

Saver's Credit

Tax Credit for Low-Income and Moderate-Income Savers

You may be eligible to claim a tax credit of up to \$1,000 when you make contributions to your 401(k) plan, 403(b) plan, government 457 plan, SIMPLE, SEP, traditional IRA, or Roth IRA. After-tax contributions to qualified employer plans are also eligible. The tax credit for low-income and moderate-income savers (or “saver’s credit”) went into effect at the beginning of 2002. This credit applies only as a reduction to your income tax liability, not as cash in hand via a refund. If you owe no federal income tax, you are not eligible for a tax credit.

In order to qualify for the saver's credit you must be:

- 18 years of age or older
- Not a full-time student
- Not claimed as a dependent on someone else's return

The tax credit ranges from 10 to 50 percent of each \$1 you contribute, up to the first \$2,000 you put in your 401(k). If you and your spouse both contribute to a 401(k) plan, you may both be eligible to receive a credit. The amount of your tax credit depends on the amount of your adjusted gross income. The income limits and applicable credit rate allowance are as shown in Figure 1.

The tax credit is in addition to other favorable tax treatment of the contribution, such as the deferral of income tax on pretax contributions. The credit is reduced by the taxable distributions you or your spouse receives from any plans eligible for the credit during the year the credit is claimed.

The credit is incredibly valuable for lower-income individuals, particularly if their employer matches their 401(k) contribution. Let’s compare Pat and Gerry. They are both single tax filers and earn identical salaries of \$15,000. Pat declines to take advantage of his employer’s 401(k) plan while Gerry elects to contribute 3 percent of her earnings. Their employer offers a 50 percent match on the first 6 percent of compensation contributed by employees. Figure 2 details the effects of the tax credit and matching contribution on each person’s net income.

While Pat’s net income exceeded Gerry’s by \$158, she has \$675 in her 401(k) plan compared to Pat’s zero. How is this possible? Gerry’s \$450 401(k) contribution was replaced by her tax credit and her employer’s match. She also lowered her adjusted gross income by \$450, and as a result paid \$67 less in tax at the 15 percent rate.

FIGURE 1: Tax Credit for Different Income Levels

Credit	Adjusted Gross Income		
	Single Filers	Head of Household	Joint Filers
50% of contribution	\$0-\$15,000	\$0-\$22,500	\$0-\$30,000
20% of contribution	\$15,001-\$16,250	\$22,501-\$24,375	\$30,001-\$32,500
10% of contribution	\$16,251-\$25,000	\$24,376-\$37,500	\$32,501-\$50,000
Credit not available	\$25,001+	\$37,001+	\$50,001+

FIGURE 1.1: Saver's Credit 2008

Credit	Adjusted Gross Income		
	Single Filers	Head of Household	Joint Filers
50% of contribution	\$0-\$16,000	\$0-\$24,000	\$0-\$32,000
20% of contribution	\$16,001-\$17,250	\$24,001-\$25,875	\$32,001-\$34,500
10% of contribution	\$17,251-\$26,500	\$25,876-\$39,750	\$34,501-\$53,000
Credit not available	\$26,501+	\$39,751+	\$53,001+

FIGURE 1.2: Saver's Credit 2009

Credit	Adjusted Gross Income		
	Single Filers	Head of Household	Joint Filers
50% of contribution	\$0-\$16,500	\$0-\$24,750	\$0-\$33,000
20% of contribution	\$16,501-\$18,000	\$24,751-\$27,000	\$33,001-\$36,000
10% of contribution	\$18,001-\$27,750	\$27,001-\$41,625	\$36,001-\$55,500
Credit not available	\$27,751+	\$41,626+	\$55,501+

FIGURE 2: Effect of Tax Credit and Matching Contribution on Net Income

	Pat	Gerry	Gerry's 401(k)
Annual income	\$15,000	\$15,000	
401(k) contribution: % of pay and dollar amount	0%	3%	\$450
Adjusted gross income	\$15,000	\$14,550	
Income tax liability before saver's credit is applied	\$836	\$769	
Saver's credit (50% of 401(k) contribution)	\$0	\$225	
After-tax income	\$14,164	\$14,006	
Employer match of 50%			\$225
Net Total:	\$14,164	\$14,006	\$675

Gerry was required to reduce her daily spending by 43.3 cents to build a real retirement nest egg.

The government established this program because it wants to reward low-income and moderate-income workers who save for retirement. Not only do you receive up to a \$1,000 deduction from the federal income taxes you owe, in many cases you will also get an employer matching contribution of 50 percent of the money you put into your plan. In other words, if you save \$1, the government gives you 50 cents back and your employer puts 50 cents into your account. That's free money.