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Finding Common Ground: The Saver's Credit Is Key to a Retirement Security Compromise

As policymakers on Capitol Hill continue to debate Social Security, pensions and private savings, opportunities for compromise are rare. But there is one policy that stands out. The Saver's Credit has been met with strong support from both sides of the aisle.



Rep. Benjamin Cardin, IFS Executive Director Lisa Mensah and Rep. Nancy Johnson led an Aspen IFS roundtable, "Helping Low Income Families Retire."

Passed as part of the pension reform bill in 2001, the Saver's Credit rewards and matches contributions to retirement savings accounts. It is a tax credit that can be claimed by low- and moderate-income individuals who have taxable income and make voluntary retirement

savings contributions to 401(k)-type plans, other employer-sponsored plans, or Individual Retirement Accounts (IRAs). The Credit is like other retirement savings incentives because it provides no benefit to workers who do not owe income tax. But unlike other retirement savings incentives, the match rate provided through the Saver's Credit is higher for families with lower incomes.

The Saver's Credit benefits low- and moderate-income households by helping to stimulate personal savings and supporting employer-based retirement programs. Its pro-

The mission of the Initiative on Financial Security (IFS) is to examine solutions to America's asset crisis so that more Americans can own homes, finance college, start businesses and prepare for a secure retirement. In collaboration with business leaders, IFS is exploring and recommending financial products that create asset building opportunities for the tens of millions of working Americans who currently lack access to tax-advantaged or employer-subsidized savings vehicles. IFS is supported by the Ford, Charles Stewart Mott and Annie E. Casey Foundations.

gressive structure is what legislators find most attractive. "This is the only program that really exists that assists low-income people in a meaningful way," said **Senator Jeff Bingaman** (D-NM), a member of the Senate Finance Committee, who spoke at a recent Aspen Institute Initiative on Financial Security (IFS) roundtable on the Saver's Credit led by **Lisa Mensah**.

In addition to subsidizing savings at the bottom of the income pyramid, the Saver's Credit works well with traditional financial products. H&R Block's Express IRA is an example of government and financial institutions working together to provide savings incentives for those who need them the most. It offers eligible individuals a simple and effective way to begin saving for the future.

MOVING THE SAVER'S CREDIT FORWARD: CONSENSUS ON CAPITOL HILL AND BEYOND

Rep. Benjamin Cardin (D-MD) and Rep. Nancy Johnson (R-CT), who both serve on the House Ways and Means Committee, said they agreed with Senator Bingaman in supporting the Saver's Credit. All three members acknowledged that the Credit's effects have been modest, and agreed that expanding it could have a broader impact. These legislators, as well as the original designers of the Credit, agree on the following ways to ensure that the Credit reaches more low- and moderate-income families:

- **Extend the Deadline for the Saver's Credit:** More than five million people have already benefited from the Saver's Credit, but the policy is set to expire in 2006. To make savings policy more effective, this deadline should be eliminated and the Credit should be extended to 2010.

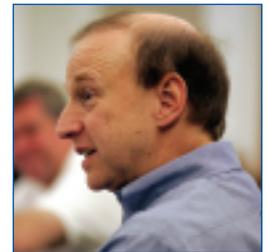
- **Make the Credit Refundable:** The Saver's Credit should be refundable so that it has the greatest impact on those who need it the most — working Americans who try to save for a better future. Other tax credits have been unpopular among low-



Sen. Jeff Bingaman speaks out on expanding the Saver's Credit.

BIPARTISAN COMMON GROUND: DIRECT FROM THE EXPERTS

"The Saver's Credit should be refundable - which is how we originally designed it - so that it reaches the more than 50 million households that need to save but have no income tax liability. Policy and legislation cannot be effective without a thorough understanding of and collaboration with the private sector, including the financial services community. That's why the Saver's Credit was designed only after extensive consultation with those who provide and market financial services and products and with sponsors of qualified plans and IRAs."



