Mega-IRAs, Mega-401(k)s, and Other Mega-Retirement Accounts: Statement for the Record

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Senate Committee on Finance
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To Chairman Wyden, Ranking Member Crapo, and Members of the Committee:

The Senate Finance Committee’s July 28 hearing spotlighted “mega-IRAs”: individual retirement accounts with balances of $5 million or more. An analysis by the Joint Committee on Taxation (JCT) in advance of the July 28 hearing found that the number of taxpayers with mega-IRAs now exceeds 28,000.¹ The hearing followed a June 2021 report by the nonprofit investigative journalism organization ProPublica, which revealed—based on leaked IRS files—that a handful of high-net-worth individuals had accumulated massive IRA balances.²

The Senate Finance Committee hearing and the ProPublica report emphasized one way that taxpayers amass mega-IRAs: by “stuffing” an account with undervalued assets such as pre-IPO stock and investment-fund carried interests. “Stuffing” no doubt occurs in some instances, and Congress could take steps to stop it (e.g., by prohibiting IRAs from holding non-publicly traded assets). However, it is unlikely that most mega-IRAs result from abusive stuffing tactics. Individuals engaged in stuffing would generally want to convert their IRAs from traditional to Roth accounts quickly. Yet JCT’s analysis found that 85 percent of mega-IRA owners hold only traditional accounts.

How, then, have tens of thousands of high-income individuals created mega-IRAs? As our submission shows, **existing rules allow high-income taxpayers to amass mega-IRAs straightforwardly—and legally—by “maxing out” 401(k) defined contribution plans,**

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¹ Memorandum from Thomas A. Barthold to Kara Getz, Tiffany Smith, and Drew Couch (July 27, 2021), https://www.finance.senate.gov/imo/media/doc/7.28.21%20JCT%20Mega%20IRA%20Data1.pdf. The JCT analysis was based on 2019 data. The number of mega-IRAs has likely increased since then.

potentially combining defined contribution plans with defined benefit plans, and investing in S&P 500 index funds or other publicly traded assets. Mega-IRAs are indeed a problem, but they are a problem primarily caused by laws that lavish excessive tax benefits on high-income individuals.

We begin by illustrating how high-income individuals can create mega-IRAs through entirely legal means. Next, we review the choices that Congress has made over the last quarter-century that opened a wide door to mega-IRAs. We then explain why the JCT data and other sources strongly suggest that most mega-IRAs do not reflect stuffing. We conclude with concrete policy recommendations to stem the tide of mega-IRAs and other mega-retirement arrangements, which undermine the progressivity and revenue-raising potential of the federal income tax system.

I. How To Create a Mega-IRA: An Illustration

We begin with an example of a high-income professional (e.g., a law-firm partner) born in 1950 who contributes the maximum amount to a 401(k) defined contribution plan starting in 1990. In addition, the individual’s employer establishes a cash balance defined benefit plan sometime after the 1996 legislative change that lifted limits on combined defined contribution and defined benefit plans maintained by the same employer. Beginning in 2010, the individual makes “backdoor” contributions to a Roth IRA. The individual retires in 2015 at the age of 65 and receives the maximum lump-sum distribution from the cash balance plan (approximately $2.5 million in 2015). She rolls over her 401(k) and deposits her cash balance plan distribution into an IRA. She invests exclusively in a portfolio tracking the S&P 500 index total return.

Table 1 shows how the individual’s retirement savings contributions would have evolved over her career. The gray shading of pre-2010 IRA contribution amounts reflects our assumption that a high-income individual would not have made any IRA contributions until backdoor contributions to a Roth IRA became possible in 2010. The gray shading of post-2015 amounts reflects our assumption that the individual would not have made any contributions after retirement.

