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The Retirement Savings Contribution Credit

The 116th Congress has shown interest in advancing policies that support retirement savings and retirement security. One provision designed to encourage retirement savings for low-income workers is the Retirement Savings Contribution Credit, or the Saver's Credit (Internal Revenue Code [IRC] §25B). This In Focus provides an overview of the credit and provides a brief discussion of the credit's effectiveness, in the context of various policy options that might be considered in the 116th Congress.

The Saver's Credit

Eligible low-income taxpayers may be able to claim a nonrefundable tax credit for contributions to certain retirement accounts. The maximum credit amount is $1,000 per person making eligible contributions.

To claim the tax credit, the individual making the contribution must (1) be at least 18 years old; (2) not be claimed as a dependent on someone else's tax return; and (3) not be a full-time student.

Retirement savings of up to $2,000 per person may be tax credit eligible. Qualified retirement savings include contributions to traditional and Roth IRAs as well as 401(k) and similar retirement plans. From 2018 through 2025, contributions made by an individual to his or her Achieving a Better Life Experience (ABLE) account may also be treated as qualified savings for the purposes of calculating the Saver's Credit.

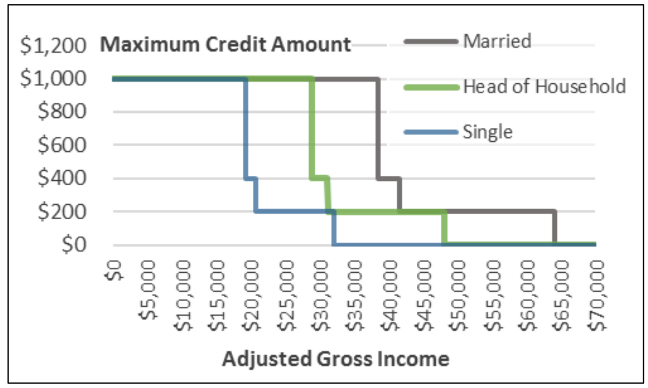
The tax credit rate depends on a taxpayer's filing status and the taxpayer's adjusted gross income (AGI). The maximum credit rate of 50% is available to taxpayers with AGI below $38,500 for married taxpayers filing joint returns ($28,875 for head of household filers and $19,250 for other filers) in 2019 (see **Figure 1**).

At certain AGI thresholds there are "cliffs." At these cliffs, the credit rate is immediately reduced. For married taxpayers filing a joint return, the credit rate is reduced to 20% once AGI reaches $38,500, and 10% once AGI reaches $41,500. Thus, if a taxpayer earning $38,500 and claiming a $1,000 credit earns one more dollar, the maximum amount of credit that could be claimed falls to $400. No credit is available for married taxpayers filing joint returns once AGI reaches $64,000.

For head of household taxpayers, the credit rate is 20% once AGI exceeds $28,875, and 10% once AGI exceeds $31,125, with no credit for taxpayers with AGI above $48,000. For all other filers, the threshold for the 20% credit is $19,250, and the threshold for the 10% credit is $20,750, with no credit available once AGI is above $32,000. These income thresholds are adjusted annually for inflation.

Figure 1. Maximum Amount of Saver's Credit per Individual, 2019

By Filing Status and Income Level



Source: CRS and IRC Section 25B.

As is discussed below, while the maximum amount of the credit is $1,000 for each person making qualifying savings contributions, most taxpayers claim much smaller amounts. The maximum tax credit is available only to the lowest-income taxpayers who (1) are less likely to have the financial capacity to save; and (2) are less likely to have a positive tax liability to reduce with a nonrefundable tax credit.

Legislative Background

The Saver's Credit was added to the IRC in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA; P.L. 107-16). When the credit was enacted, Congress believed that providing an additional tax incentive for low- and middle-income taxpayers would enhance their ability to save for retirement. Inadequate retirement savings of low- and middle-income taxpayers was cited as a policy concern, and Congress observed that lower-income families spend a larger portion of household budgets on necessities, leaving limited resources for retirement savings. When first enacted, the credit was temporary, initially scheduled to be effective for tax years 2002 through 2006.

The Saver's Credit was made permanent in the Pension Protection Act of 2006 (P.L. 109-290). This legislation also indexed the income limits applicable to the Saver's Credit to inflation beginning in 2007 (from 2002 through 2006 the AGI thresholds were fixed).

The 2017 tax act (P.L. 115-97, commonly known as the "Tax Cuts and Jobs Act") temporarily, through 2025, allows taxpayers to claim the Saver's Credit for contributions to ABLE accounts. ABLE accounts are a tax-favored savings program designed specifically for individuals with disabilities.

Saver's Credit Statistics: Who Claims? How Much? What's the Cost?

