



**INTERACTION OF AUTOMATIC IRAS AND THE
RETIREMENT SAVINGS CONTRIBUTIONS CREDIT
(SAVER'S CREDIT)**

A Report Prepared for AARP

**By:
Optimal Benefit Strategies, LLC
Judy Xanthopoulos, PhD
Mary M. Schmitt, Esq.**

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TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	1
I. EXECUTIVE SUMMARY	2
II. OVERVIEW OF CURRENT LAW SAVER’S CREDIT	5
A. In General	5
B. Current Law Incentives for Retirement Savings and the Saver’s Credit.....	6
III. UTILIZATION OF THE SAVER’S CREDIT UNDER CURRENT LAW	17
A. Evidence on the Demographics of Taxpayers Using the Saver’s Credit During the First Year of the Credit	17
B. Utilization of the Saver’s Credit by Year.....	19
IV. OVERVIEW OF AUTOMATIC IRAS	24
A. Structure of Automatic IRAs.....	24
B. Demographics of Automatic IRA Eligible Individuals	25
V. ESTIMATED EFFECTS OF AUTOMATIC IRAS ON UTILIZATION OF THE SAVER’S CREDIT	32
A. Effects of Automatic IRAs on Utilization of the Saver’s Credit Under Current Law	33
B. Effects of Automatic IRAs on the Saver’s Credit Assuming Various Enhancements to the Credit	34

LIST OF TABLES

Table 1	Adjusted Gross Income Thresholds for Saver’s Credit (2007).....	5
Table 2	Tax Advantages of IRA Contributions (2007).....	9
Table 3	Implicit Matching Rates of Current Law Saver’s Credit	10
Table 4	Tax Advantages of IRA Contributions, Various Incomes (2007)	12
Table 5	Tax Advantages of \$2,000 Traditional IRA Contributions (2007).....	13
Table 6	Tax Advantages of IRA Contributions for Married Couples (2007)....	14
Table 7	Tax Advantages of IRA Contributions, Traditional v. Roth IRA (2007)	15
Table 8	Tax Advantages of IRA Contributions for Married Couples, Various Incomes (2007)	16
Table 9	Amount of the Saver’s Credit Unclaimed by Qualified Taxpayers	17
Table 10	Use of the Saver’s Credit by Credit Rate, 2002.....	18
Table 11	Estimated Distribution of Taxpayers <i>Eligible</i> for Automatic IRA and Estimated Average Contributions	31

LIST OF GRAPHS

Graph 1	Tax Advantages of IRA Contributions for Taxpayers with \$15,500 in Gross Incomes, Tax Year 2007, Roth v. Traditional IRA Contributions.....	7
Graph 2	Tax Advantages of a \$4,000 IRA Contribution for Married Taxpayers, Roth v. Traditional IRA, for Various Incomes, Tax Year 2007	8
Graph 3	Effect of \$1 Additional Gross Income on a \$2,000 Roth IRA Contribution, Tax Year 2007	11
Graph 4	Tax Advantages of \$2,000 Traditional IRA Contributions, Increases in Gross Income from \$17,500 to \$17,501, Tax Year 2007	12

Graph 5	Tax Advantages of \$2,000 Roth IRA Contributions, Increases in Gross Income from \$31,000 to \$31,001, Tax Year 2007.....	13
Graph 6	Tax Advantages of \$2,000 IRA Contributions for Taxpayers with \$31,000 in Gross Incomes, Tax year 2007, Roth v. Traditional IRA Contributions.....	14
Graph 7	Tax Advantages of \$2,000 Roth IRA Contributions, for Taxpayers with Various Gross Incomes, Tax Year 2007	15
Graph 8	Total Returns Claiming the Saver’s Credit, Tax Years 2002 through 2005	19
Graph 9	Total Amount of Saver’s Credit Claimed, Tax Years 2002 through 2005	20
Graph 10	Distribution of Taxpayers Claiming the Saver’s Credit, Tax Year 2002.....	21
Graph 11	Distribution of Taxpayers Claiming the Saver’s Credit, Tax Year 2003.....	21
Graph 12	Distribution of Taxpayers Claiming the Saver’s Credit, Tax Year 2004.....	21
Graph 13	Distribution of Taxpayers Claiming the Saver’s Credit, Tax Year 2005.....	21
Graph 14	Taxpayers Claiming the Saver’s Credit, as a Percentage of All Taxpayers in Adjusted Gross Income Class, Tax Year 2002	22
Graph 15	Taxpayers Claiming the Saver’s Credit, as a Percentage of All Taxpayers in Adjusted Gross Income Class, Tax Year 2003	22
Graph 16	Taxpayers Claiming the Saver’s Credit, as a Percentage of All Taxpayers in Adjusted Gross Income Class, Tax Year 2004	22
Graph 17	Taxpayers Claiming the Saver’s Credit, as a Percentage of All Taxpayers in Adjusted Gross Income Class, Tax Year 2005	22
Graph 18	Separation Rates for Selected Industries, Seasonally Adjusted.....	28
Graph 19	Estimated Taxpayers, Eligible for the Automatic IRA.....	30