5 A high-income individual who participates in a defined benefit or defined contribution plan would be precluded from making nondeductible contributions to a traditional IRA or direct contributions to a Roth IRA. I.R.C. §§ 219(g), 408A(c)(3). Starting in 2010, an individual at any income level could make nondeductible contributions to a traditional IRA and then immediately convert the traditional IRA to a Roth IRA. See Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. No. 109–222, § 512, 120 Stat. 345, 365–66 (2006) (amending I.R.C. § 408A for taxable years beginning after December 31, 2009).
<table>
<thead>
<tr>
<th>Year</th>
<th>401(k) Plan</th>
<th>IRA</th>
<th>Notes</th>
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<tr>
<td></td>
<td>All Ages</td>
<td>Age ≥50 Catchup</td>
<td>All Ages</td>
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<tr>
<td>1990</td>
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<td>1996</td>
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<td>Section 415(e) limit repealed (effective 2000)</td>
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<td>Roth IRAs established (effective 1998)</td>
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<td>Effective start of defined benefit/defined contribution combos</td>
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<tr>
<td>2020</td>
<td>$57,000</td>
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<tr>
<td>2021</td>
<td>$58,000</td>
<td>$6,500</td>
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* Figures are for elective deferrals plus employer contributions.
* High-income individuals generally precluded from making tax-advantaged contributions to IRAs until 2010.
* Prior to the effective date of section 415(e) repeal, defined benefit/defined contribution combinations were technically permitted but subject to strict limits on benefits and contributions.
* Illustration assumes no 401(k) or IRA contributions after 2015 retirement.

Figure 1 illustrates how the individual’s combined IRA and 401(k) would have grown over the 1990–2021 period, assuming investments appreciate at the S&P 500 index total return rate. We show how the individual’s balance (including investment returns) would have grown based on (a) 401(k) contributions alone, (b) 401(k) contributions plus backdoor Roth IRA contributions starting in 2010, and (c) both of the above plus a cash balance defined benefit.
plan distribution in 2015. We provide an online data file showing our calculations at bit.ly/megaira.

**Figure 1. Illustration of IRA/401(k) Balance for Individual Born in 1950 and Retiring in 2015**

![Graph showing IRA/401(k) balance over time](image)

**Notes:** Investment growth rate equal to S&P 500 index total return (with new contributions added at end of year).  
*401(k) only:* Maximum employer-plus-employee contributions to 401(k) plan from 1990 through 2015.  
*401(k) + backdoor Roth IRA: 401(k) only + maximum backdoor Roth IRA contribution from 2010 through 2015.  
*401(k) + backdoor Roth + cash balance defined benefit: Both of the above + lump-sum distribution from cash balance defined benefit plan of $2,452,050 at end of 2015. Amounts calculated through August 9, 2021. For further details, see bit.ly/megaira.*

In our illustration, the individual ends up with a mega-IRA balance of $13.4 million as of August 2021. If she had made 401(k) contributions and backdoor Roth IRA contributions (without a cash balance defined benefit plan), the value of her IRA would be $7.5 million. If she had made 401(k) contributions only and rolled over to an IRA, her IRA balance would be $7.4 million.

Our illustration **understates** the amount that an individual could accumulate in an IRA through legal means. A higher balance would be feasible with the following modifications:

- **More years of contributions.** If our individual started contributing to her 401(k) in 1985 at age 35, her IRA balance as of 2021 (including the effect of backdoor Roth contributions and a cash balance payout) would be $18.7 million (see online data file). If she had made 401(k) contributions only, the balance would be $12.7 million.
• **Multiple 401(k) or cash balance plans.** We assumed the individual contributed to only one 401(k) plan and received only one lump-sum distribution from a cash balance plan. An individual with income from employment and self-employment could potentially contribute a combined total of $122,500 in 2021 to an employer-sponsored 401(k) and a solo 401(k). An individual who switches employers could potentially receive a lump-sum payout from the first employer’s cash balance plan and participate in the second employer’s cash balance plan.

• **Inheritances.** We assumed the individual did not merge her IRA with anyone else’s. Someone who inherited an IRA, such as a surviving spouse, could have a total balance much larger than the amount illustrated.  

