

Insight on the Issues

Improving the Saver's Credit for Low- and Moderate-Income Workers

Jennifer Erin Brown,
Manager of Research
National Institute on Retirement Security

David C. John
Senior Strategic Policy Advisor
AARP Public Policy Institute

EXECUTIVE SUMMARY

In 2001, Congress created the *Saver's Credit*, a tax credit available to low- and moderate-income taxpayers who contribute to a retirement savings plan. Although the number of taxpayers claiming the Saver's Credit has increased since its inception, it has only slightly improved retirement savings, due to the way that it is structured and administered.¹ Another key reason for the underutilization of the Saver's Credit is the fact that many low- to moderate-income taxpayers do not make a contribution to a retirement savings plan because they are not offered a payroll deduction retirement savings plan by their employers. Improving the Saver's Credit and making it easier to claim, along with increasing access to retirement savings accounts, could greatly increase the retirement security for many low- to moderate-income households.

This report reviews the existing structure of the Saver's Credit and proposes several ways to make it more effective; it also discusses the current retirement plan coverage for low- to moderate-income workers and considers a number of ways to improve both the effectiveness and the utilization of the credit.

This report finds the following:

- **Millions of low- to moderate-income individuals have been unable to use the credit.** The primary requirement to file for the credit is contributions to a qualified retirement plan. Among individuals whose income makes them eligible for the credit, many lack access to retirement accounts at work and cannot save through payroll deduction. For those individuals with the lowest incomes, not having a tax liability keeps millions of them from being able to use the credit as designed. In addition, by structuring the Saver's Credit with steep drops in the credit rates, a taxpayer can lose a significant amount of the credit by earning just a single dollar in additional income.
- **The Saver's Credit is woefully underutilized.** From 2006 through 2014, between 3.25 percent and 5.33 percent of eligible filers claimed the credit, and the average value of the credit ranged from \$156 to \$174 over this time period.
- **As currently structured, the Saver's Credit does not adequately help the low- and moderate-income individuals it was designed to assist.**



**Public Policy
Institute**

- **A series of changes—some small and others more substantial—would enable more of the tax credit’s target population to benefit from the Saver’s Credit and build significant retirement resources.** The most beneficial changes would be to restructure the credit into a match similar to the matching contribution some employers offer in their retirement savings plans and making the Saver’s Credit more like the Earned Income Tax Credit. Simplifying the tax-filing requirements would give low- and moderate-income individuals overall greater ease of use, helping them take advantage of a tax benefit that seeks to better balance the tax incentives for retirement across income levels.

I. INTRODUCTION

In a recent survey of Americans, 88 percent of individuals indicated that workers’ salaries were not keeping up with the cost of living, and this was a major factor that made it harder to prepare for retirement.² Increased debt was another major cause, with 83 percent of these same individuals reporting that it made preparing for retirement difficult.

To encourage individuals to save for retirement, public policy provides financial incentives in the tax code. The most common tax incentive for retirement savings occurs because the income tax due on contributions to employee retirement accounts is not paid until the employee withdraws money, typically during retirement. This is referred to as tax exclusion. Due to the nature of the tax system, the distribution of these retirement tax benefits is tilted toward higher earners. The Congressional Budget Office (CBO) reports that in 2013, two-thirds of the value of the favorable tax treatment went to the top quintile of taxpayers, while the bottom three quintiles shared 16 percent of the tax exclusion benefits that year.³

In 2001, as a way to level the playing field for low- and moderate-income retirement savers, Congress created a new *Saver’s Credit*, a tax credit designed to encourage low- and moderate- income workers to save for retirement. In order to take advantage of the credit, a filer must meet specified income

Requirements for the Saver's Credit



- ✓ Age 18 and over
- ✓ Not a full-time student
- ✓ Not claimed as a dependent on another filer’s return
- ✓ Make less than \$31,000 if single, or \$62,000 if married
- ✓ Make a retirement contribution to an IRA, 401(k), 403, or 457 plan
- ✓ File a U.S. Individual Income Tax Return using a Form 1040 or 1040A

requirements, contribute to a qualified retirement plan, file for the credit on his or her individual income tax return, and have a tax liability on his or her individual tax return.

Although the number of taxpayers claiming the Saver’s Credit has increased to almost 8 million taxpayers in 2014, the credit has, unfortunately, only slightly improved retirement savings due to the way that it is structured.⁴ A key factor in the current utilization level of the Saver’s Credit is that many low- to moderate-income taxpayers do not make contributions to a retirement savings plan; many of them lack access to an employer-sponsored retirement savings plan or to a payroll deduction retirement savings program through their employer.

Ownership of retirement savings accounts by households is highly concentrated among higher earners. Just 21 percent of households that earn less than \$21,000 a year and 51 percent of households that earn less than \$41,035 a year own retirement

accounts.⁵ The typical household that earns less than \$67,200 a year has no retirement savings, while the average savings held in retirement accounts by households with incomes of less than \$53,657 a year (the median household income in 2014) is \$99,372.⁶

Estimates of the number of Americans without access to an employer-sponsored retirement savings plan vary,⁷ but about 55 million US wage and salary workers between the ages of 18 and 64 do not have payroll deduction to save for retirement.⁸

Low- to moderate-income workers are the least likely to be offered a payroll deduction retirement savings plan by their employers. At best, these workers may have intermittent coverage during their careers, and at worst, they have no coverage at all. This leaves them at retirement with little more than their Social Security benefits, which average only about \$1,300 a month.⁹ Improving the Saver’s Credit, making it easier to claim, and increasing access to payroll deduction retirement savings accounts could greatly boost low- to moderate-income households’ retirement security.

This report reviews the existing structure of the Saver’s Credit and proposes several ways to make it more effective. Section II offers a brief description of the credit; section III discusses the current retirement plan coverage for low- to moderate-income workers. Section IV considers a number of ways to improve both the effectiveness and the utilization of the credit. Section V concludes by summarizing issues with the credit as well as policy proposals that can improve it.