– Mark Iwry
Former Benefits Tax Counsel, U.S. Treasury Department
Clinton Administration

"Everybody realizes that it's the lower income people who are most in need of savings, and they're also the people that traditional tax incentives don't reach. But the people you're trying to incent to save are the people that don't have any tax liability in the first place, so it's really difficult to address this population. That is why people are talking about a refundable credit. If it's not a refundable credit, then it's not really working for most low-income individuals. If we really want more individuals at the bottom of the income pyramid to save, then the most effective credit is a refundable credit."



– Bill Sweetnam
Former Benefits Tax Counsel, U.S. Treasury Department
Bush Administration

income families because those who do not owe income tax cannot benefit from them. With refundability, millions of individuals who work and have incomes low enough to qualify would receive the Credit's economic benefit. Refundability has been a way to allow low-income families to benefit from other tax credits, such as the Earned Income Tax Credit (EITC).

At the Aspen IFS roundtable, Rep. Johnson said she strongly supported refundability, saying that it is one clear way to ensure that the Credit reaches more low-income people. According to a recent experiment conducted by H&R Block, 50 million low-income families would be able to benefit from the Credit if it were refundable.

A SMART SOLUTION FOR A SAVINGS SOCIETY

Moving beyond the retirement security gridlock means finding common sense, bipartisan solutions that help *all* Americans save for the future. Expanding the Saver's Credit presents a unique opportunity to build retirement savings incentives that work for those at the bottom of the income pyramid. Not only does the Saver's Credit subsidize savings for those who need it most, but it also works well with financial products to translate policy into real solutions.

The Saver's Credit has the potential to help millions more households save for retirement. Even though it is only part of the solution, both sides of the aisle agree that extending the Credit to 2010 and making it refundable will bring our country one step closer to creating a savings society.

GOOD POLICY IS GOOD BUSINESS: HOW H&R BLOCK USED THE SAVER'S CREDIT TO HELP MORE AMERICANS SAVE

The Saver's Credit is an example of a smart public subsidy that can help low- and moderate-income people save for the future. But translating policy into practice means that government and financial institutions must work together. H&R Block's Express IRA (X-IRA) is an example of a financial product that complements and even strengthens the Saver's Credit.

THE H&R BLOCK EXPRESS IRA: HOW IT WORKS

- Clients may fund their X-IRA (either a Roth or Traditional IRA) with their tax refund, by check or by direct deposit from a bank account.
- The account-opening process is completed by the tax professional as part of the tax interview.
- Opening an X-IRA requires an initial investment of either \$300 (which includes any Saver's Credit match) or establishing a direct deposit of \$25 per month.
- An annual fee of \$10 is charged for accounts with balances below \$1,000; no fee is charged for accounts over \$1,000. This fee is assessed only in the second year, and it is waived if the client has set up a direct deposit.
- X-IRA funds are invested in an FDIC-insured money market account.

INITIAL RESULTS

- Introduced in the 2002 tax season, about 15-20 percent of H&R Block's tax filers who were eligible for the Saver's Credit opened X-IRAs. These tax filers likely represent new savers who would not have saved for retirement without the combination of both the Saver's Credit and the X-IRA.

THE SAVER'S CREDIT AT A GLANCE

What is the Saver's Credit?

- Set to expire in 2006, the Saver's Credit is a tax credit that can be claimed by low- and moderate-income individuals who have taxable income and make voluntary retirement savings contributions to 401(k)-type plans, other employer-sponsored plans, or Individual Retirement Accounts (IRA).
- The Credit was enacted as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 and costs approximately \$1 billion per year. This compares to \$83.5 billion in tax expenditures on employer-sponsored retirement plans and pensions and \$10.4 billion in tax expenditures on individual-based retirement savings plans in FY 2003.¹ The existing tax preferences disproportionately benefit higher-income families.²
- The Credit is the first and only retirement savings policy targeted to low- and moderate-income individuals.
- In 2003, approximately 5.4 million taxpayers took advantage of the Saver's Credit.

How does the Saver's Credit work?

- It applies to contributions of up to \$2,000 per year per individual. The contributions can be made to a 401(k)-type plan by either the worker or employer, or to an IRA.
- The Credit rate is 50 percent for married taxpayers filing jointly with an adjusted gross income (AGI) up to \$30,000; 20 percent for joint filers with AGI between \$30,001 and \$32,500; and 10 percent for joint filers with AGI between \$32,501 and \$50,000. The following table provides AGI thresholds for other filing statuses.