INTRODUCTION

The success of an Automatic IRA program hinges on the ability of the program to generate retirement savings by a class of individuals who have demonstrated an inability to save on their own. An important element of the incentive to participate in an Automatic IRA program is the application of the Saver's Credit to individuals in the Automatic IRA eligible population.

In this paper, we explore the interaction of Automatic IRAs and the Saver's Credit. We provide an overview of the operation of the Saver's Credit under current law, examine available data on utilization of the Saver's Credit during the first four years of the credit, examine the demographics of the Automatic IRA eligible population, and estimate the potential effects of Automatic IRAs on utilization of the Saver's Credit under current law and assuming certain enhancements to the Saver's Credit are enacted.

I. EXECUTIVE SUMMARY

Overview of the current law Saver's Credit

The Saver's Credit is a nonrefundable tax credit intended to encourage low- and moderate-income taxpayers to save for retirement. Up to \$2,000 of annual retirement savings contributions are eligible for the Saver's Credit. The credit rate is 50 percent, 20 percent, or 10 percent of retirement savings contributions depending upon a taxpayer's adjusted gross income (AGI). Thus, the maximum credit amount is \$1,000, \$400, or \$200. For 2007, the credit is not available to taxpayers with AGI above \$52,000 (married couples filing a joint return), \$39,000 (heads of households), or \$26,000 (single taxpayers).

The Saver's Credit has a unique feature in that the credit rates are subject to AGI cliffs. Thus, a taxpayer who has \$1 of AGI above a credit rate cliff will be subject to the lower credit rate. The AGI cliffs create very high effective tax rates for taxpayers with income just above the cliff.

Nonrefundability of the Saver's Credit

Nonrefundability of the Saver's Credit reduces the value of the credit for low-income individuals, particularly those individuals who otherwise would be eligible for the 50 percent credit rate. For most single taxpayers, we calculate that nonrefundability limits the maximum credit rate that will apply to a \$2,000 retirement savings contribution to approximately 33 percent, rather than 50 percent. The same result occurs for a married couple filing a joint return. Depending upon their circumstances, other taxpayers could be limited to even lower credit rates by nonrefundability.

Saver's Credit as an implicit match for retirement savings contributions

The Saver's Credit provides an implicit match for retirement savings contributions. At a 50 percent credit rate, the Saver's Credit provides an implicit match of 100 percent. The 20 percent Saver's Credit provides an implicit match of 25 percent and the 10 percent Saver's Credit provides an implicit match of 11 percent. However, because of nonrefundability, the implicit match rates will be lower for many taxpayers otherwise eligible for the 50 percent credit rate and may be lower for other taxpayers as well.

Data on utilization of the Saver's Credit under current law

An in-depth study of the first year of the Saver's Credit uncovered interesting data. The first-year data may not be representative of the operation of the credit in later years, but a similar study has not been performed on any newer utilization data.

In the first year of the Saver's Credit, 5.3 million taxpayers claimed Saver's Credits equal to \$1.058 billion. Overall, the average Saver's Credit claimed was \$199; for taxpayers eligible for the 50 percent credit rate, the average credit was \$356, for taxpayers eligible

for the 20 percent credit rate, the average credit was \$235, and for taxpayers eligible for the 10 percent credit rate, the average credit was \$140.