II. THE SAVER’S CREDIT: BACKGROUND

Enacted in 2001, the *Elective Deferrals and IRA Contributions by Certain Individuals* tax credit is commonly referred to as the *Saver’s Credit*. As displayed in **Table 1**, Taxpayers with yearly incomes of less than \$31,000 for single filers and \$62,000 for married filers in 2017 can claim a credit of up to \$1,000 for contributions to a qualified retirement plan or individual retirement account (IRA) if they have a tax liability.¹⁰ As currently structured, the Saver’s Credit provides taxpayers who fall within its income limits with tax credits equal to 50 percent, 20 percent, or 10 percent on up to \$2,000 of the amount individuals saved in a qualifying retirement account.¹¹ Taxpayers filing married or joint returns in 2017 with adjusted gross incomes under \$37,000 a year can qualify for a 50 percent tax credit, while those with incomes between \$37,001 and \$40,000 a year qualify for a 20 percent credit, and those with incomes between \$40,001 and \$62,000 a year qualify for a 10 percent credit.¹²

The Saver’s Credit evolved from a series of efforts in the late 1990s to expand retirement plan coverage among low- and moderate-income workers and to distribute tax-preferred retirement benefits more evenly along the income scale. It was first proposed in 2000, when the Treasury Department designed a refundable tax credit for low- and moderate-income savers earning at least \$5,000 a year who contributed to a qualified defined contribution retirement savings account or a defined benefit pension plan. This expansive tax credit was designed to act like a matching contribution to the retirement account, and income-eligible workers

TABLE 1
2017 Saver’s Credit Income Eligibility and Credit Rates

2017 Saver’s Credit			
Credit Rate	Married Filing Jointly	Head of Household	All Other Filers
50% of your contribution	Adjusted Gross Income not more than \$37,000	Adjusted Gross Income not more than \$27,750	Adjusted Gross Income not more than \$18,500
20% of your contribution	\$37,001–\$40,000	\$27,751–\$30,000	\$18,501–\$20,000
10% of your contribution	\$40,001–\$62,000	\$30,001–\$46,500	\$20,001–\$31,000
0% of your contribution	More than \$62,000	More than \$46,500	More than \$31,000

Source: Internal Revenue Service

would get the credit regardless of income tax liability (a refundable tax credit). In 2000, the Treasury Department estimated the proposal to cost \$54 billion in tax revenue over 10 years.¹³

Concerned by the potential cost of the proposal, as part of the Economic Growth and Tax Relief Reconciliation Act of 2001, Congress passed a nonrefundable version of the Saver's Credit that was estimated to cost \$10 billion in tax revenue.¹⁴ Initially, the credit was temporary and was to expire after five years. In addition, eligibility was based on income limits that were not indexed for inflation. Both of those features were changed by a provision in the Pension Protection Act of 2006 (PPA).¹⁵

In spite of the legislation's intended purpose, millions of low- to moderate-income people have been unable to use or have not opted for the credit. Reasons include failure to contribute to a qualified retirement plan, failure to file for the credit, or insufficient tax liability to receive a tax credit. In addition, by structuring the credit with steep drops in the credit rates, taxpayers can lose a significant amount of the credit by earning just a single dollar in additional income. These shortcomings, combined with a general lack of awareness of the credit among taxpayers, severely limit its use.

Concerns about the Saver's Credit were raised almost immediately—as were potential solutions. A 2005 study found that in the credit's first year (2001), 5.3 million taxpayers claimed almost \$1 billion using the Saver's Credit.¹⁶ However, almost 43 percent of the taxpayers who qualified to receive a 50 percent credit, and who claimed the credit, received less than they could have because they had a tax liability that was lower than the amount of the credit. The study also found that almost 86 percent of taxpayers with income levels making them eligible for the credit did not claim it—in most cases because they had not made a contribution to a savings plan.

Looking at more years of data, the CBO calculated that 25 percent of all workers who filed tax returns in 2006 were eligible to claim the Saver's Credit based on their income and tax liability, yet only 13 percent (5.6 million) of those eligible filers claimed the credit—receiving an average amount of \$156.¹⁷ Eighteen percent of those who filed a tax return met the income criteria for the Saver's Credit but

received no benefit because they had no tax liability to be offset. This was true regardless of whether they had made a contribution to an account. Overall, this study suggested that only 3.25 percent of all tax filers used the Saver's Credit in 2006.

This underutilization continues with low- and moderate-income tax filers who receive modest credits. In 2014, the average value of the Saver's Credit equaled \$174 and the number of tax filers claiming the credit increased to 7.9 million, or 5.33 percent of all filers. In total, working Americans received nearly \$1.4 billion dollars as Saver's Credit benefits. **Figure 1** displays the most recent claiming history of the Saver's Credit, showing a 30 percent increase from the 4.18 percent of filers who claimed the credit in 2007 to the 5.33 percent who claimed it in 2014. Over the 2007–14 period, the average amount claimed by taxpayers has varied by \$14 or less, as shown in **Figure 2**, although the value of the credit claimed has generally increased since the end of the most recent recession.¹⁸

III. RETIREMENT PLAN COVERAGE IS A KEY FACTOR IN SAVER'S CREDIT UNDERUTILIZATION

As noted above, a key reason for underutilization of the Saver's Credit is the fact that many low- to moderate-income taxpayers do not make a contribution to a retirement savings plan. In most cases, their employers do not offer a plan that uses payroll deduction. The share of the workforce covered by an employer-sponsored payroll deduction retirement saving plan has remained relatively flat in recent decades. In 1987, about 51 percent of private-sector workers ages 21 to 64 had access to a retirement savings or pension plan through their employers. The share of the workforce covered by plans rose to 59 percent by 2000, but then fell gradually back to 51 percent as of 2013.¹⁹ It is true that workers without such a plan could, in theory, use an IRA to save, but only about 1 in 20 workers with earnings of \$30,000 to \$50,000 a year and no access to a payroll deduction plan actually contribute to an IRA consistently.²⁰

About 55 million US wage and salary workers between the ages of 18 and 64 lack access to an employer-related payroll deduction plan.²¹ Younger workers, members of minority groups, and those with low to moderate incomes are more likely to work for

FIGURE 1
Percentage of Returns Eligible Compared with Returns that Actually Claimed the Saver's Credit, Tax Years 2008–13

