

# CRS Report for Congress

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## The Retirement Savings Tax Credit: A Fact Sheet

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### Summary

Section 618 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16) authorized a non-refundable tax credit of up to \$1,000 for eligible individuals who contribute to a traditional IRA or an employer-sponsored retirement plan that is qualified under §401, §403 or §457 of the Internal Revenue Code. The credit was first available in 2002. It will expire after 2006 unless extended by Congress. The maximum credit is 50% of retirement contributions up to \$2,000. The saver's credit can reduce the amount of taxes owed, but the tax credit itself is non-refundable. The maximum credit is the lesser of either \$1,000 or the tax that the individual would have owed without the credit. Eligibility is based on the taxpayer's adjusted gross income. Taxpayers under age 18 or who are full-time students are not eligible for the credit. This report will be updated in the event of legislative action affecting the saver's credit.

Section 618 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16) authorized a retirement savings tax credit to encourage low — and moderate — income families and individuals to save for retirement. Eligible taxpayers who contribute to a traditional individual retirement account (IRA) or to an employer-sponsored plan that is qualified under §401, §403 or §457 of the tax code can receive a non-refundable tax credit of up to \$1,000. This credit is in addition to the tax deduction for contributing to a traditional IRA or to an employer-sponsored retirement plan. In determining the amount of the saver's credit, neither the amount of refundable tax credits for which the taxpayer is eligible nor the adoption credit are taken into consideration. The retirement savings credit was first available in 2002 and will expire after 2006 unless extended by Congress.

Taxpayers claim the credit on the income tax return they file with the Internal Revenue Service (IRS). Individuals who contribute up to \$2,000 (for all plans combined) to a traditional IRA or to an employer-sponsored retirement plan receive a proportional credit that reduces the amount of income tax they owe. The maximum credit is the lesser of \$1,000 or the amount of tax that would have been owed without the credit. The percentage of a contribution that can be claimed as a credit declines as income increases. For single workers with adjusted gross incomes under \$15,000 and families with incomes

under \$30,000, the credit is 50% of contributions up to \$2,000 for a maximum credit of \$1,000.<sup>1</sup> (See **Table 1**) Because the credit is based on adjusted gross income, it increases the net benefit of contributing to a retirement plan. For example, a married couple filing jointly with income of \$32,000 who contribute \$2,000 to a \$401(k) plan would reduce their taxable income to \$30,000 and thus also qualify for a \$1,000 tax credit. The net effect is that the \$2,000 contribution to the 401(k) plan costs them only \$1,000.

**Table 1. Credit Amounts for the Savers' Credit**

Filing Status and Adjusted Gross Income			Amount of Credit
Single	Head of Household	Married, Filing Jointly	
\$1 to \$15,000	\$1 to \$22,500	\$1 to \$30,000	50% of contribution up to \$2,000 (\$1,000 maximum credit)
\$15,001 to \$16,250	\$22,501 to \$24,375	\$30,001 to \$32,500	20% of contribution up to \$2,000 (\$400 maximum credit)
\$16,251 to \$25,000	\$24,376 to \$37,500	\$32,501 to \$50,000	10% of contribution up to \$2,000 (\$200 maximum credit)
More than \$25,000	More than \$37,500	More than \$50,000	Zero

The saver's credit is not available to taxpayers under age 18 or to full-time students. If a worker or spouse receives a pre-retirement distribution from a retirement plan (such as a hardship withdrawal), any credit taken in that same year and in the two subsequent years will be reduced by the amount of the distribution. For example, if an individual took a \$1,000 hardship withdrawal in 2003 and qualified for a \$500 credit for that year, \$500 of the hardship withdrawal would offset the \$500 credit in 2003. The remaining \$500 of the hardship withdrawal would offset any credits (up to \$500) in 2004 and 2005. Because it is non-refundable, some families may not benefit from the retirement savings tax credit because they have no net income tax liability. Also, the credit may not be large enough to provide a savings incentive for families with incomes near the upper limits. For families in the highest income bracket that qualifies for the credit, the maximum credit is \$200 for a contribution of \$2,000. On the other hand, families that increase their saving to claim the retirement savings credit and who are eligible for the earned income tax credit (EITC) may increase the amount of the EITC for which they qualify.

A sample of tax returns examined by the IRS showed that the retirement savings credit was claimed on 2.9% of 2002 tax returns. H&R Block, a tax preparation service, has estimated that clients who claimed the credit for tax year 2002 reduced their income tax by an average of \$175. Those who contributed to both an IRA and \$401(k) plan received an average tax credit of \$306. H&R Block also reports that many who claimed the credit were first-time contributors to a retirement savings plan.<sup>2</sup> This indicates that the saver's credit has encouraged some lower-income taxpayers to save for retirement.

<sup>1</sup> Adjusted gross income (AGI) includes wages, interest, capital gains, and income from retirement accounts after deducting contributions to certain retirement accounts, but before subtracting the standard deduction, itemized deductions, or personal exemptions.

<sup>2</sup> B. Tumulty, "White House Shuns Retirement Tax Credit," *Gannett News Service*, Feb. 20, 2004.