The study found that 43 percent of taxpayers claiming the Saver's Credit in 2002 had their credit amount limited by nonrefundability of the credit. In addition, the study estimated that 89 percent of taxpayers who made Saver's Credit contributions would have had their credit limited by nonrefundability if they had made the maximum permitted contribution.

In addition, the study found that 34 percent of all eligible taxpayers (2.7 million taxpayers) failed to claim nearly \$500 million of Saver's Credit despite the fact that they made retirement savings contributions eligible for the credit.

After the first year of the Saver's Credit, the numbers of returns claiming the Saver's Credit declined slightly. In addition, the overall credits claimed declined. In 2003, 5.297 million taxpayers claimed \$1.034 billion of credits. In 2004, 5.289 million taxpayers claimed \$1.012 billion of credits; and in 2005, 5.294 million taxpayers claimed \$945 million of credits.

Demographics of Automatic IRA eligible individuals

We have estimated that 48 million workers will be eligible to participate in Automatic IRAs through their employers. These workers can be divided into three classes of individuals.

First, some workers who become Automatic IRA eligible may already be saving for retirement on their own or may have already saved for retirement through another employer's retirement plan. Some of the retirement savings that occurs through Automatic IRAs with this class of workers would have occurred in the absence of the program.

Second, there are individuals who will begin saving for the first time through Automatic IRAs. These workers may work for a small employer that does not offer a retirement plan, but haven't begun to save on their own.

Finally, there is a class of workers who are unlikely to become retirement savers even if they are eligible for Automatic IRAs. For example, many of the lowest income workers who are eligible for Automatic IRAs may face liquidity constraints that will hinder their ability to save for retirement through an Automatic IRA.

The Automatic IRA eligible population will likely be lower income, employed part-time or part of the year, work for a relatively small employer, or are relatively young. Because they will tend to be lower income, interaction with the Saver's Credit may be an important part of the retirement savings incentives under an Automatic IRA program.

Estimated effects of Automatic IRAs on utilization of the Saver's Credit

Introduction of an Automatic IRA program, even with low participation rates, is likely to nearly double the utilization of the Saver's Credit. Assuming a 10 percent (on average) participation rate in Automatic IRAs, it is estimated that an additional 6.0 million taxpayers would begin saving for retirement through an Automatic IRA. Of these 6.0 million taxpayers, it is estimated that 4.9 million would be eligible for some portion of the Saver's Credit. Overall, we estimate that Automatic IRAs would increase the revenues attributable to the current law Saver's Credit by \$500 million per year.

As the Automatic IRA program becomes more mature, it is assumed that participation rates would increase. Assuming a 40 percent participation rate, we estimate that 19 million additional taxpayers would begin saving for retirement, resulting in an increase in Saver's Credit revenues of approximately \$1.2 billion per year.

If the Saver's Credit were made fully refundable, we estimate that a 10 percent Automatic IRA participation rate would increase the revenues from the Saver's Credit by \$850 million per year. At a 40 percent participation rate, the increased revenues would be \$1.7 billion per year.

If the Saver's Credit were modified to increase the income thresholds eligible for a 50 percent credit to \$52,000 (in the case of married taxpayers filing joint returns) and to eliminate the cliff effects of the credit, we estimated there would be additional revenues attributable to the Saver's Credit of \$680 million at a 10 percent Automatic IRA participation rate and \$1.6 billion at a 40 percent Automatic IRA participation rate.

II. OVERVIEW OF THE CURRENT LAW SAVER'S CREDIT

A. In General

The Saver's Credit is a nonrefundable tax credit intended to encourage low-income taxpayers to save for retirement.¹ The credit is available for contributions to certain qualified retirement plans, such as elective deferrals in a 401(k) plan, a tax-sheltered annuity, an eligible deferred compensation arrangement of a state or local government, a SIMPLE plan, or a simplified employee pension (SEP); contributions to a traditional or Roth IRA; and certain after-tax employee contributions to a qualified retirement plan.

Up to \$2,000 of annual contributions are eligible for the Saver's Credit. The credit rate is 50 percent of the contributions, 20 percent, or 10 percent, depending upon the taxpayer's adjusted gross income (AGI). Thus, the maximum credit available is \$1,000, \$400, or \$200, depending upon the applicable credit rate. For 2007, the credit is not available to taxpayers with AGI above \$52,000 (married couples filing joint returns), \$39,000 (heads of households) or \$26,000 (single and other taxpayers).