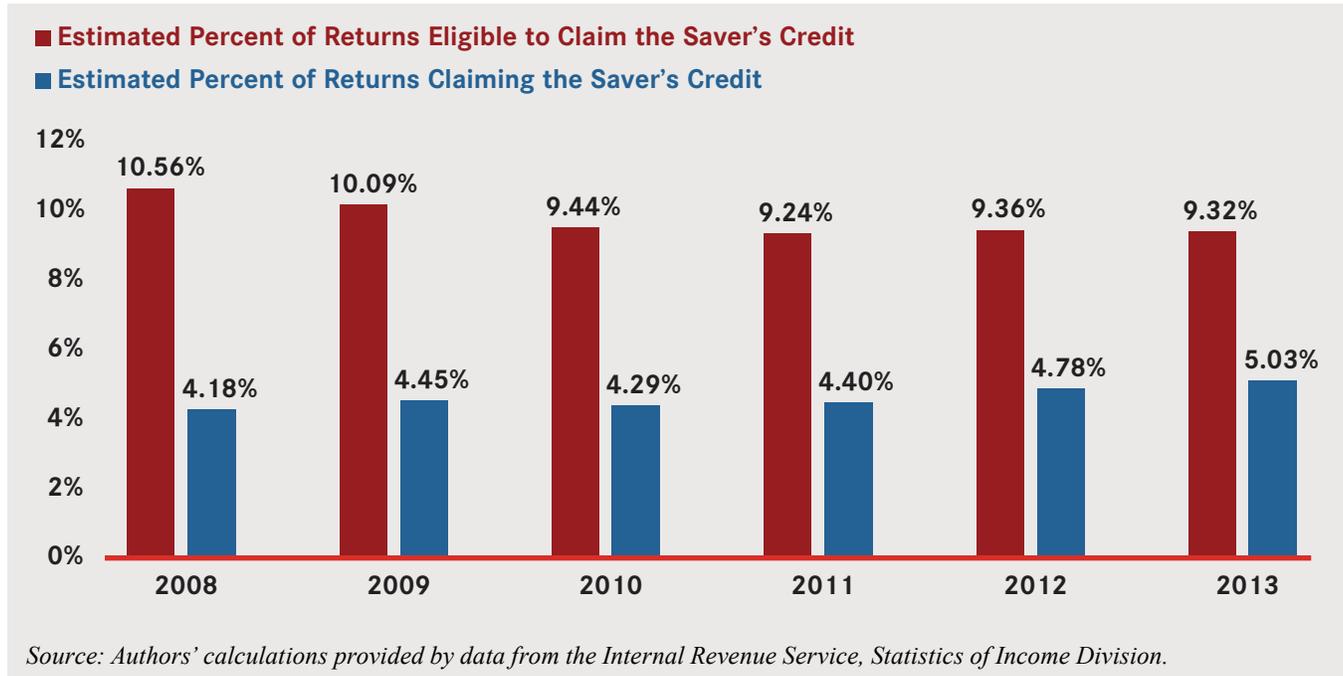
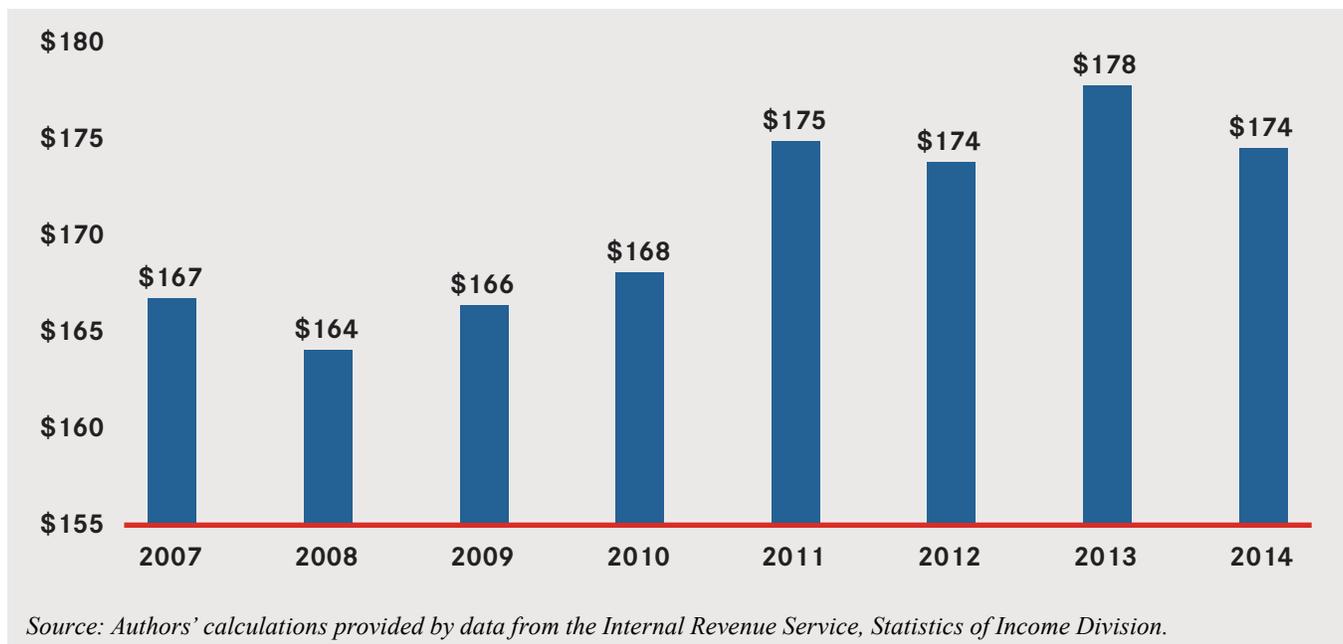


FIGURE 2
Average Amount of the Saver's Credit, Tax Years 2007–14



an employer without a pension or retirement plan.²² 66 percent of Hispanics, 50 percent of African Americans, and 52 percent of Asian-Americans do not have access to an employer-sponsored retirement plan. In addition, 75 percent of workers earning less than \$14,000 a year lacked such a plan, as did 63 percent of workers earning between \$14,000 and \$25,000 a year.²³

Small-business employees are especially at risk. A US Government Accountability Office (GAO) study found that only about 14 percent (1 in 7) of businesses with 100 or fewer employees offer their employees a retirement plan. GAO also found that for the 42 million people who work for a small business, estimates of those who lack the ability to save for retirement via an employee plan were between 51 percent and 71 percent.²⁴