• **Higher rate of return on investments.** Although the S&P 500 generated an impressive 10.6 percent annualized return from 1990 to August 2021 (assuming reinvestment of dividends), some 401(k) plan participants and IRA owners have likely outperformed the index without stuffing nonpublic assets into their accounts. For example, Berkshire Hathaway executive Ted Weschler—who reportedly had $264.4 million in his IRA at the end of 2018—states that he has “invested the account in only publicly-traded securities.”

II. How We Got Here

If pre-1996 laws had remained in effect, the individual in our illustration could have contributed the $30,000 maximum to her 401(k) plan each year until retirement in 2015. She could not have taken advantage of a backdoor Roth IRA, and she could not have participated in a cash balance defined benefit plan without running into the former section 415(e) limits. Her IRA balance in August 2021 would be approximately $6.1 million (see online data file), and she would need to begin taking RMDs this year.

More than half of the $13.4 million balance in our illustration ($7.3 million, or 54 percent) is attributable to legislative changes starting in 1996. We summarize the most significant changes in Table 2. We include, with gray shading in the last row, the Securing a Strong Retirement Act of 2021, or “SECURE Act 2.0,” which was reported out of the House Ways and Means Committee on May 5, 2021. If the SECURE Act 2.0 becomes law, high-income individuals will be able to make even larger contributions to 401(k) plans before age 65, and owners of mega-traditional IRAs would be able to delay RMDs for even longer.

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6 An individual who inherits an IRA from a spouse can add the inherited IRA to her own IRA. Under the SECURE Act of 2019, IRAs inherited from someone other than a spouse generally must be distributed over 10 years, but IRAs inherited before 2020 are exempt from the SECURE Act’s 10-year rule. See Setting Every Community Up for Retirement Enhancement Act of 2019, Pub. L. No. 116–94, § 401, 133 Stat. 2534, 3176.

7 See Elliott, Callahan & Bandler, supra note 2.


Table 2. Legislative Changes Since 1996 That Have Facilitated the Rise of Mega-IRAs

<table>
<thead>
<tr>
<th>Year</th>
<th>Legislation</th>
<th>Effects</th>
</tr>
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<tbody>
<tr>
<td>1996</td>
<td>Small Business Jobs Protection Act of 1996</td>
<td>Repealed section 415(e), which had limited the amount that individuals could save through defined contribution and defined benefit plans with the same employer</td>
</tr>
<tr>
<td>1997</td>
<td>Taxpayer Relief Act</td>
<td>Established Roth IRAs with no required minimum distributions (RMDs)</td>
</tr>
<tr>
<td>2001</td>
<td>Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)</td>
<td>Raised IRA and 401(k) contribution limits; added catchup contributions; raised maximum allowable benefit under defined benefit plans; established Roth 401(k)s</td>
</tr>
<tr>
<td></td>
<td><strong>Note:</strong> Changes scheduled to sunset after 2010</td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>Tax Increase Prevention and Reconciliation Act of 2005</td>
<td>Lifted income limits on traditional-to-Roth conversions; opened the door to backdoor Roth IRA contributions</td>
</tr>
<tr>
<td>2006</td>
<td>Pension Protection Act of 2006</td>
<td>Made key provisions of EGTRRA permanent; removed several remaining barriers to cash balance defined benefit plans</td>
</tr>
<tr>
<td>2019</td>
<td>SECURE Act of 2019</td>
<td>Raised RMD age for traditional accounts and Roth 401(k) plans from 70 ½ to 72; repealed age cap on contributions to traditional IRAs (thereby allowing high-income individuals ≥ age 70 ½ to use backdoor Roths)</td>
</tr>
<tr>
<td>2021?</td>
<td>SECURE Act 2.0 Reported out of House Ways &amp; Means Committee on May 5</td>
<td>Would raise RMD age to 75; increase catchup contributions to $10,000 for 401(k) participants ages 62-64; and allow employees to elect Roth treatment for employer contributions to 401(k) plans</td>
</tr>
</tbody>
</table>

These changes primarily benefited the rich. As Figure 2 illustrates, households in the top decile by net worth have increased their average retirement account balances by vastly more than the rest of the population over the past three decades.

