The Saver's Credit and Retirement Saving Behavior

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Overview

- Federal tax code provides preferential tax treatment of retirement saving relative to other forms of saving
  - IRAs
  - 401(k)-type arrangements
  - Traditional DB and DC pension plans
  - SEP
  - SIMPLE plans
- Traditionally, tax benefits accrued to higher-income households

Overview

- Benefits based on deductibility of contributions
  - » Classic, deductible IRAs
  - » 401(k)-type arrangements
- Tax deferral from inside build-up at the pre-tax rate of return
- Tax value rises with the marginal tax rate
- Employment-based pension coverage rises with income
  - » Exacerbates policy concerns that most of tax preference for goes to high-income households

Overview

- Policy changes: Saver’s Credit and automatic enrollment
- Formally, “Retirement Savings Contributions Credit”
- Enacted in 2001
- Provides incentives for low- to middle-income families to save
- Attempts to reverse the “upside down” tax-based incentives to save
- Policy discussion limited to tax-preferred saving—no mention of Social Security

Design of the Credit

- Enacted in 2001 (EGTRRA)
  - » Originally scheduled to sunset in 2006
- Nonrefundable
  - » Originally designed to be refundable
- Credit claimed for voluntary retirement-saving contributions to
  - » 401(k)-type arrangements
  - » IRAs
  - » Other employer-based plans
- File IRS Form 8880 to claim credit

Design of the Credit

Form **8880**
Department of the Treasury
Internal Revenue Service

Credit for Qualified Retirement Savings Contributions
▶ **Attach to Form 1040, Form 1040A, or Form 1040NR.**
▶ **See instructions on back.**

OMB No. 1545-0074
2008
Attachment Sequence No. 54

Name(s) shown on return | **Your social security number**

You **cannot** take this credit if **either** of the following applies.

- The amount on Form 1040, line 38; Form 1040A, line 22; or Form 1040NR, line 36 is more than $26,500 ($39,750 if head of household; $53,000 if married filing jointly).
- The person(s) who made the qualified contribution or elective deferral **(a)** was born after January 1, 1991, **(b)** is claimed as a dependent on someone else's 2008 tax return, or **(c)** was a **student** (see instructions).

			(a) You	(b) Your spouse
1	Traditional and Roth IRA contributions for 2008. **Do not** include rollover contributions	1		
2	Elective deferrals to a 401(k) or other qualified employer plan, voluntary employee contributions, and 501(c)(18)(D) plan contributions for 2008 (see instructions)	2		
3	Add lines 1 and 2	3		
4	Certain distributions received **after** 2005 and **before** the due date (including extensions) of your 2008 tax return (see instructions). If married filing jointly, include **both** spouses' amounts in **both** columns. See instructions for an exception	4		
5	Subtract line 4 from line 3. If zero or less, enter -0-	5		
6	In each column, enter the **smaller** of line 5 or $2,000	6		
7	Add the amounts on line 6. If zero, **stop**; you cannot take this credit			7

Design of the Credit

- Credit amount limited to $1000 for single, $2000 for married filing jointly
- Eligibility limited according to AGI
  - » Originally, AGI thresholds not indexed to inflation
- Other restrictions
  - » 18 years or older
  - » Not a full-time student
  - » Cannot be claimed as a dependent
- Credit acts as a form of government matching contributions

Design of the Credit

Table 1. Saver's Credit Rates and Effective Matching Rates by Income[1]

Dollars except where stated otherwise

Adjusted gross income					
Married filing jointly	Singles and married filing separately	Credit rate (percent)	Tax credit for $2,000 contribution	After tax cost of $2,000 contribution	Effective after tax match rate (percent)
0-30,000	0-15,000	50	1,000	1,000	100
30,001-32,500	15,001-16,250	20	400	1,600	25
32,501-50,000	16,251-25,000	10	200	1,800	11

Design of the Credit

- Pension Protection Act (2006)
  - » Made credit permanent
  - » Still nonrefundable
  - » Indexed AGI thresholds
- 2008 AGI thresholds
  - » Single, Married Filing Separately: $26,500
  - » Married Filing Jointly: $53,000
  - » Head of Household: $39,750

The Key Questions of Interest to Economists

- Positive analysis
  - » Descriptive analysis: Who uses the credit?
  - » Take-up: How do the credit's incentives to contribute affect participation in tax-preferred retirement saving plans?
  - » Real behavior: Do contributions associated with the credit represent overall new household saving?
  - » The second is easier to answer than the third, both conceptually and in terms of required data

The Key Questions of Interest to Economists

- Normative analysis
  - » How ought tax-based saving incentives be designed to meet saving targets for different groups of the population at the lowest cost
    - Lost revenue to Treasury
    - True economic cost
  - » Most difficult question to answer
  - » Requires knowing more than just the answer to the positive-analysis issues above

Existing Studies by Economists

- Little has been written about the saver's credit, even descriptive analysis
- Little is known about the impact of the credit's incentives on take-up
- These are good places to start on research
- Even on broader questions about the impact of established subsidies (IRAs, 401(k)s, pensions)
  - » little analysis
  - » little agreement among economists
  - » especially given the trillions invested in these assets