Notably, savings rates have less to do with income levels than one might think; savings variability, it appears, has more to do with retirement plan access. When employees are presented with a plan at work that provides guidance, they take the opportunity to save. This is true at all income levels. The same GAO study on why lower-income people are less likely to save showed very similar participation rates in plans among income levels.²⁵ Eighty-six percent of those with incomes under 300 percent of the poverty line participated in a retirement savings system or pension if they were offered one and were eligible, compared with 95 percent of those with higher incomes.²⁶ Since the PPA clarified the use of automatic enrollment in retirement plans, retirement savings plans have reported higher participation levels among employees at lower income levels.²⁷

The Employee Benefit Research Institute’s 2017 Retirement Confidence Survey²⁸ demonstrated both the value of a workplace plan and the cost of not having one. It found that about 67 percent of employees with access to a retirement savings plan through their employer had more than \$25,000 saved, and 45 percent had \$100,000 or more saved.²⁹

Current Steps in Claiming the Saver’s Credit

- ✓ **Save for Retirement.** Contribute to an IRA or a 401(k), 403(b), or 457 plan!
- ✓ **Confirm Income Makes You Eligible.** You must make less than \$62,000 if married and \$31,000 if single.
- ✓ **Prepare and File Your Taxers Using a “Long-Form” 1040.**
- ✓ **Complete a Form 8888 to Calculate Amount of Saver’s Credit.**

However, 87 percent of those without access to such a plan had less than \$25,000 in total savings and investments, and only 5 percent had \$100,000 or more.

Increasing the number of low- to moderate-income workers who are offered a payroll deduction to save for retirement would be beneficial in itself, but it would also enable a greater number of taxpayers to utilize the Saver’s Credit. A worker, of course, cannot benefit from the credit without first contributing to a retirement plan; thus, increasing the number of workers participating in retirement plans has the added benefit of reducing the underutilization, and it is one key piece of the solution to realizing the credit’s true potential.

IV. OPPORTUNITIES FOR IMPROVING THE STRUCTURE OF THE SAVER’S CREDIT AND EXPANDING THE ABILITY TO RECEIVE IT

As currently structured, the Saver’s Credit does not adequately help the low- and moderate-income individuals it was designed to assist; however, a series of changes—some small and others more substantial—would enable more of the tax credit’s target population to benefit from it and build significant retirement resources. This section covers several options for potential reforms, starting with the most aggressive.

A. Make the Saver’s Credit a Savings Match

The best way to encourage low- to moderate-income workers to save for retirement and to build their retirement balances would be to replace the

existing Saver's Credit with a savings match. The match approach is easier to understand and helps further build retirement savings. Eligible savers would receive a match equal to 50 percent of the amount they contributed during that tax year. It would be claimed through their tax return and would go directly into their retirement savings account. As a further part of the reform, once the match is there, it would remain in the account until the saver reaches retirement age, resulting in a higher amount at retirement, since the investment earnings on the match would also be added to the retirement principal. The match would phase out gradually for higher incomes.

This structure is far superior to the existing credit for a number of reasons. First, the match helps members of the target population build their savings balances much faster. This will be especially true for younger savers who will see these increased amounts grow even more over time. For example, a \$1,000 match contributed to a retirement account at

age 25 would accumulate to more than \$10,000 by age 65, assuming an interest rate of 6 percent. As a result, when participants reach retirement, savers will be more likely to have enough to supplement their Social Security benefits for a more secure retirement. As a side benefit, as more workers are able to build their own retirement assets, they will have less need to rely on other taxpayer-financed programs.

Second, the match provides a definite incentive to save. While tax benefits have only a limited impact on retirement savings, a properly structured match encourages more people to save—and to save more than they might have otherwise. For instance, one study of IRA contributions at tax time found that a match resulted in more people saving and higher contributions among those who saved.³⁰ Several 401(k) studies have found similar results.³¹ Because few low- to moderate-income workers are employed by companies that offer a retirement plan at all, much less an employer match, we believe that a federal

THE BENEFITS OF A SAVINGS MATCH: A CASE STUDY

The Women's Institute for a Secure Retirement (WISER) developed the Appalachian Savings Project in the mid-Appalachian region of Ohio and West Virginia; the project ran between December 2012 and June 2015.³⁵ The project, which followed 28 low-income childcare workers for a period of one year, simulated a refundable Saver's Credit by providing participants with a 50 percent savings match for the purchase of up to \$500 of Series I US Savings Bonds.³⁶

On average, participants purchased \$767 in savings bonds during the course of the project and received a match of \$383.³⁷ The participants' total savings, including the match, averaged \$1,150, which was 5.5 percent of their incomes.³⁸ Participants reported saving an average of \$1,227 due to the program, which was higher than their savings bond accumulations.³⁹

Through surveys and interviews with program participants, it became clear that the match

is the primary reason why they signed up for the program and purchased savings bonds. Specifically, participants reported saving an extra \$692 that they otherwise would not have saved without the match.

One participant said, "I set [the automated savings bond purchase] a little higher than what I normally would have; however, I really wanted that match."

Another said, "The match forced me to save."

One participant showed complete awareness of the program design in commenting, "I know some companies match what you put into your 401(k), and that's similar to what this is."

As WISER points out, this program shows that a low-dollar, easily accessible savings vehicle, combined with a matched incentive to save, can produce significant savings by low-wage earners.⁴⁰ In this case, the program participants' estimated monthly incomes were \$1,761, or about \$21,000 annually.

match will improve both participation and savings amounts. An example based on a recent study appears later in this section.

Third, a match is simple to understand, claim, and administer. As the accompanying case study to this paper attests (see sidebar, “The Benefits of a Savings Match: A Case Study”), taxpayers will quickly grasp that for every dollar they save in an eligible account, they will receive an additional 50 cents, declining to lower levels as their incomes increase. If the match is included on all income tax forms, a reform that we propose later in this paper, all taxpayers with eligible income levels will find it much easier to claim it. And once the current structure changes, it will be simple for the Internal Revenue Service (IRS) to verify eligible savings by workers and to direct the match to providers for inclusion in the account.³²

Finally, the reformed structure guarantees that the match is used only for its intended purpose by restricting any withdrawals of the match until a specified age. While the taxpayer’s contributions are his or her individual property and can be withdrawn early under certain conditions, this would not apply to the match. Because it goes directly into the account and remains there, the match cannot be used for other purposes; further, if it has been claimed inappropriately, the match can easily be repaid. Savers receiving the match will be notified that the match amounts are not eligible for early withdrawal.