Table 1: Saver's credit by filing status and income³

AGI range for:						
Joint filers	Heads of households	Singles	Credit rate	Tax credit for \$2,000 contribution	After-tax cost incurred by individual to create \$2,000 account balance	Effective after-tax matching rate
0-\$30,000	0-\$22,500	0-\$15,000	50%	\$1,000	\$1,000	100%
\$30,001-\$32,500	\$22,501-\$24,375	\$15,001-\$16,250	20%	\$400	\$1,600	25%
\$32,501-\$50,000	\$24,376-\$37,500	\$16,251-\$25,000	10%	\$200	\$1,800	11%

- The average income of those who opened X-IRAs was \$31,000, and half were considered unbanked.
- Eighty percent of those who opened X-IRAs were first-time retirement savers, and 85 percent maintained their IRA account balances.⁴
- In three tax seasons, over 400,000 X-IRA accounts have been opened, with a total asset size of approximately \$300 million. The average initial deposit was \$539, and the average overall account balance was about \$720.

PUTTING POLICY INTO PRACTICE: LESSONS LEARNED

Defying Conventional Wisdom: H&R Block's experience with X-IRAs disproves the common assumption that members of low-income households do not have the ability and desire to save. Clients with incomes between \$20,000 and \$29,999 represented the group most likely to contribute to X-IRAs, and those with incomes between \$10,000 and \$19,999 represented the group second most likely to save.

Tax Time is Savings Time: The X-IRA is an example of a creative approach to incentivizing and facilitating savings for those least likely to be saving today. Approximately 80 percent of savers funded their X-IRA through a direct deposit of their tax refunds, consistent with recent research indicating that tax time can be a powerful moment to encourage savings.

Selling Savings: Savings should be promoted not just through social marketing and good policy formation, but also through one-on-one financial advice. H&R Block marketed the Saver's Credit to its clientele of nearly 20 million households – 60 percent of whom have a household income of \$30,000 or lower. The financial advice that tax professionals offered to clients regarding the Credit and X-IRAs resulted in retirement savings that probably would have not occurred otherwise.

MATCH MATTERS

H&R Block used the Express-IRA (X-IRA) as a vehicle to explore savings incentives. In the month leading up to April 15, 2005, they conducted an experiment among 15,000 low- and middle-income customers in St. Louis, Missouri. Customers were randomly assigned a 20 percent match on X-IRA contributions, a 50 percent match, or no match (no match being the control group). Contributions were matched up to \$1,000; the minimum X-IRA contribution was \$300.

H&R Block found that, when given the opportunity and incentive, low-income households would save money in an IRA. Key findings include:

- **The higher the match, the higher the participation.** When offered no match, only 3 percent of customers contributed to an IRA. When offered a 20 percent match, 10 percent contributed, and when offered a 50 percent match, 17 percent of customers contributed.
- **The higher the match, the higher the savings.** The average contribution level (with the match included) was \$860 for the control group, \$1,480 for the 20 percent match group, and \$1,870 for the 50 percent match group.
- **Simplicity matters.** Professional assistance, clear information and easily accessible savings vehicles all influence the willingness of households to contribute to retirement saving accounts.⁵

¹ *Hidden in Plain Sight: A Look at the \$335 Billion Federal Asset-Building Budget (Summary)*. Corporation for Enterprise Development. January 1, 2004.

² Gale, William G., J. Mark Iwry, and Peter R. Orszag (2004). "The Saver's Credit: Issues and Options." *Tax Analysts Tax Break*. May 3, 2004.

³ *Ibid.*

⁴ Wilson, Bernard. Testimony on "Building Assets for Low-Income Families," before Subcommittee on Social Security and Family Policy of the Senate Finance Committee. April 28, 2005.

⁵ Duffo, Esther, William Gale, Jeffrey Liebman, Peter Orszag and Emmanuel Saez (2005). "Saving Incentives for Low- and Middle-Income Families: Evidence from a Field Experiment with H&R Block." *The Retirement Security Project Policy Brief No. 2005-5*. May 2005.



THE ASPEN INSTITUTE

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