Saver's Credit

Dear Client:

I'm writing to let you know about a tax credit that can save you up to $1,000 in taxes just for putting money aside for your retirement. It's called the "saver's credit." The credit is a "reward" you receive for putting up to $2,000 a year in an individual retirement account (IRA), Roth IRA, 401(k) plan, or other plan, as explained below. This is an additional tax benefit on top of any other benefits available for the contribution. And unlike deductions, which only reduce taxable income, the credit reduces your tax bill dollar for dollar (but not below zero).

To qualify for the credit, you must be 18 years old (as of the end of the year of the contribution), not a full-time student, and not claimed as a dependent on another person's return.

The credit is determined as a percentage of your "qualifying contribution" (defined below). The percentage varies depending on your adjusted gross income (AGI). A taxpayer's qualifying contribution is limited to $2,000 per year.

For married couples filing jointly, if joint AGI for 2017 is $37,000 or less, the percentage is 50%. Thus, for example, if each spouse contributes the $2,000 maximum, for a total of $4,000, they can claim a total saver's credit of $2,000 ($4,000 × 50%) on their joint return. If AGI is above $37,000 but not over $40,000, the credit is 20% of qualifying contributions ($800 in the above example: $4,000 × 20%). If AGI is above $40,000 but not over $62,000, the credit is 10% of qualifying contributions ($400 in the above example: $4,000 × 10%). If AGI is over $62,000, no credit is available.

For single taxpayers, if AGI for 2017 is $18,500 or less, the percentage is 50%. If AGI is above $18,500 but not over $20,000, the credit is 20% of qualifying contributions. If AGI is above $20,000 but not over $31,000, the credit is 10% of qualifying contributions. And if AGI is over $31,000, no credit is available. (Other income thresholds apply for a taxpayer who files as a "head of household.")

Contributions qualifying for the saver's credit include those made to traditional or Roth IRAs (other than rollover contributions), and elective ("salary reduction") contributions made to a 401(k) plan, a Section 403(b) annuity, a governmental 457 plan, a SIMPLE IRA plan, or a salary reduction Simplified Employee Pension (SEP). The credit is also available for voluntary "after tax" employee contributions to a qualified retirement plan or Section 403(b) annuity. (If you have questions about whether a contribution would qualify, please call.)

Your qualifying contribution is reduced by any taxable distribution received by you (or your spouse, if you file jointly) from a plan described above during a "testing period." This is a period consisting of (i) the two years preceding the year for which you're claiming the saver's credit, (ii) the year for which you're claiming the credit, and (iii) the period after that year up to the due date (including extensions) for the tax return for that year. For example, if a credit is claimed for a qualifying contribution made in 2017, the testing period includes 2015, 2016, 2017, and the period from Jan. 1 through April 15 of 2018 (or the extended due date for filing the 2017 return, if applicable). A qualifying contribution is also reduced by *nontaxable* distributions received from Roth IRAs during the testing period, unless rolled over. No reduction is made for a rollover from a traditional IRA to a Roth IRA.

Example. Tom contributes $3,000 to his 401(k) plan during 2017, but took a $1,200 taxable IRA withdrawal during 2015. Tom's qualifying contribution for purposes of computing his saver's credit for 2017 is $1,800 ($3,000 minus $1,200).

This "reduction" rule can make withdrawals from an IRA or other plan very costly. Not only can the withdrawal be taxable, it can reduce or eliminate the saver's credit for the entire testing period. The reduction rule even applies to "special" distributions, i.e., those taken to pay first-time homebuyer expenses or higher education costs.

The saver's credit is available in addition to any other benefit you may receive from the contribution. Thus, for example, if you contribute $2,000 to a traditional IRA and qualify to deduct that amount, you may also qualify for the saver's credit for that contribution. In fact, since your deduction for the IRA contribution reduces AGI, it may qualify you for a higher credit percentage (see above).

Due to the wide variety of retirement vehicles available to taxpayers, this area of the tax law has grown unusually complex. The saver's credit should not be overlooked, however, because it offers great opportunities for tax savings. Please call me if you have questions or would like to discuss these matters further.

Very truly yours,

Cohen & Grieb, P.A.