

Split Refund and Saver's Credit: Two Better Ways to Save for Retirement



The Retirement Security Project

This tax filing season, taxpayers have two improved incentives to help them save for retirement — the split refund option and the Saver's Credit.

Splitting Your Refund

A “Savable Moment”

Each year more than 100 million American households receive an income tax refund. The refunds average more than \$2,000 each, representing the single largest payment many Americans will receive all year. These refunds present a unique opportunity — a “savable moment” — to increase personal saving, either for retirement or for shorter-term needs.

How Refund Splitting Works

Traditionally, households getting a tax refund receive a check. Taxpayers can also choose to have the IRS directly deposit that refund into their bank account or other financial institution. In fact, direct deposit is the preferred way to receive refunds: more than 60 percent of the refund dollars and more than half the refunds received by individual taxpayers last year were processed via direct deposit.

Unfortunately though, direct deposit of refunds for years was an all or nothing proposition. The IRS was unable to send only a portion of the refund to the taxpayer's account by direct deposit or to divide the direct deposit between more than one account. As a result, few who used direct deposit sent the refund to an IRA or other savings account.

Average Refund by Income

Adjusted Gross Income (AGI)	Average refund	Number of filers (in millions)
No AGI	\$ 3,000	0.7
\$ 1 - 15,000	1,100	28.2
15,000 - 30,000	2,100	25.0
30,000 - 50,000	2,100	19.7
50,000 - 100,000	3,000	21.1
100,000 - 150,000*	4,300	3.1
150,000+*	6,900	4.1

Note: Computed from the 2005 Statistics of Income (SOI) Individual Income Tax Returns (Complete Report), Publication 1304, Internal Revenue Service. AGI ranges correspond very roughly to AGI limits for IRA contributions/deductions.
* Because these two AGI ranges fall between those reported in the SOI data, average refund and number of filers in these ranges are approximate.

The Breakthrough

After sustained efforts within and outside the federal government, the IRS has begun to allow taxpayers to have refunds directly deposited to more than one account. Starting with returns filed in January 2007, Americans can choose to send a portion of their tax refund to a savings account or IRA and use the rest to meet immediate needs — simply by checking a box on their tax return and providing a routing number and account number.

With the new split refund option:

- Direct deposits of 2007 federal income tax refunds can now be earmarked for up to three accounts at financial institutions.
- Taxpayers can choose multiple types of accounts including IRAs, other savings accounts, and checking accounts.
- Both paper and electronic filers are eligible.
- The power of “automatic” saving for retirement now applies to tax refunds.

Since federal income tax refunds total nearly \$245 billion a year (more than twice the estimated annual aggregate amount of net personal saving in the United States), even a modest increase in the proportion of refunds saved every year could bring about a significant increase in saving.

E-filing software providers Drake Software and TaxWise have offered the split refund option in their software starting last year. This year, Intuit (makers of TurboTax products) and TaxCut have added the split refund option to their software.

The Saver's Credit

The Saver's Credit is an incentive for middle- and lower-income taxpayers to save in 401(k)s and IRAs. The Saver's Credit is designed to level the playing field for the majority of American workers — households in the 15 percent or lower federal income tax bracket — by augmenting the traditional tax incentives for saving.

Traditional tax incentives reward saving based on income, providing a much greater incentive to save for those in higher income brackets. The Saver's Credit addresses this anomaly by rewarding saving for those earning up to \$53,000 (married filing jointly for 2008). A single individual — or, in the case of a married couple, each spouse — can get a tax credit of up to \$1,000.

- Last year, more than 5 million households claimed the Saver's Credit on their tax returns.

The Saver's Credit, originally scheduled to expire at the end of 2006, was made permanent with the signing of the Pension Protection Act of 2006. Because temporary tax benefits are generally not as fully utilized by taxpayers and preparers as permanent ones, we expect that, over time, more taxpayers will now take advantage of the Saver's Credit.

While the Saver's Credit provides a great benefit for middle- and lower-income earners who take advantage of it, improvements must be made. The Retirement Security Project is calling for the following changes:

- Congress provided for a sliding scale involving 3 credit rates — 10 percent, 20 percent and 50 percent. The original proposal outlined a simple 50 percent credit rate which would have applied to all eligible households. This needs to be restored.
- Congress removed the refundable feature of the Saver's Credit so that it is available only to offset a taxpayer's income tax liability. This makes the credit unavailable to the 50 million working households who pay payroll taxes but have no income tax liability. The credit needs to be made refundable — either by depositing it directly into the IRA or 401(k) to which the household is contributing or by giving the household a direct tax refund.
- The Retirement Security Project also recommends extending the Saver's Credit to households with joint incomes up to \$70,000 — the level originally proposed — as opposed to the current limit (\$52,000 for tax year 2007, \$53,000 for tax year 2008).

Income Limits for Tax Year 2007

Credit Rate	Single, widow(er) or married separate filer income limits	Married, joint filer income limits	Head of household filer income limits
50%	Up to \$15,500	Up to \$31,000	Up to \$23,250
20%	\$15,501 to \$17,000	\$31,001 to \$34,000	\$23,251 to \$25,500
10%	\$17,001 to \$26,000	\$34,001 to \$52,000	\$25,501 to \$39,000
No Credit	\$26,001+	\$52,001+	\$39,001+

The Saver's Credit also helps employers sponsoring 401(k) plans because it encourages more middle- and lower-income employees to save, which tends to improve the plan's score on the 401(k) nondiscrimination tests. In fact, the IRS has a sample notice employers can use to notify employees that they may be eligible to claim the Saver's Credit for voluntary contributions to 401(k), 403(b), 457, SIMPLE or other employer plans. The credit also applies to contributions to both traditional and Roth IRAs.

Number of Tax Filers (in Millions) Qualifying for the Saver's Credit

Qualifying credit rate	Number of tax filers qualifying	Number of tax filers qualifying if credit were refundable	Actual take-up
Any credit	23.9	73.5	5.3
50%	13.3	48.1	—
20%	2.1	3.6	—
10%	8.4	21.8	—

Note: Computed based on data from the 2005 Statistics of Income (SOI) Individual Income Tax Returns (Complete Report), Publication 1304, Internal Revenue Service. Numbers are approximate, and update previous estimates of filers who qualify for the 50 percent credit.

More than 73 million tax filers had incomes low enough to be eligible for the Saver's Credit in 2005. However, nearly 50 million of these filers — more than two-thirds — actually failed to qualify for the credit because they had no federal income tax liability. If the Saver's Credit were made refundable, these 50 million additional tax filers would have qualified for it had they contributed to retirement savings.



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