The Saver's Credit has a feature that makes it unique. Many deductions and credits that are only available to taxpayers with income below a specified level are phased out over a specified income range. The Saver's Credit, on the other hand, has three AGI cliffs at which the applicable credit rate changes. For example, a single individual with \$15,500 of AGI for 2007 will be eligible for a 50 percent Saver's Credit rate, whereas a single individual with \$15,501 of AGI will be eligible for a 20 percent Saver's Credit rate. Table 1, below shows the 2007 AGI levels at which the applicable Saver's Credit rates change.

	50% Credit	20% Credit	10% Credit	Credit Not Available
Married couple filing joint return	\$0-\$31,000	\$31,001-\$34,000	\$34,001-\$52,000	Over \$52,000
Heads of households	\$0-\$23,250	\$23,251-\$25,500	\$25,501-\$39,000	Over \$39,000
Singles and all other filers	\$0-\$15,500	\$15,501-\$17,000	\$17,001-\$26,000	Over \$26,000

Because the Saver's Credit is nonrefundable, it can only be used to offset income tax liability. If a taxpayer does not have income tax liability up to the full amount of credit to which the taxpayer would otherwise be entitled, the full value of the credit cannot be used. The following example illustrates this point:

¹ The Saver's Credit was, as originally enacted, a temporary credit. It was made permanent as part of the Pension Protection Act of 2006.

Assume an individual who claims the standard deduction has AGI of \$15,500 and the individual makes a \$2,000 contribution to an IRA. Assume also that the individual has no other credits or adjustments and has no dependents. After taking one personal exemption of \$3,400 and the standard deduction of \$5,350 (amounts for 2007), the individual has taxable income of \$6,750. Under the 2007 Federal tax rate schedules, the individual has Federal tax liability of \$675 (10% times \$6,750). Because the individual's Federal income tax liability is less than \$1,000, the Saver's Credit will only be allowed up to \$675.

This example illustrates that the full amount of the Saver's Credit is unlikely to be utilized by many taxpayers. If a single individual with the maximum amount of AGI eligible for the 50 percent credit cannot fully utilize the credit assuming one personal exemption and the standard deduction, it is unlikely that there are many scenarios in which the full \$1,000 credit can be claimed. One study found that 43 percent of taxpayers eligible for the Saver's Credit in 2002 had their credit limited by their tax liability.²

Furthermore, the lower an individual's AGI, the more likely it is that the individual will face liquidity constraints that will make it unlikely that the individual will make retirement contributions eligible for the credit.

B. Current Law Incentives for Retirement Savings and the Saver's Credit

In general, current law provides tax incentives for retirement savings – an exclusion from income (or deduction) for an employer or employee contribution to a qualified retirement savings plan, the exclusion from income of the earnings (insides buildup) on retirement savings contributions, and the Saver's Credit for retirement savings contributions. In the case of a Roth 401(k) or Roth IRA, there is no upfront exclusion from income or deduction, but amounts withdrawn from the account are not included in income.³

The current value of the income exclusion (or deduction) provided with respect to retirement savings contributions increases as an individual's marginal income tax rate increases. For example, if an individual makes a \$2,000 deductible IRA contribution, the current value of the tax benefit of the deduction is \$200 if the individual is in the 10 percent income tax bracket and is \$700 if the individual is in the 35 percent income tax bracket. The individual in the 35 percent tax bracket receives more than twice the tax benefit of the individual in the 10 percent bracket for the same contribution. Thus, the tax benefit is more valuable as the marginal tax rate increases.

² Koenig, Gary and Harvey, Robert. *Utilization of the Saver's Credit: An Analysis of the First Year*. National Tax Journal, Vol. LVIII, No. 4, December 2005.

³ If a taxpayer faces the same marginal tax rate when a retirement savings contribution is made and when the contributions is withdrawn, then the tax benefit of a Roth 401(k) or Roth IRA contribution is equivalent to the tax benefit of a contribution that is excludable (deductible) when made and taxed upon withdrawal.