Few taxpayers claim the credit, and the average credit claim is small. In 2016, 5.6% of taxpayers claimed the Saver's Credit, and the average credit amount claimed was $182 (**Table 1**). This is for all taxpayers, regardless of whether they have AGI that would make them eligible.

Since the credit first became available in 2002, the share of taxpayers claiming the credit has slowly trended up. In 2002, 4.1% of tax returns filed had a Saver's Credit claim. The average credit amount was $199 the first year the credit was available (in 2002). Average credit amounts fell during the late 2000s, before rising again to the current level.

The take-up rate for the credit varies across the income distribution. At very low levels of income, those with AGI below $10,000, 0.02% of taxpayers claim the credit (**Table 1**). Few taxpayers at this income level have a positive tax liability. The taxpayers who do claim the credit from these income groups, however, tend to claim higher credit amounts. These taxpayers are eligible for the 50% tax credit rate. Having zero or negative AGI in a given year may be temporary. Taxpayers in this position may be able to draw on other resources to make retirement contributions, which may explain the higher average credit amount for this group.

In 2016, 13.6% of taxpayers with AGI of $25,000 up to $50,000 claimed the Saver's Credit (**Table 1**). Depending on their filing status, taxpayers in this AGI group may have a lower credit rate (40% or 20%), or not be eligible for the Saver's Credit at all. For taxpayers in this income group claiming the Saver's Credit is 2016, the average credit amount was $190.

In the $50,000 to $75,000 AGI group, only married taxpayers filing joint returns with AGI below the final income threshold could claim the credit, and the maximum credit amount was $200 per contributor (or $400 for a married couple filing jointly).

Table 1. Share of Tax Returns Claiming Saver's Credit and Average Credit Amount, 2016

AGI	Share Claiming	Average Credit
No AGI	0.0%[a]	$957
$1 – <$10K	0.0%[a]	$245
$10K – < $25K	7.1%	$171
$25K - <$50K	13.6%	$190
$50K - <$75K	6.4%	$168
$75K+	0.0%	$0
All Taxpayers	5.6%	$182

Source: CRS and IRS Statistics of Income (SOI).

a. The share claiming the credit is nonzero but rounds to 0.0%.

The Joint Committee on Taxation (JCT) estimates the Saver's Credit reduces tax revenue by $1.2 billion per year (FY2018 through FY2022).

Does the Credit Increase Savings for Low-Income Taxpayers?

Empirical studies have found the Saver's Credit ineffective at increasing retirement savings among the target population (low-income taxpayers). Overall, the take-up rate for the Saver's Credit is low. Further, it is not clear that the Saver's Credit results in additional savings, as opposed to rewarding taxpayers for savings that would have occurred without the Saver's Credit.

A feature of the tax credit that potentially limits effectiveness is that the credit is nonrefundable. According to the Tax Policy Center, in 2018, 81.8% of taxpayers with cash income between $10,000 and $30,000 did not have a positive income tax liability. For cash incomes in the $30,000 to $50,000 range, 53.6% did not have a positive tax liability. For the lowest-income taxpayers, those with positive cash incomes of less than $10,000, 99.8% had no tax liability. Since the Saver's Credit is nonrefundable, only taxpayers with positive tax liability benefit from the credit.

Even if the Saver's Credit encourages additional retirement savings, it may not increase overall savings. One barrier to retirement savings via IRAs is the early withdrawal penalty. If the Saver's Credit helps overcome this barrier, it is possible that taxpayers choose to shift other forms of savings into retirement accounts, but do not necessarily increase total savings. Not all taxpayers are aware of the credit, however, and lack of awareness may be another barrier impeding the credit's effectiveness.

While evidence suggests that the Saver's Credit is not effective at increasing savings, some taxpayers do respond to the credit. There is some evidence that taxpayers "bunch" at the income threshold amounts, adjusting income to maximize tax credits at points just below the cliff.

Policy Options

There are various policy options that might address some of the reasons the Saver's Credit is believed to fall short. In recent years, there have been a number of legislative proposals. In the 115th Congress, the Retirement Security and Savings Act of 2018 (S. 3781) would have enhanced the credit and made the credit refundable, although the credit would be paid to retirement accounts instead of being claimed as a credit against tax. The Encouraging Americans to Save Act of 2018 (S. 3636) would have replaced the Saver's Credit with a match for lower-income taxpayers contributing to certain retirement accounts, transferring matching funds directly into retirement accounts as opposed to reducing tax bills. In the 113th Congress, the Savings for American Families' Future Act of 2013 (H.R. 837) would have expanded the Saver's Credit, made the credit refundable, and provided a larger credit if deposited into a retirement account as matching funds.

Others have proposed that the Saver's Credit be allowed for additional types of savings, such as for contributions to tax-deferred college savings accounts (for example, the Boost Saving for College Act [S. 1790] in the 115th Congress).

Molly F. Sherlock, Specialist in Public Finance

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