

Tax Credit for Retirement Savings Contributions

Who is eligible for the new tax credit for making contributions to a retirement savings plan?

You may be eligible to receive a tax credit of up to 50% of the amount you contribute to a retirement savings plan if your adjusted gross income is below \$25,000 (single), \$37,500 (head of household) or \$50,000 (married) and you meet other eligibility requirements. This credit is available on contributions of up to \$2000 made to a 457, 401(k), 403(b), regular IRA, Roth IRA, SIMPLE or SEP retirement plan, or to any combination of these plans. This special credit is only available during the next five years: 2002, 2003, 2004, 2005, and 2006.

For example, a City employees whose adjusted gross income is \$14,500 and who files a single tax return could receive a tax credit of \$1000 for making a \$2000 retirement saving contribution. This credit is offered in addition to the regular tax deferral on contributions which would be 15% or \$300 in this example. Therefore, the \$2000 retirement savings contribution would only cost this person \$700 in out-of-pocket expense.

Find your gross (before tax) income and filing status on the chart below to determine the credit you may be able to receive. (If you file a 1040A your adjusted gross income is on Line 19; if you file a 1040EX it is on line 4; and if you file a 1040 it is on Line 33.)

Adjusted Gross Income

| Joint Return | | Head of Household | | Single or Other | | Credit Rate |
|--------------|----------|-------------------|----------|-----------------|----------|-------------|
| Over | Under | Over | Under | Over | Under | |
| \$0 | \$30,000 | \$0 | \$22,500 | \$0 | \$15,000 | 50% |
| \$30,000 | \$32,500 | \$22,500 | \$24,375 | \$15,000 | \$16,250 | 20% |
| \$32,500 | \$50,000 | \$24,375 | \$37,500 | \$16,250 | \$25,000 | 10% |
| \$50,000 | | \$37,500 | | \$25,000 | | 0 |

Remember that deferrals to the 457 plan and the 401(k) plan reduce your adjusted gross income, so if you are close to one of these limits, you may be able to move into the next category by increasing your deferrals.

If my income falls within the eligible levels, are there any circumstances under which I would not be eligible for this credit?

This is structured as a credit towards the taxes you owe for the year. If you don't pay any taxes, you won't receive any value from the credit. Full-time students, individuals under age 18 and dependents are not eligible for this credit.

To prevent individuals from making contributions just to receive the credit and then withdrawing the money from the plan, eligibility for the credit is also linked to distributions the individual has received. The amount of any contribution eligible for the credit is reduced by distributions received by the taxpayer (and spouse if a joint return is filed) from any of the eligible savings arrangements during the year for which the credit is claimed, the two years before the year for which the credit is claimed, and during the period after the end of the taxable year and prior to the due date for filing the taxpayer's return for the year.

What is a tax credit and how do I claim it?

A personal tax credit reduces the amount of tax you owe to the Internal Revenue Service (IRS) for the year. If you have not yet paid your taxes, it reduces the amount you will have to pay when you file your tax return. If all of your taxes have already been withheld by your employer, it would entitle you to a refund. The Internal Revenue Code offers several types of "nonrefundable personal tax credits" that can be claimed by eligible individuals when they file their tax return. Other available personal credits include a credit for expenses for dependent care services necessary for gainful employment, a credit for the elderly and disabled, a credit for adoption expenses, and credits for higher education tuition and related expenses. Each credit has a special tax form which must be completed and attached to your 1040 tax return for the year. The IRS has not yet published the form for the retirement savings tax credit.

Will this really help me?

Each year that you are able to take advantage of the full amount of this tax credit, you could set aside \$2,000 for retirement at an actual cost* to you of only \$700. That's an immediate return of 286%. After 30 years, every \$2,000 annual deposit could grow to over \$15,000 with 7% earnings.

What's the down side?

You won't receive the tax credit until you file your tax return for the year. Although you could get back up to \$1000 after you file your tax return, it's going to take some advance planning to budget for this up-front expense.

* Actual cost will vary depending on tax filing status, adjusted gross income and other factors.