inequality differ between NW and CWV? We would expect a lower Gini coefficient for

CWV than NW because the rich face a higher marginal tax rate than poorer households and thus the after-tax wealth of the rich is devalued more. However, counteracting this effect is the fact that DCW constitutes a much smaller share of the assets of the rich than the middle class. I will determine the trade-off between these two factors. Third the same issues arise with regard to AW. Fourth, how do wealth gaps by demographic characteristics and income class differ among these two measures (for example, is the racial wealth gap smaller or larger?) Fifth, how are international comparisons affected when CWV is used instead of NW? A comparison will be made for Canada versus the U.S. One would expect that the U.S. position is over-valued vis-à-vis Canada when NW is used instead of CWV since DCW likely constitutes a significantly higher proportion of assets in the U.S.

Results show that netting out implicit taxes lowered measured pension wealth by about a quarter in 2016. However, there is no significant time trend between 1983 and 2016. SSW was devalued by 14 percent in 2016, NW by 4.8 percent, and AW by 7.8 percent but in these cases there was a sharp increase in the gap between before-tax and after-tax values. Subtracting implicit taxes lowered measured inequality in pension wealth and SSW, as predicted, but had no appreciable impact on NW or AW inequality.

#### Reference

Poterba, James M. 2004. "Valuing Assets in Retirement Savings Accounts." *National Tax Journal*, 57(2, Part 2): 489-512.