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The Retirement Savings Tools You Use Could Affect How Long Your Money Lasts

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Lakewood Ranch, Fla. _ A new study published by the American Accounting Association finds that people who rely on "deferred-tax" accounts to save for retirement may exhaust their savings faster than people who use "currently-taxed" accounts.

In the U.S., some retirement savings instruments are deferred-tax (DT) accounts, in which users pay taxes on the money only when they withdraw it. Other retirement savings instruments – such as Roth IRAs – are currently-taxed (CT), meaning the money is taxed before being placed in the account and not taxed when people withdraw it.

"We wanted to see if the decision to use DT or CT accounts influences the way people spend money in retirement," says Shane Stinson, co-author of the study and an associate professor of accounting at the University of Alabama. "A better understanding of this behavior can inform decisions by people who are saving for retirement now."

To address the issue, the researchers developed an experiment designed to assess how people would spend money in a DT or CT account. The researchers then enlisted 350 study participants, all of whom were U.S. adults over the age of 40 who had filed at least five tax returns over the previous seven years.

A key variable in the experiment was the amount of money study participants had to work with. Given equal starting balances, the DT account offered less real spending power than the CT account, because users hadn't paid tax on it yet. The CT balance was fully available to the user because the funds had already been taxed.

The study had two key findings. First, the researchers found CT users and DT users both spent money at the same rate when given equal starting balances. Second, DT users exhausted their savings more quickly.

"People are spending money on the same things, so their expenses are the same," says Marcus Doxey, co-author of the study and also an associate professor of accounting at Alabama. "However, DT users also pay tax on their savings every time they use them – which means, in practice, they're paying an additional fee. As a result, their savings decline at a faster rate."

“We gave the study participants options,” Stinson says. “And we found all participants spent money based on the perceived amount of money in their accounts. But DT users didn’t fully account for the percentage of the account balance that would be paid in taxes, even when we explicitly told them about the tax consequences.”

“Our findings suggest people with deferred accounts may need to save more than they think, unless they’re confident in their ability to account for taxes when making spending decisions in retirement,” Doxey says.

“The findings are useful for financial planners, accountants who provide tax advice to clients, and anyone saving for retirement,” Stinson says.

The paper, “How Does Tax Timing Affect Spending In Retirement?,” appears in the *Journal of the American Taxation Association*. The paper was co-authored with Donna Bobek Schmitt, professor of accounting and Chelsea Rae Austin, associate professor of accounting, both at the University of South Carolina.

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