Basic Facts on the Credit for 2006

Size of adjusted gross income	Retirement savings contribution credit	
	Number of returns	Amount
	(12)	(13)
All returns, total	**5,192,133**	**893,957**
No adjusted gross income	273	92
$1 under $5,000	* 106	* 106
$5,000 under $10,000	43,737	2,886
$10,000 under $15,000	259,377	60,963
$15,000 under $20,000	608,572	84,049
$20,000 under $25,000	1,184,202	197,554
$25,000 under $30,000	631,116	161,471
$30,000 under $40,000	1,296,260	196,164
$40,000 under $50,000	1,167,867	190,627
$50,000 under $75,000	* 625	* 44

Basic Facts on the Credit for 2006

- For those with AGI < $50,000, 1-11% claim credit
- Persons filing
  - » 87% for elective deferrals to 401(k)-type arrangements
  - » 13% for IRA contributions
- Dollars of contributions
  - » 73% for 401(k)-type arrangements
  - » 27% for IRAs

Basic Facts on Retirement Account Saving for Target Population

- For those with AGI < $50,000
- Pension eligibility: 5-42%
  - Rises smoothly with AGI
- Currently contributing to an IRA: 2-12%
- Currently contributing to a deductible IRA: 0-5%

Methods: Impact of Credit on Retirement-Account Saving

- How do the matching incentives in credit affect participation in retirement accounts?
- Economists obsessed with isolating cause and effect
- Fundamental issue in empirical work identifying causal relationship
  - » Households who claim the credit may be "high savers"
  - » More likely to contribute to tax-preferred retirement accounts <u>even in the absence of the credit</u>
- So, it is difficult to disentangle the true impact of the credit's matching incentives from unobserved household characteristics

Methods: Impact of Credit on Retirement-Account Saving

- Gold standard: randomized trial
  - » Treatment – gets access to credit and its matching incentives
  - » Control – does not
  - » Effect of credit is difference in participation in (and contributions to) retirement accounts
  - » Randomization breaks link between use of credit and unobserved heterogeneity in saving
- Problem: IRS does not experiment

Methods: Impact of Credit on Retirement-Account Saving

- But H&R Block does
  - » Field experiment on impact of matching contributions on IRA participation and contributions
  - » For low- and middle-income households in St. Louis
  - » Duflo, Gale, Liebman, Orszag, Saez
  - » Random assignment
  - » Findings: Matching has big impact on IRA participation and saving
  - » Not a saver's credit experiment, but relevant to thinking about potential impact of saver's credit

Methods: Impact of Credit on Retirement-Account Saving

- Second-best approach: Quasi- (or natural) experiment
- Examine impact of policy, before vs. after adoption
- Identify groups plausibly affected and not affected by policy
  - “Treatment” and “Control”
  - As long as policy not implemented in a way that is correlated with unobserved heterogeneity in saving behavior, then proceed as if policy was randomly assigned
- Often referred to as “difference-in-difference” approach
- Can be simply implemented with linear regression

Application to the Saver’s Credit

- Identify groups plausibly affected and not affected by policy
  - “Treatment” – Under $50,000 in AGI starting in 2002
  - “Control” – Under $50,000 in AGI prior to 2002 and Over $50,000 in AGI in all years
  - Within “Treatment”, there are differential matching incentives built into credit
  - Differential dose response
    - By AGI
    - By filing status
    - By whether any taxes owed

Application to Saver's Credit

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Application to the Saver’s Credit

- Determine outcome(s) of interest
  - » Participation in and contributions to
    - 401(k)-type arrangements
    - IRAs (Classic, Roth, SIMPLE)
    - SEP

Application to the Saver's Credit

- Identify appropriate data
  - » Don't need longitudinal (panel) data; repeated cross-sectional data will do
  - » IRS SOI Public-Use files, 2000-2006, could be used to answer some questions
  - » 2000-2001 "before"
  - » 2002-2006 "after"
  - » Micro-data detailed enough to determine tax-based incentives to contribute

Feasibility

- Any preliminary analysis to determine if this approach will work out?
- Used IRA participation data from IRS website
  - » by AGI class
  - » 2000-2004 (what was available)
  - » On IRA participation
  - » Saver credit usage
- Focused on deductible IRAs
- Econometrically modeled the impact of matching incentives on IRA contributions

Feasibility

- Linear regression estimates suggest
  - » Elasticity of IRA participation with respect to saver's credit match rate of 0.60
    - Double the match rate (e.g., from 25% to 50%)
    - Increase participation in the deductible IRA participation rate by 60% (not percentage points)
  - » Accounted for differential match rates by marital status and AGI
  - » Accounted for non-refundability
  - » Overall, suggests low- to middle-income savers are quite responsive to government matching incentives

Future Directions

- Interesting results based on aggregate data
- Would they hold up in detailed analysis of micro-data?
- Only done for deductible IRAs
- Would like to know effects for 401(k)s, other types of IRAs to assess overall impact of saver's credit on participation in and contributions to retirement accounts
  - » Are gains in deductible IRAs offset by declines in other retirement accounts
  - » Shifting across plan types
  - » If so, overall effect will be muted
- Broader question of whether saver's credit raises overall household saving is much more difficult to answer
  - » Cannot be done with IRS data alone