Recent technological advances make the reform to create a match feasible. Today, very few retirement accounts carry routing numbers that would make direct deposit of a match possible; however, implementation of a match would spur such a change, and in the interim, the Treasury Department can send providers a single wire transfer containing the match amount for many or all of their eligible customers’ accounts along with a memo with information on which account numbers should receive a match and how much each is due. Because retirement accounts are matched with the owner’s Social Security number, crediting the individual accounts would be fairly simple. The match would be invested the same way as the rest of the account, with earnings on the match also being ineligible for early withdrawal.

Similarly, record keepers are now able to subdivide retirement accounts. As a result, it would be possible for them to keep a separate record of federal matches received and to prevent those funds from being accessed before the account owner reaches a specified retirement age.³³

One key question is how to ensure that owners of both Roth and traditional accounts receive the same tax treatment upon withdrawal. Otherwise, during retirement Roth account owners would be able to receive the match and any earning it generates tax-free, but traditional account owners would have to pay income tax on those amounts. The simple solution is to treat the match like a Roth contribution. If the match is already accounted for separately from the rest of the account, then making its tax treatment like a Roth contribution, including deeming the match to be an after-tax contribution, would be fairly simple. However, when the taxpayers reach retirement, traditional account owners will need some form of notification to let them make appropriate withdrawal choices.³⁴

B. Make It Easier to Claim the Saver’s Credit

Changes to the existing filing requirements would provide another opportunity for reform that could improve usability and ultimately foster more savings. Today, low- to moderate-income individuals and families must jump through two hoops in order to file for the Saver’s Credit. These two hoops are not required for other tax credits that target the same population. First, they must file a “long-form” 1040 or 1040A form—they cannot file a 1040EZ form. Second, they must also complete a Form 8880, which requires the filer to record the total amount of distributions received from his or her retirement plans for the prior three years.

In order to best assist low- and moderate-income taxpayers, the most important reform would be to allow eligible taxpayers to claim the Saver’s Credit on the 1040EZ form. Regardless of what other changes are made, this is an essential step toward increasing the number of eligible taxpayers who can claim the credit. A second important step would be to require the IRS to make the credit’s availability more prominent on all relevant tax forms. Additionally, employers that offer a

retirement savings plan should include prominent information on the Saver's Credit and its eligibility standards when employees sign up for the plan or are automatically enrolled in it.

Compared with filing for the Earned Income Tax Credit (EITC), which is also designed to benefit low- and moderate-income individuals, filing for the Saver's Credit is significantly more complicated for a much smaller tax credit value.⁴¹ The EITC does not require the use of a long-form 1040 or 1040A and allows the individual to claim that credit using a 1040EZ. In addition, the EITC only requires taxpayers to file a short six-question worksheet rather than a separate form, with no look-back to previous years' income required. Given these hoops, it is not surprising that in 2014, while 15.04 percent of taxpayers who were income eligible filed for the EITC, only 5.33 percent of taxpayers who were income eligible filed for the Saver's Credit.⁴²

In order to improve utilization of the Saver's Credit, its filing requirements should more closely mirror those of the EITC. In addition to being able to claim the Saver's Credit on the 1040EZ form, individuals wishing to file for the Saver's Credit should be able to complete a simple worksheet that asks their income, filing status, and retirement contributions and recent withdrawals in order to calculate their credit. By eliminating these hoops, many more individuals will be able to claim the Saver's Credit and will be incentivized to save more for retirement.

Previously discussed features of the new mechanism, meanwhile, would eliminate the need for Form 8880, which includes information on withdrawals from retirement savings plans and is designed to prevent taxpayers from claiming the credit and then promptly withdrawing the qualifying savings. As discussed above, the need for such a look-back requirement could be eliminated if the Saver's Credit were deposited directly into the retirement account and taxpayers were prevented from withdrawing it until a set age. Using a worksheet or having the credit directly deposited to the retirement account would serve as a substitute for the filing of Form 8880. The same type of withdrawal restrictions could also be imposed on

personal contributions used to qualify for the Saver's Credit, either permanently or for a set minimum period of time.

C. Increase the Percentage of Workers Who are Eligible to Receive the Credit

Another reform to make the Saver's Credit more effective would be to increase the income limits so that more people would be eligible for it and to phase it out as income increases; however, for maximum effectiveness, these moves should be combined with turning the credit into a match.

A number of papers proposing reforms include this provision and propose various income limits.⁴³ These papers are also joined by a number of legislative proposals, the most recent of which is the Encouraging Americans to Save Act from Senator Ron Wyden.⁴⁴ In both the Wyden bill and the Obama budget, taxpayers with incomes up to \$65,000 a year would qualify for the 50 percent match, while those with incomes up to \$85,000 a year would qualify for a smaller amount.

Raising the income limits would increase the number of people who could claim the Saver's Credit, but the newly eligible taxpayers would also be more likely to have a positive tax liability that could be offset by the credit. Thus, the budgetary impact could be significant, depending on how many additional savers would receive the credit and in what amounts. One way to reduce the cost would be to reduce the maximum amount that the saver could receive. For instance, the 2011 Obama budget proposed to reduce the credit to a maximum of 50 percent of the first \$1,000 saved; this reduction is also included in the 2012 Aspen proposal, the 2016 Wyden legislation, and other plans.

D. Replace "Cliff" Income Limits with Gradual Phase-Out of the Credit

Another improvement over the existing Saver's Credit would be to replace the three levels of credit based on exact-dollar income limits with one level that is phased out gradually. Currently, earning a mere one dollar in additional income could see the credit shrink from 50 percent of savings to just 20 percent. A 50 percent credit that gradually phases down to zero would be just as simple to administer

by the IRS, but it would provide potentially greater benefits to the saver. The budgetary impact would depend on how fast the phase-out is and at which income level it starts; it could be structured to be budget neutral.

E. Further Publicize the Saver's Credit

The emergence of state-sponsored retirement savings plans⁴⁵ for small-business employees will increase the opportunity for a greater number of eligible savers to file for the Saver's Credit. Under such a state program, information about potential eligibility for the credit should be provided to all new participants in state-sponsored plans as well as in year-end statements of account balances. While not all participants will qualify for the Saver's Credit, it would be simpler and cheaper to make this information available to all savers rather than to try to target specific groups.