Figure 2. Retirement Accounts by Percentile of Net Worth (1989—2019)

![Figure 2](https://ssrn.com/abstract=3903624)

**Notes:** Authors’ calculations based on Federal Reserve Survey of Consumer Finance, 1989—2019.
**Stuffing.** Importantly, “stuffing” plays no part in our illustration. “Stuffing” occurs when an individual uses an IRA to acquire non-publicly traded assets at prices below fair market value. The ProPublica report indicates that tech entrepreneur Peter Thiel started on the path to his mega-IRA by purchasing pre-IPO shares of PayPal at a very low price. An October 2014 report by the Government Accountability Office suggested that private equity funds and hedge funds were allowing key employees to use their Roth IRAs to purchase profits interests (commonly known as “carried interests”) at potentially abusive valuations.\(^{10}\) The GAO report concluded that strategies involving non-publicly traded assets are “likely” the cause of mega-IRAs.\(^{11}\)

Stuffing is primarily a problem with respect to Roth IRAs. Stuffing a traditional IRA with pre-IPO stock or private equity fund carried interests is generally a questionable tax-avoidance strategy because it converts what would often be long-term capital gains (taxed at a top rate of 23.8 percent) into ordinary income (taxed at a top rate of 37 percent).\(^{12}\) As Table 3 illustrates, most of the mega-IRAs identified by JCT are traditional IRAs. According to the JCT data, 85 percent of all mega-IRAs are traditional IRAs, and at least 79 percent of the aggregate balance of mega-IRAs lies in traditional accounts.

### Table 3. Mega-IRAs by Account Balance Ranges and Type (2019)

<table>
<thead>
<tr>
<th># of Taxpayers</th>
<th>(\geq$5m) to $10m</th>
<th>(\geq$10m) to $15m</th>
<th>(\geq$15m) to $25m</th>
<th>(\geq$25m)</th>
<th>All Mega-IRAs ((\geq$5m))</th>
</tr>
</thead>
<tbody>
<tr>
<td>Traditional only</td>
<td>24,990</td>
<td>2,275</td>
<td>853</td>
<td>497</td>
<td>28,615</td>
</tr>
<tr>
<td>Roth only</td>
<td>21,682</td>
<td>1,709</td>
<td>557</td>
<td>303</td>
<td>24,251</td>
</tr>
<tr>
<td>Both</td>
<td>2,175</td>
<td>425</td>
<td>237</td>
<td>156</td>
<td>2,993</td>
</tr>
</tbody>
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<thead>
<tr>
<th>Total Balance (millions)</th>
<th>(\geq$5m) to $10m</th>
<th>(\geq$10m) to $15m</th>
<th>(\geq$15m) to $25m</th>
<th>(\geq$25m)</th>
<th>All Mega-IRAs ((\geq$5m))</th>
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<tbody>
<tr>
<td>$160,111</td>
<td>2,275</td>
<td>853</td>
<td>497</td>
<td>28,615</td>
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<tr>
<td>$26,917</td>
<td>21,682</td>
<td>1,709</td>
<td>557</td>
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<tr>
<td>$15,926</td>
<td>853</td>
<td>497</td>
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<td>$279,566</td>
<td>28,615</td>
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**Source:** Memorandum from Thomas Barthold to Kara Getz, Tiffany Smith & Drew Crouch (July 27, 2021).

**Notes:** “Both” reflects taxpayers with traditional and Roth IRAs whose aggregate balance \(\geq\$5m\).


\(^{11}\) Id. at 26. The GAO report said that it was “improbable” that an individual could accumulate an account balance above \$5 million through contributions to a 401(k) plan, and it added that “an accumulation of more than \$5 million looks large in comparison to … the maximum lump sum payable to a 65-year-old DB participant” (which GAO calculated to be \$2.3 million to \$2.6 million in 2011). See id. at 25. However, the GAO report failed to consider the possibility that an individual could combine a 401(k) defined contribution plan with a cash balance defined benefit plan. The GAO data also is 10 years old now and does not factor in the intervening decade of stock market growth.