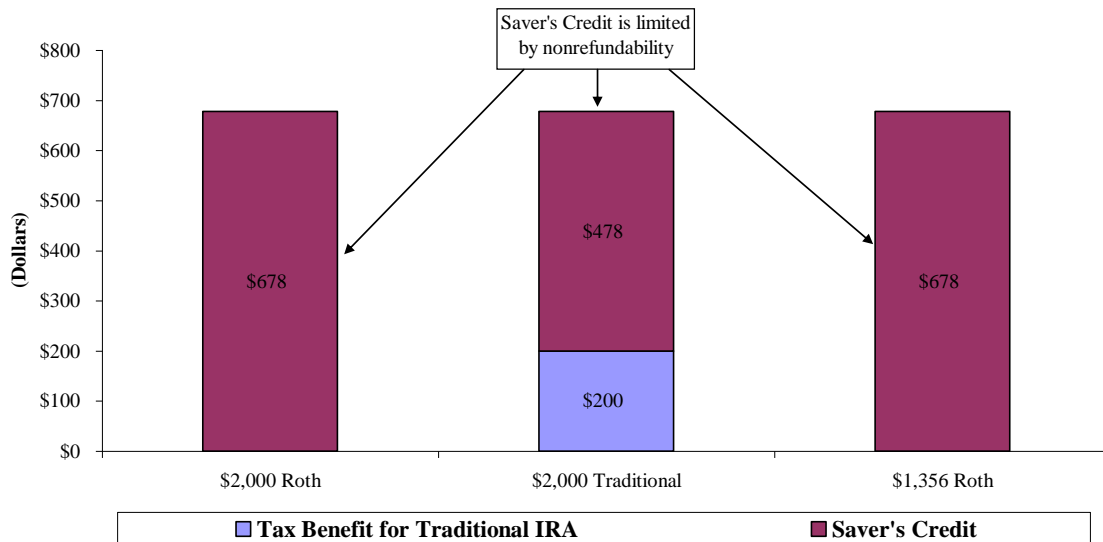
The exclusion (or deduction) for retirement savings contributions was provided to create an incentive for individuals to save for retirement. If an individual is already saving for retirement, the tax incentive rewards behavior that would have taken place in the absence of the exclusion or deduction. Savings behavior is positively correlated with income; individuals with higher income are more likely to be saving for retirement than individuals with lower income. Thus, the exclusion or deduction for retirement savings contributions provides a greater tax benefit to those individuals who (1) are higher income and (2) are likely to save in the absence of the exclusion or deduction.

The retirement savings credit (Saver’s Credit) was enacted to counteract this effect by increasing the tax incentive for lower income individuals to save for retirement. However, the design of the Saver’s Credit reduces the value of the credit as an incentive mechanism for retirement savings. This section details some of the problems with the current law tax incentives for retirement savings.

Nonrefundability of the Saver’s Credit

Nonrefundability of the Saver’s Credit reduces the value of the credit for low-income individuals, particularly those individuals who otherwise would be eligible for the 50 percent credit rate. The examples in Graph 1 and Table 1 below highlight this problem.

**Graph 1 Tax Advantages of IRA Contributions for Taxpayers
with \$15,500 in Gross Incomes, Tax year 2007
Roth v. Traditional IRA Contributions
(Single Taxpayer, No Dependents, Wage & Salary Income Only)**



Graph 1 displays the total tax benefits of IRA contributions for a taxpayer with \$15,500 of gross income. The data for Graph 1 is displayed in Table 1, below. The tax benefits reflect a taxpayer that is a single filer with no dependents. The first two bars show the total tax benefit of a Roth and a Traditional IRA contribution of \$2,000. The third bar