Most states that have passed legislation on a state-sponsored retirement savings plan require employers to offer their employees either the state plan or a comparable plan available through private providers. Faced with this choice, a recent study suggests, about half of the affected employers may choose to open a plan from a private provider.⁴⁶ In order to reach these savers and provide a tax-time reminder, states should also provide clear notice about claiming the federal Saver's Credit in their state income tax instructions. As many state income taxes are based on information from the federal tax form, this information would allow savers to go back to the federal form if they have not filed for the credit.

F. Create State Tax Benefits Similar to the Federal Tax Credit

Another way to increase both retirement savings and the usage of the Saver's Credit would be for states to create additional tax benefits that would be both on top of the federal Saver's Credit and linked to it. In order to receive the state credit for retirement savings, the taxpayer would first have to claim the federal Saver's Credit. Such a move would be in the long-term interest of the states, as several recent studies show that an increase in retirement assets would reduce the cost of several subsistence programs to state taxpayers.⁴⁷ States could look

to similar existing tax credits that could provide a model for state retirement savings credits.

Examples of state tax credits that could be used as models include the following:

- The section 529 college savings plan, which is an investment account run by a state that qualifies for both federal and state tax deductions in order to encourage individuals to save for college. Currently, 34 states and Washington, D.C., offer full or partial state tax deductions for contributions, with six of those states extending the credits to individuals making contributions to any state 529 plan.⁴⁸ Congress legalized such college savings plans under the Small Business Job Protection Act of 1996, and almost 13 million Americans have used them to save more than \$250 billion.⁴⁹
- Maryland's Long-Term Care Credit, a one-time tax credit of up to \$500 for individuals that purchase long-term care insurance contracts for themselves or family members⁵⁰
- Indiana's Unified Tax Credit for the Elderly, a refundable tax credit for low-income seniors—up to \$100 for an individual or \$140 for a couple, depending on age, marital status, and income⁵¹
- The Massachusetts Real Estate Tax Credit, or the Circuit Breaker Credit, which provides seniors (age 65 or older) with a refundable tax credit on the payment of either the real estate tax, if they are homeowners, or rent, if they are not⁵²
- The Montana Elderly Homeowner/Renter Credit, a refundable tax credit for seniors up to \$1,000, depending on age, residency, income of all household members, and the amount paid in rent or property taxes.⁵³

As these examples show, states could easily develop a tax benefit that could supplement the federal Saver's Credit and encourage its use. This credit could be an add-on that goes directly into the individual's account—especially if the state sponsors a retirement savings plan that the saver is part of—or it could be a credit against state income or other taxes.

V. CONCLUSION

The existing Saver's Credit could do a better job of serving its target population. In its current form, the credit is overly complex, poorly publicized, available only on tax forms that its target population is least likely to use, and available mainly to people who will have insufficient tax liability to receive it. Further, because the credit does not go into the taxpayer's retirement account and is not required to stay there until retirement, it may not achieve its purpose of building additional retirement security.

However, with some revisions, the Saver's Credit or, better still, a match that substitutes for it,

could become an effective tool for increasing the retirement incomes of those who most need assistance. Even if an optimal reform is not chosen, there are a number of smaller available Saver's Credit improvements—such as allowing it to be claimed on the 1040EZ or eliminating the income cliffs—that could increase its utilization. Nevertheless, the optimal reform of the Saver's Credit—that is, to change it to a match—could both increase savings for the target population and reduce potential costs that states and the federal government may otherwise face in providing for those who retire with little more than Social Security benefits.

-
- 1 Testimony of J. Mark Iwry before the US Senate Special Committee on Aging, April 2005, <http://www.aging.senate.gov/imo/media/doc/hr139mi.pdf>.
 - 2 Diane Oakley and Kelly Kenneally, "Retirement Security 2017: A Roadmap for Policy Makers," National Institute on Retirement Security, Washington, DC, 2017.
 - 3 Congressional Budget Office (CBO), "The Distribution of Major Tax Expenditures in the Individual Income Tax System," CBO, Washington, DC, 2013. The Joint Committee on Taxation estimates the value of the tax exclusion for defined contribution plans to be \$584 billion over the period of 2016 to 2020: House Committee on Ways and Means, "Estimates of Federal Tax Expenditures for Fiscal Years 2016-2020," Washington, DC, 2017, Accessed on 14 August 2017, <https://www.jct.gov/publications.html?func=startdown&id=4971>.
 - 4 Testimony of J. Mark Iwry.
 - 5 Nari Rhee and Ilana Boivie, "The Continuing Retirement Savings Crisis," National Institute on Retirement Security, Washington, DC, 2015.
 - 6 Authors' calculations provided by data from the U.S. Census Bureau's Survey of Income and Program Participation (SIPP) and the Internal Revenue Service, Statistics of Income Division. This number includes only households with retirement balances. The median retirement savings for households with retirement savings is \$40,000.
 - 7 Estimates vary depending on data source and whether it includes both full- and part-time private-sector employees or if state and federal government employees are included.
 - 8 David John and Gary Koenig, "Workplace Retirement Plans Will Help Workers Build Economic Security," AARP Public Policy Institute, Washington, DC, October 2014; Nari Rhee, "Proposed Congressional Repeal of Federal Regulations Supporting State Auto-IRAs Threatens Retirement Security of 13 Million Workers in Five States," UC Berkeley Center for Labor Research and Education, Berkeley, CA, 2017.
 - 9 "Monthly Statistical Snapshot, May 2017," Social Security Administration, June 2017, Accessed on 14 August 2017, https://www.ssa.gov/policy/docs/quickfacts/stat_snapshot/2017-05.html.
 - 10 For the 2017 tax year, single taxpayers with yearly incomes of less than \$31,000, married taxpayers with incomes less than \$37,000, and head of household taxpayers with incomes of less than \$27,750 will be eligible for the Saver's Credit.
 - 11 Qualifying accounts include a traditional or Roth IRA; a traditional 401(k), SIMPLE IRA, SARSEP, 403(b), 501(c)(18) or governmental 457(b) plan; and Roth 401(k) and 403(b) plans.
 - 12 For those filing as head of household, the income limits are \$27,750, \$30,000, and \$46,126. For all other filers, they are \$18,500, \$20,000, and \$30,750.
 - 13 Jane Gravelle, "Individual Retirement Accounts (IRAs): Issues, Proposed Expansion, and Retirement Savings Accounts (RSAs)," RL30255, Congressional Research Service, Washington, DC, September 2000.

