Saver's Credit Can Help You Save for Retirement

Article Highlights:

- Benefits
- Who Can Claim The Credit
- Rules for Students, Dependents of Others and Individuals Under the Age of 18

Low- and moderate-income workers can take steps to save for retirement and earn a special tax credit.

The saver's credit, also called the retirement savings credit, helps offset part of the first $2,000 workers voluntarily contribute to traditional or Roth Individual Retirement Arrangements (IRAs), SIMPLE-IRAs, SEPs, 401(k) plans, 403(b) plans for employees of public schools and certain tax-exempt organizations, 457 plans for state or local government employees, and the Thrift Savings Plan for federal employees. Also known as the retirement savings contributions credit, the saver's credit is available in addition to any other tax savings that apply as a result of contributing to retirement plans.

The credit for 2015 is determined from the table illustrated below and is based upon both filing status and income (AGI).

Modified Adjusted Gross Income (AGI) *						Applicable percentage
Joint return		Head of household		Others		
Over	Not over	Over	Not over	Over	Not over	
$ 0	$36,500	$ 0	$27,375	$ 0	$18,250	50
36,500	39,500	27,375	29,625	18,250	19,750	20
39,500	61,000	29,625	45,750	19,750	30,500	10
61,000		45,750		30,500		0

**** Modified AGI*** *- Is determined without regard to the foreign or possessions earned income exclusion and foreign housing exclusion or deduction.*

Like other tax credits, the saver's credit can increase a taxpayer's refund or reduce the tax owed. Though the maximum saver's credit is $1,000 ($2,000 for married couples if both spouses contribute to a plan), taxpayers are cautioned that it is often much less and, due in part to the impact of other deductions and credits, may in fact be zero for some taxpayers.

The amount of a taxpayer's saver's credit is based on his or her filing status, adjusted gross income, tax liability, and amount contributed to qualifying retirement programs.

Example *– Eric and Heather are married and filing a joint return. Eric contributed $3,000 through his 401(k) plan at work, and Heather contributed $500 to her IRA account. Their modified AGI for the year was $37,000. The credit is computed as follows:*

Eric's 401(k) contribution was $3,000, but only the first $2,000 can be used	*$2,000*
Heather's IRA contribution was $500, so it can all be used……………………………	*500*
Total Qualifying contributions………………………………………………………………………	*$2,500*
Credit percentage for a joint return with AGI of $37,000 from the table………	*X .20*
***Saver's credit**……………………………………………………………………………………………..*	***$500***

This example illustrates how the credit phases out for higher-AGI taxpayers. In this example, the couple's AGI of $37,000 only allowed them a credit of 20% times their qualifying contributions. Had their AGI been $36,500 or less, their credit percentage would have been 50% of their qualified contributions, for a credit of $1,250.

The saver’s credit supplements other tax benefits available to people who set money aside for retirement. Generally, except for Roth IRA contributions, workers’ contributions to retirement plans are tax deductible, either in the form of a deduction on their tax return (traditional IRAs and certain self-employed retirement plans) or through a reduction of wages that would otherwise be taxable (such as pre-tax contributions to a 401(k), 403(b), etc.). So in addition to the saver’s credit, contributions to retirement plans provide a tax deduction for traditional IRAs or income reductions for certain other plans, which will lower an individual’s tax before the credit is applied. The credit itself can only be used to reduce the tax (income and alternative minimum taxes only) to zero, and any amount in excess of a taxpayer’s tax liability is lost.

Other special rules that apply to the saver’s credit include the following:

- Eligible taxpayers must be at least 18 years of age.
- Anyone claimed as a dependent on someone else’s return cannot take the credit.
- A full-time student cannot take the credit. A person enrolled as a full-time student during any part of five calendar months during the year is considered a full-time student.

The credit is provided to encourage taxpayers to save for their retirement. To prevent taxpayers from taking distributions from existing retirement savings and re-depositing them to claim the credit, the qualifying retirement contributions used to figure the credit are reduced by any retirement plan distributions taken during a “testing period.” The testing period includes the prior two tax years, the current year, and the subsequent tax year before the due date (including extensions) for filing the taxpayer's return for the tax year of the credit.

As you can see, qualifying for and being able to use this credit involves a complicated set of rules. If you have questions about how this tax benefit might apply in your situation, please give this office a call.