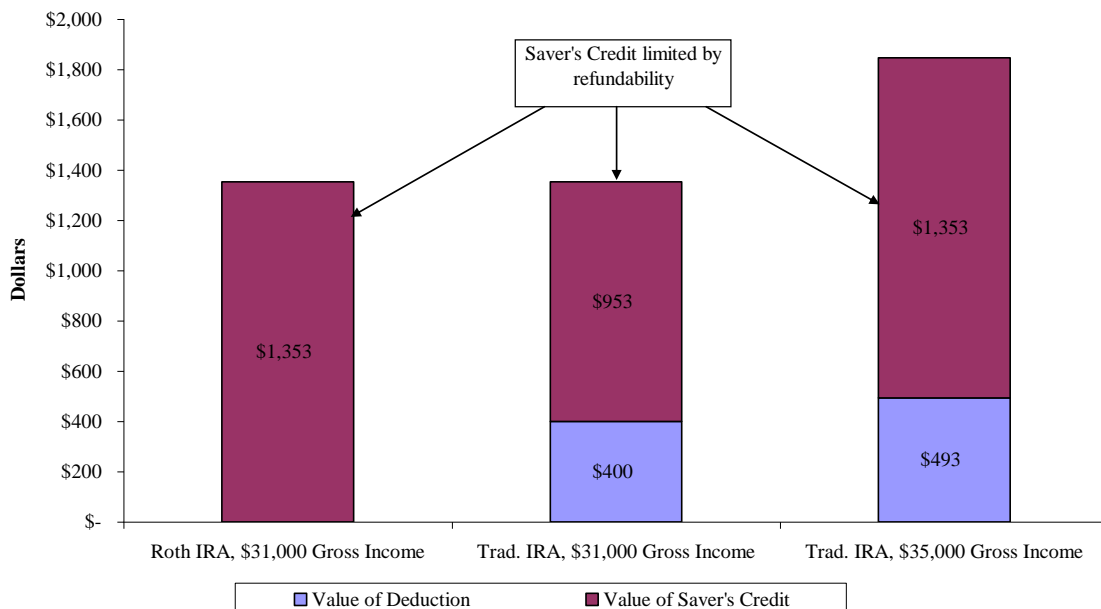
shows that an individual making a Roth IRA contribution of \$1,356 receives a tax benefit equivalent to the \$2,000 traditional and Roth IRA contributions. This is because the nonrefundability of the credit limits the credit amount in the first two cases.

Two points are clear from the graph. First, nonrefundability of the credit creates an incentive for taxpayers to make Roth IRA contributions. In the example above, because the current tax benefit is the same irrespective of whether a taxpayer makes a traditional or Roth IRA contribution, the taxpayer gains no additional current tax benefit from the deductibility of retirement savings contributions. Thus, the taxpayer should make a Roth IRA contribution that will be excluded from income when withdrawn. Second, for taxpayers affected by nonrefundability, there is no incentive to make contributions greater than two times the maximum credit available (\$1,356 in the example above). As the third bar in the graph above shows, nonrefundability means that a taxpayer receives the same tax benefit for a \$2,000 contribution as the taxpayer receives for a \$1,356 contribution.

We calculate that, for most single taxpayers, nonrefundability limits the maximum credit rate that will apply to a retirement savings contribution of \$2,000 is approximately 33 percent, rather than 50 percent.

A similar result occurs when the effect of the Saver's Credit for married couples filing joint returns is examined. Assuming the simplest case, a married couple filing a joint return with no dependent children and only wage and salary income is likely to be affected by the nonrefundability of the Saver's Credit. Graph 2, below, shows the results for a married couple with maximum income eligible for the 50 percent credit rate.

Graph 2 Tax Advantages of a \$4,000 IRA Contributions for Married Taxpayers, Roth v. Traditional IRA, for Various Incomes, Tax Year 2007
(Married Couple Filing Joint Return, No Dependents, Wage and Salary Income Only)



As with single taxpayers, the maximum credit rate available to a married couple filing a joint return is approximately 33 percent.

Table 2 – Tax Advantages of IRA Contributions (2007)						
Single Individual, No Dependents, Wage and Salary Income Only						
				Current Tax Benefits of IRA Contributions		
Gross Income	AGI	Roth IRA Contribution	Traditional IRA Contribution	Tax Benefit of Deduction for Traditional IRA Contributions	Saver’s Credit	Total 2007 Tax Benefit
\$15,500	\$15,500	\$2,000		0	\$678*	\$678*
\$15,500	\$13,000	0	\$2,000	\$200	\$478*	\$678*
\$15,500	\$15,500	\$1,356	0	0	\$678*	\$678*
Married couple, No Dependents, Wage and Salary Income Only						
				Current Tax Benefits of IRA Contributions		
Gross Income	AGI	Roth IRA Contribution	Traditional IRA Contribution	Tax Benefit of Deduction for Traditional IRA Contributions	Saver’s Credit	Total 2007 Tax Benefit
\$31,000	\$31,000	\$4,000			\$1,353*	\$1,353*
\$31,000	\$27,000		\$4,000	\$400	\$953*	\$1,353*
\$35,000	\$31,000		\$4,000	\$493	\$1,353*	\$1,846*
\$31,000	\$31,000	\$2,706			\$1,353*	\$1,353*

