Saver's Tax Credit for 2011: Workers can Save for Retirement And Reduce Income Taxes

The Saver's Tax Credit can reward workers who make contributions to a retirement plan or Individual Retirement Account (IRA).Workers can receive a tax credit worth up to 50 percent of a maximum $2,000 contribution. Married workers may each make the maximum contribution. The Saver's Tax Credit, is referred to in IRS tax forms as the "Credit for Qualified Retirement Savings Contributions." This may be particularly valuable for workers in areas where matched-savings plans, such as Individual Development Accounts (IDAs), are not available or when saving for retirement is a higher priority for a family than the uses that may qualify for matched savings in an IDA.

The Saver's Tax Credit will reduce or eliminate a worker's income tax but, unlike the Earned Income Credit, workers who owe no income tax will not benefit from the Saver's Tax Credit. However, some moderate-income workers with children may see increased benefits from the EIC when they make contributions to a retirement account through pre-tax salary deductions and take advantage of the Saver's Tax Credit. Here's why:

• Generally, only taxable earned income is counted in figuring the EIC. Most EIC claimants who make contributions for retirement through pretax salary deductions are in the "phase-down" range of the EIC, where EIC amounts decrease as taxable income increases. Since the salary deductions made for retirement reduce the worker's taxable income, the worker will qualify for a larger EIC.

Example: Randy and Meg earned $30,000 in 2011 and have two children attending college full-time. They ordinarily would owe income tax of $360 and would qualify for an EIC of $3,379. However, during 2011 they made contributions of $1,000 to Meg's retirement plan at work through pre-tax salary deductions. This reduces their taxable income to $29,000, and reduces their income tax to $260 — a $100 savings. Since only their $29,000 in taxable earnings is considered in calculating the EIC, they will qualify for a higher EIC of $3,589, an increase of $210. And, they can take the Saver's Tax Credit (in their case worth up to 50 percent of their $1,000 contribution — as much as $500 in reduced income tax), which eliminates their $260 income tax. *Overall, by making the $1,000 contribution to Meg's retirement account and taking the Saver's Tax Credit, the couple gets a tax benefit of $570. (Their original income tax amount was reduced by $100 and then the remaining $260 was eliminated, for a total tax reduction of $360. In addition, by reducing their taxable income, they were able to claim an EIC that was $210 higher than it would have been had they not made the retirement plan contribution: $360 + $210 = $570.)*

Who Is Eligible to Claim the Saver's Tax Credit?

The credit may be claimed by taxpayers who:

- are age 18 or older,
- are not full-time students,
- are not claimed as a dependent on someone else's return; and
- have adjusted gross income in 2011 no higher than these amounts:
  - $57,500 if married filing jointly
  - $43,125 if filing as head of household
  - $28,750 if filing single or married filing separately

What Retirement Contributions Qualify for the Saver's Tax Credit?

Contributions workers elect to make through salary reduction to a variety of employer-administered retirement plans are eligible for the credit, as are contributions to both traditional and Roth Individual Retirement Accounts (IRAs). Salary reduction contributions made to the following types of plans are eligible:

- a 401(k) plan, including a SIMPLE 401(k)
- a section 403(b) annuity
- an eligible deferred compensation plan of a state or local government (a "governmental 457 plan")
- a SIMPLE IRA plan
- a salary reduction SEP (Simplified Employee Pension)

Individuals entitled to deduct IRA contributions may still do so and also claim the Saver's Tax Credit. Voluntary after-tax contributions to a qualified retirement plan or 403(b) annuity also qualify for the Saver's Tax Credit.

How is the Amount of the Saver's Tax Credit Figured?

The credit can range from 10 percent to 50 percent of the worker's contribution to retirement, based upon the worker's adjusted gross income for the tax year. In the example of Randy and Meg above, their taxable income of $30,000 as married joint filers qualifies them for a credit worth 50 percent of their $1,000 contribution (see chart below).

How do Workers Claim the Saver's Tax Credit?

Workers must complete IRS Form 8880,"Credit for Qualified Retirement Savings Contributions," enter the amount of the credit on Form 1040 or 1040A, and attach Form 8880 to their tax return. Form 8880 may be downloaded from the IRS website at: *www.irs.gov/formspubs*. *For additional information, see the chapter on this credit in IRS Publication 590, "Individual Retirement Arrangements."*

2011 Adjusted Gross Income

Married filing jointly	Head of household	All other filers	Credit
$0 - $34,500	$0 - $25,875	$0 - $17,250	50% of contribution
$34,501 - $37,500	$25,876 -$28,125	$17,251 - $18,750	20% of contribution
$37,501 - $57,500	$28,126- $43,125	$18,751 - $28,750	10% of contribution
Over $57,500	Over $43,125	Over $28,750	Credit not available

To learn more about IRAs see "Roth IRAs" in the More Facts About Tax Credits section at www.eitcoutreach.org.