- 14 Section 25B of the Internal Revenue Code was added by Economic Growth and Tax Relief Reconciliation Act of 2001 (Pub. L. No. 107-16, § 618, 115 Stat. 38). See also IRS Announcement 2001-106, 2001-44 I.R.B. (Oct. 29, 2001), IRS Announcement 2001-120, 2001-2 CB 583 (Nov. 23, 2001), and IRS News Release IR 2001-107, 2001-44 I.R.B. (Oct. 29, 2001).
- 15 Pension Protection Act of 2006 (Pub. L. No. 109-280, 120 Stat. 780).
- 16 Gary Koenig and Robert Harvey, "Utilization of the Saver's Credit: An Analysis of the First Year," *National Tax Journal* 58, no. 4 (2005): 787–806, Accessed on 14 August 2017, <http://www.ntanet.org/NTJ/58/4/ntj-v58n04p787-806-utilization-saver-credit-analysis.pdf?v=%CE%B1&r=10061070252614357>.
- 17 Congressional Budget Office (CBO), *Use of Tax Incentives for Retirement Saving in 2006* (Washington, DC: CBO, October 2011), Accessed on 14 August 2017, <https://www.cbo.gov/sites/default/files/112th-congress-2011-2012/reports/2011-10-14-TaxIncentives.pdf>.
- 18 Author's calculations provided by data from the Internal Revenue Service, Statistics of Income Division.
- 19 Craig Copeland, "Employment-Based Retirement Plan Participation: Geographic Differences and Trends," EBRI Issue Brief 45, Employee Benefit Research Institute, Washington, DC, 2014.
- 20 Employee Benefit Research Institute, Unpublished estimates of the 2004 Survey of Income and Program Participation Wave 7 Topical Module, 2006.
- 21 David John and Gary Koenig, "Workplace Retirement Plans."
- 22 Nari Rhee and Ilana Boivie, "Continuing Retirement Savings Crisis."
- 23 Jennifer Brown, "Retirement Insecurity for Asian Americans," National Institute on Retirement Security, Washington, DC, 2017.
- 24 Testimony of C. Jeszeck, "Retirement Security: Challenges and Prospects for Employees of Small Businesses," GAO-13-748T, US Government Accountability Office, Washington, DC, July 2013, Accessed on 14 August 2017, <http://www.gao.gov/assets/660/655889.pdf>.
- 25 US Government Accountability Office (GAO), "Automatic IRAs: Lower-Earning Households Could Realize Increases in Retirement Income," GAO-13-699, GAO, Washington, DC, August 2013, Accessed on 14 August 2017, <http://www.gao.gov/assets/660/657171.pdf>.
- 26 April Y. Wu and Matthew S. Rutledge, "Lower-Income Individuals without Pensions: Who Misses Out and Why," CRR Working Paper 2014-2, Boston College Center for Retirement Research, Chestnut Hill, MA, March 2014, Accessed on 14 August 2017, <http://crr.bc.edu/working-papers/lower-income-individuals-without-pensions-who-misses-out-and-why/>.
- 27 Jeffrey Clark, Stephen Utkus, and Jean Young, 2015 (Jan.), "Automatic enrollment: the power of default." Vanguard Research, p. 5, Valley Forge, PA.
- 28 Employee Benefit Research Institute (EBRI), "Preparing for Retirement in America," 2016 RCS Fact Sheet 3, EBRI, Washington, DC, 2016, Accessed on 14 August 2017, https://www.ebri.org/files/RCS_16.FS-3_Preps.pdf.
- 29 This question applies to employees of all ages.
- 30 Esther Dufo et al., "Saving Incentives for Low- and Middle-Income Families: Evidence from a Field Experiment with H&R Block," National Bureau of Economic Research, Cambridge, MA, October 2005, Accessed on 14 August 2017, <http://www.nber.org/papers/w11680>.
- 31 Gur Huberman, Sheena Iyengar, and Wei Jiang, "Defined Contribution Pension Plans: Determinants of Participation and Contributions Rates", *Journal of Financial Services Research* 31, no. 1 (2007):1-32, Accessed on 14 August 2017, <https://link.springer.com/article/10.1007%2Fs10693-007-0003-6>; and Olivia Mitchell, Stephen Utkus, and Tongxuan (Stella) Yang, "Turning Workers Into Savers? Incentives, Liquidity, and Choice in 401(K) Plan Design", *National Tax Journal* 60 (2005):469-489, find that employer match rates significantly increase 401(k) participation.
- 32 Contributions to 401(k)-type accounts are noted on the employees' W-2 earnings form, while trustees report contributions to an IRA on Form 5498.
- 33 While individual contributions are available for withdrawal without penalty starting at age 50 ½, this does not need to be the age at which matching contributions can be withdrawn. Instead, withdrawals could be restricted until the account owner is eligible for Social Security retirement benefits or qualifies for a Social Security disability benefit.