*Credit limited by nonrefundability

A study of the first year of the Saver’s Credit found that 43 percent of all taxpayers eligible for the 50 percent Saver’s Credit rate had their credit limited by nonrefundability of the credit.⁴ In addition, the study found that 89 percent of taxpayers eligible for the 50 percent Saver’s Credit rate would have their credit limited by nonrefundability if they made the \$2,000 maximum contribution eligible for the credit.

⁴ Koenig and Harvey, 2005.

Saver's Credit as an implicit match for retirement savings contributions

The Saver's Credit provides an implicit match for retirement savings contributions. For example, if an individual eligible for a 50 percent Saver's Credit makes a \$2,000 contribution to an IRA, the individual receives a tax credit equal to \$1,000, reducing their net out-of-pocket contribution to \$1,000. This is equivalent to an individual making a \$1,000 contribution to the account and having the Federal government match the contribution dollar-for-dollar. Thus, the implicit matching rate is 100 percent.

For an individual eligible for a 20 percent Saver's Credit, the implicit match rate is lower. If an individual eligible for the 20 percent Saver's Credit made a \$2,000 contribution to an IRA, the individual would receive a credit of \$400, reducing the cost of the contribution to \$1,600 (for an implicit matching rate of 25 percent). If the same individual were only eligible for a 10 percent Saver's Credit, the credit would be \$200, reducing the cost of the contribution to \$1,800 (for an implicit matching rate of approximately 11 percent).

The implicit matching rates for the various Saver's Credit levels are shown in Table 3, below.

Saver's Credit Rate	Implicit Match Rate
50%	100%
20%	25%
10%	11%

It is important to note that these implicit matching rates are affected by the nonrefundability of the Saver's Credit. Thus, to the extent the Saver's Credit is limited by nonrefundability, the implicit matching rates go down.

In addition, true matching contributions would result in increases in overall retirement savings. In a 401(k) plan with an employer match, an employee's contributions will be matched with some level of employer contributions made to the 401(k) plan.

With an implicit match such as that provided by the Saver's Credit, the level of retirement savings does not increase by the value of the credit. Rather, an individual's after-tax cost of the retirement savings contributions is reduced. Thus, in effect, the implicit match increases amounts available for consumption, rather than increasing the overall amount of retirement savings. If the Saver's Credit were provided as an explicit match, this effect would be eliminated. However, it is also important to note that an explicit match may reduce overall individual contributions to retirement savings. Assume an individual who makes a \$2,000 contribution to retirement savings under current law and is eligible for the 50 percent credit, resulting in an implicit match of \$1,000. If the individual were instead eligible for an explicit 100 percent match rate, the