\(^{12}\) Stuffing a traditional IRA still may yield modest benefits if the deferral advantage outweighs the negative rate arbitrage, or larger benefits if assets otherwise would have generated income taxed at ordinary rates (e.g., carried interests in some hedge funds). However, any taxpayer who stuffed an IRA in 2010 or afterwards could convert to a Roth. The fact that most mega-IRAs are traditional IRAs is evidence that they do not reflect stuffing.
Stuffing an IRA—even a Roth IRA—provides only a modest benefit to start-up founders and early-stage investors who have access to other legal tax-avoidance strategies. For example, individuals who hold shares of stock or other property until death can qualify for tax-free stepped-up basis. Since 2010, start-up founders and early-stage investors who acquire pre-IPO stock and hold it for at least five years can—in many circumstances—exclude $10 million or more of capital gains on the sale of the stock under section 1202. These strategies allow individuals to replicate (roughly) the benefits of Roth IRA stuffing without legal risk.

III. Takeaways

We see at least three takeaways from our illustration and analysis:

1. High-income individuals can create mega-IRAs by maximizing their tax-favored savings across multiple plans and then consolidating their balances into IRAs—all of which Congress expressly permits. We are encouraged that members of Congress are focusing attention on the mega-IRA problem. However, rather than revealing mega-IRAs to be an “abuse,” our review demonstrates that mega-IRAs are a product of choices that Congress has made over the last quarter century—choices that foreseeably allowed high-income individuals to shift eight-figure sums into tax-favored accounts.13

2. Cash balance defined benefit plans—especially when combined with defined contribution plans—put many high-income professionals within close reach of mega-IRAs even before accounting for investment growth. The number of cash balance plans has grown dramatically over the last two decades, from 1,477 in 2001 to an estimated 25,040 in 2019.14 These plans are especially concentrated in the medical and financial sectors and among professional practices such as law firms. The largest law-firm cash balance plan is now approaching $1 billion in assets, and cash balance plans in total hold more than $1 trillion.15 An estimated 97 percent of cash balance plans are add-ons to existing 401(k) plans.16 Mega-IRAs will become increasingly common as long as Congress allows high-income individuals to pair defined contribution and defined benefit plans.

3. The mega-IRA problem is not limited to Roths—and not even limited to IRAs. A mega-traditional IRA is simply a mega-IRA that the owner has not (yet) chosen to convert to a Roth. The owner of a mega-traditional IRA may delay conversion for any number of reasons. For example, she may anticipate that top tax rates will go down (as indeed they did at the end of 2017). She may be planning to change her tax domicile from a high-tax state (e.g., New York) to

13 Congress’s choice to lift income limits on traditional-to-Roth IRA conversions (effective 2010) was particularly cynical: lawmakers characterized the move as a revenue-raiser, even though independent analysis showed that the change would reduce net long-term federal revenues by at least $14 billion in present value terms. See Leonard E. Burman, Roth Conversions as Revenue Raisers: Smoke and Mirrors, Tax Notes, May 22, 2006, at 953.
15 Id. at 7-8.
a low-tax state (e.g., Florida). Or she may be planning to stretch a conversion over several years so that more of her income can be taxed at lower marginal rates. From a policy perspective, the fact that a mega-IRA owner has not yet chosen to Rothify her account does not make the existence of the mega-IRA any less problematic.

Indeed, it is not clear why—from a policy perspective—we should care whether a mega-retirement account balance is in an IRA or any other tax-favored vehicle. The individual in our illustration could have reaped similar tax benefits if she had left her 401(k) balance in her employer-sponsored plan rather than rolling over to a mega-IRA. Any solution that seeks to tackle the mega-IRA problem also must address mega-401(k)s and other tax-favored mega-accounts.