- 34 In addition to the notice, rules and/or the law will need to specify how the match and earnings on it would be treated if withdrawal rules and/or tax treatment is different from the underlying account. For instance, are first distributions from the retirement account coming from employee contributions, the government match, or is it on a pro-rata basis? For instance, if the overall account has traditional after-tax treatment for employee contributions and a subaccount with Roth tax treatment for the government match, should withdrawals first come from the employee contributions and earnings on them, which are taxable as income, or from the government match and earnings on them, which are not taxable? Alternately, they could be a mixture of both, in which case only a proportion of the total would be taxable.
- 35 Collin O'Rourke, "Savings Matches, Small Dollar Accounts, and Childcare Worker's Decisions to Save: 2012-2015 Appalachian Savings Project," Women's Institute for a Secure Retirement, Washington, DC, 2015.
- 36 Ibid.
- 37 Collin O'Rourke, "Savings Matches."
- 38 Collin O'Rourke, "Savings Matches."
- 39 Collin O'Rourke, "Savings Matches."
- 40 Kathy Stokes and Lara Hinz, "Creating Opportunity: The Impact of Matched Savings for Childcare Workers", Women's Institute for a Secure Retirement, Washington, DC, 2016.
- 41 According to data from the Internal Revenue Service, the \$2,400 average EITC benefit paid in 2014 is more than 10 times the average Saver's Credit benefit of \$174 in the same year. Internal Revenue Service, "Statistics for 2014 Tax Year Returns With EITC", Washington, DC, 2016, Accessed on 14 August 2017, <https://www.eitc.irs.gov/EITC-Central/eitcstats/2014stats>.
- 42 Authors' calculations from Internal Revenue Service, Statistics of Income, 2015, "Individual Income Tax Returns, Line Item Estimates," Accessed on 14 August 2017, <https://www.irs.gov/pub/irs-soi/13inlinecount.pdf>.
- 43 William G. Gale, J. Mark Iwry, and Peter R. Orszag, "The Saver's Credit: Expanding Retirement Savings for Middle- and Lower-Income Americans," The Retirement Security Project, Washington, DC, 2005, Accessed on 14 August 2017, <https://www.brookings.edu/wp-content/uploads/2016/06/20050310orszag.pdf>; Camille Busette and Jordan Eizenga, "A Small Change to the Saver's Credit Can Go a Long Way," Center for American Progress, Washington, DC, January 2012, Accessed on 14 August 2017, https://cdn.americanprogress.org/wp-content/uploads/issues/2012/01/pdf/small_change_savers_credit.pdf; Lisa Mensah, Raymond O'Mara III, Colby Farber, and Robert Weinberger, "The Freedom Savings Credit: A Practical Step to Build Americans' Household Balance Sheets," The Aspen Institute, Washington, DC, February 2012, Accessed on 14 August 2017, https://assets.aspeninstitute.org/content/uploads/files/content/docs/pubs/FreedomSavingsCredit_0.pdf; 2011 Office of Mgmt. & Budget, Exec. Office of the President, Budget of the United States Government, Fiscal Year 2011 (2010), Accessed on 14 August 2017, <https://www.gpo.gov/fdsys/pkg/BUDGET-2011-BUD/pdf/BUDGET-2011-BUD.pdf>.
- 44 Encouraging Americans to Save Act, S. 2492, 114th Cong. (2016), Accessed on 14 August 2017, <http://www.finance.senate.gov/imo/media/doc/020316%20Savers%20Credit%20Bill.pdf>.
- 45 To date, eight state have passed legislation on this subject, with California, Connecticut, Illinois, Maryland, and Oregon setting up Secure Choice plans based on the Automatic IRA; New Jersey and Washington setting up marketplaces where employers can choose among plans meeting certain specifications; and Massachusetts setting up a 401(k)-like plan for employees of small nonprofits.
- 46 The Pew Charitable Trusts, "Small Business Views on Retirement Savings Plans," The Pew Charitable Trusts, January 2017, Accessed on 14 August 2017, http://www.pewtrusts.org/~media/assets/2017/01/small-business-survey-retirement-savings_f.pdf.
- 47 Philip A. Trostel, *The Fiscal Implications of Inadequate Retirement Savings in Maine* (Orono, ME: The University of Maine, 2017), Accessed on 14 August 2017, <https://mcspolicycenter.umaine.edu/wp-content/uploads/sites/122/2017/03/final-aarp-report.pdf>.
- 48 Matthew Toner, "How Much Is Your State's 529 Plan Tax Deduction Really Worth?" *Savingforcollege.com*, 2017, Accessed on 14 August 2017, <http://www.savingforcollege.com/articles/how-much-is-your-states-529-plan-tax-deduction-really-worth-733>; Internal Revenue Service (IRS), "How 529 Plans Help Families Save for College and How the American Recovery and Reinvestment Act of 2009 Expanded 529 Plan Features," IRS, Washington, DC, September 2009, Accessed on 14 August 2017, <https://www.irs.gov/uac/how-529-plans-help-families-save-for-college-and-how-the-american-recovery-and-reinvestment-act-of-2009-expanded-529-plan-features>.

- 49 Andrea Feirstein, "529 College Savings Plans: Lessons for Publicly Sponsored Private Retirement Plans," Policy Brief 16(2), Georgetown University McCourt School of Public Policy Center for Retirement Initiatives, Washington, DC, November 2016, Accessed on 14 August 2017, <http://cri.georgetown.edu/wp-content/uploads/2016/11/Policy-Brief-16-2.pdf>.
- 50 In order to qualify, the filer must be a Maryland resident and the credit cannot be claimed by another taxpayer. Comptroller of Maryland, "Long-Term Care Insurance Credit", Accessed on 14 August 2017, http://taxes.marylandtaxes.com/Individual_Taxes/General_Information/Tax_Credits_and_Deductions/Long-Term_Care_Insurance_Credit.shtml.
- 51 In order to qualify, the filer must be 65 or older, be an Indiana resident, have an adjusted gross income of less than \$10,000, and claim the credit by June 30 of the tax year. Indiana Department of Revenue, "Tax Credits," Accessed on 14 August 2017, <http://www.in.gov/dor/4745.htm#unified>.
- 52 Filers must own or rent residential property in Massachusetts that is also their principal residence; their income cannot exceed \$56,000 for individuals, \$70,000 for head of household, and \$84,000 for joint filers; and the residence cannot be valued at higher than \$691,000. Massachusetts Department of Revenue, "Real Estate Tax Credit for Persons Age 65 and Older (known as the Circuit Breaker Credit) – Refundable Credit", Accessed on 14 August 2017, <http://www.mass.gov/dor/individuals/filing-and-payment-information/guide-to-personal-income-tax/credits/real-estate-tax-credit.html>.
- 53 Filers must be age 62 or older, be a Montana resident, and have total household income of less than \$45,000. Montana Department of Revenue, "Property Tax Relief", Accessed on 14 August 2017, <https://revenue.mt.gov/propertytax-relief#Elderly-Homeowner-Renter-Credit-907>.

Insight on the Issues 132, September 2017

© AARP PUBLIC POLICY INSTITUTE
601 E Street, NW
Washington DC 20049

[Follow us on Twitter](#)
[Follow us on Facebook](#)
[Visit our Web site](#)

For more reports from the Public Policy Institute, [visit the Public Policy Institute Web site](#).



Real Possibilities

**Public Policy
Institute**