Slightly less than half of all workers are covered under some type of employer-sponsored defined-contribution pension plan; over one-fifth contribute more than 11% of their salary to such plans. Although 401(k) and similar plans lower one’s current taxes, they may not have the same effect on lifetime taxes. The lifetime result depends partly on future changes in tax rates. Even if taxes do not increase, taxable withdrawals from qualified plans upon retirement may place some individuals in higher marginal tax brackets. Similarly, tax-favored saving plans may reduce a younger person’s current marginal tax bracket and lower the value of current mortgage-interest deductions. Most important, large plan withdrawals in the future may subject a greater fraction of one’s Social Security benefits to income taxation.

These factors could pack enough punch to raise an individual’s lifetime tax liability and reduce lifetime spending, especially for low earners who participate heavily in such plans. A recent study shows that those who earn less than $50,000 and receive a 6% rate of return on their contributions may lose money over a lifetime through larger tax liabilities and smaller spending budgets.

Most 401(k) account balances are invested in equities, which may earn a high rate of return, increasing the likelihood that future plan withdrawals will push individuals into higher income tax brackets. Hence, low earners’ conservative approach to investing plan assets—as evidenced by the fact that more low earners invest none of these assets in equities—seems justified.