IV. Policy Implications

1. Mega-IRAs and other mega-retirement accounts are a serious problem, even when they do not result from abusive stuffing tactics. Mega-retirement accounts allow high-income individuals to reduce tax either on the front end (by excluding traditional 401(k) contributions and defined benefit accruals from income) or on the back end (by excluding Roth withdrawals), all the while avoiding year-to-year tax on accumulations. Whether traditional or Roth, these tax-favored vehicles deliver a windfall to individuals at the very top of the income distribution, exacerbating already wide inequalities. Furthermore, if Congress fails to address the problem of mega-IRAs and other mega-retirement accounts, revenue losses are likely to grow as more and more employers offer supersized defined benefit/defined contribution combinations.

2. Congress could address the mega-retirement plan problem by establishing a lifetime limit on all tax-favored retirement benefits—as proposed by the Obama-Biden administration. Under the Obama-Biden proposal, the cap would be set such that an individual could retire at age 62 and purchase a lifetime annuity for herself and her spouse paying the maximum annual benefit for a defined benefit plan. In 2016, that amount would have been $210,000 per year, corresponding to a maximum balance of approximately $3.4 million for a 62-year-old. Once an individual reached the cap, she could no longer make additional contributions or receive additional defined benefit accruals, though her balance could continue to grow with investment earnings.

The Obama-Biden proposal, if implemented, would constitute an important step toward stopping the growth of mega-retirement accounts. Under the proposal, an individual still could use tax-favored retirement savings arrangements to ensure a comfortable retirement for herself and her spouse. But IRAs, defined contribution plans, and defined benefit plans would no longer be tools for preserving dynastic wealth. Moreover, the Obama-Biden plan rightly

17 For an explanation of the theoretical equivalence between traditional and Roth IRA benefits (an application of the “Cary Brown theorem”), see Christopher H. Hanna, Tax Theories and Tax Reform, 59 SMU L. Rev. 435 (2006).
recognized that mega-IRAs are just one type of mega-retirement plan. Capping only IRAs (or only Roth IRAs) would arbitrarily penalize individuals who decided to take rollovers rather than leaving their balances in an employer-sponsored plan (or who decided to pay tax on a traditional-to-Roth conversion rather than delaying conversion until a more opportune time). Worse yet, an IRA-specific or Roth-specific reform would simply shift the problem to other accounts that currently feed into mega-IRAs.

3. Supplemental steps. We know of no adequate substitute for the cross-plan cap proposed by the Obama-Biden administration. However, Congress could supplement that legislative change with additional measures:

- **Mandating RMDs starting at age 72 from all accounts, including Roth IRAs.** Congress created tax-favored retirement plans to support individuals in their later years. Without RMDs, these plans can quickly become intergenerational wealth-transmission devices. The SECURE Act 2.0 proposal to raise the RMD age to 75 would exacerbate the mega-retirement plan problem.

- **Ending backdoor Roths.** Congress created Roth IRAs as savings vehicles for low- and middle-income Americans—not as mechanisms for high-income individuals to add onto their other savings. Congress could shut the Roth “backdoor” by barring high-income individuals from making nondeductible IRA contributions—the first step of the backdoor two-step.

- **Prohibiting IRAs and defined contribution plans from holding non-publicly traded assets.** While we do not think that a majority of mega-IRAs arise from “stuffing” strategies, there is no reason for Congress to allow “stuffing” in the first place. A ban on non-publicly traded assets in IRAs, 401(k)s, and other defined contribution plans would limit both stuffing and self-dealing (i.e., improper transactions between an IRA and its owner).

V. Conclusion

We are troubled by mega-IRAs, which undermine the progressivity and revenue-raising potential of the federal income tax. However, mega-IRAs are a symptom of an even more serious disease: a retirement savings system that disproportionately favors the rich. Instead of simply treating the symptom, Congress could cure the disease—a disease largely caused by Congress’s own choices.