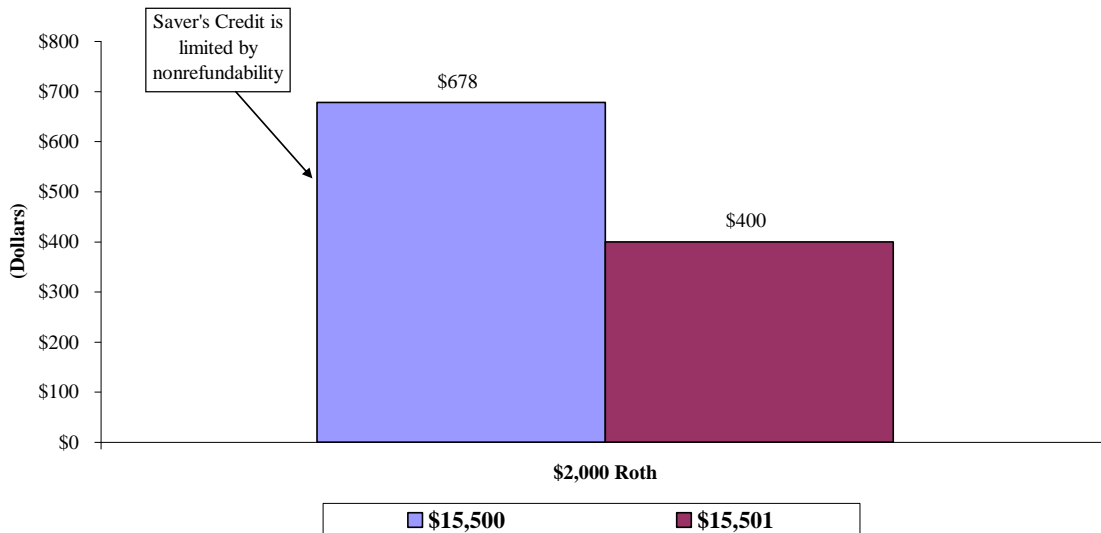
individual might reduce his or her retirement savings contribution to \$1,000, receive the explicit match of \$1,000, and be in the same net position as under current law.

However, there is some evidence that some individuals would not fully alter their savings behavior when faced with an explicit match. Koenig and Harvey found that, in 2002, approximately 2.7 million taxpayers were eligible to claim the Saver's Credit for retirement savings contributions, but failed to claim the credit. This class represented 34 percent of all eligible taxpayers and they could have claimed nearly \$500 million of credits. This suggests that some taxpayers are saving under current law irrespective of the Saver's Credit and that these taxpayers might continue to save the same amounts irrespective of an explicit match.

Cliff effect of the Saver's Credit

The Saver's Credit rates drop from 50 percent to zero in three increments. One problem is that the rate drop-offs occur as cliffs – in other words, for one additional dollar of AGI, the credit rate drops from 50 to 20 percent, from 20 to 10 percent, and from 10 percent to zero. These cliffs result in extraordinary marginal tax rates for taxpayers just above the cliff amount. Table 4 and Graph 2, below, show the effects of the Saver's Credit cliff.

Graph 3 Effect of \$1 Additional Gross Income on a \$2,000 Roth IRA Contribution, Tax year 2007
(Single Taxpayer, No Dependents, Wage & Salary Income Only)



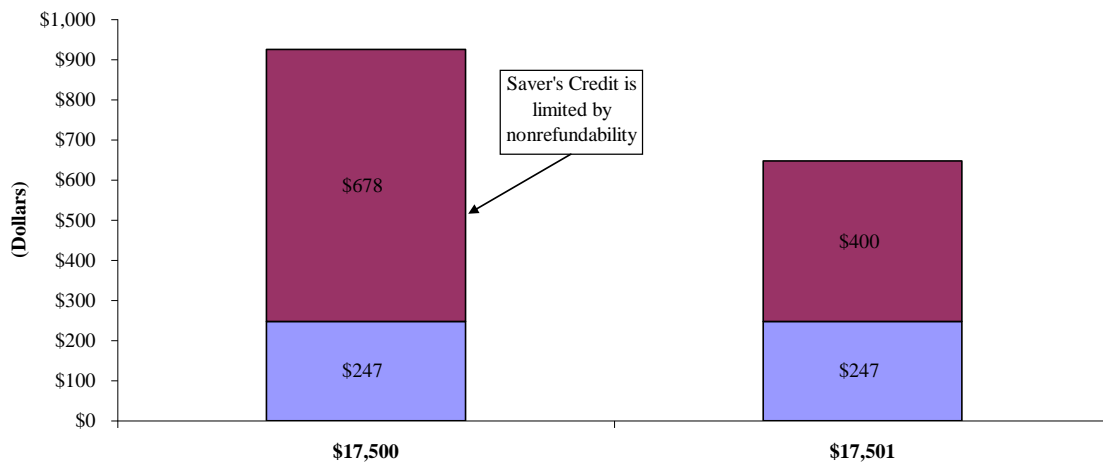
Graph 3 displays the total tax benefits of a \$2,000 Roth IRA contribution. The tax benefit reflects a taxpayer that is a single filer with no dependents. This graph demonstrates the diminished tax benefits for a \$1 increase in gross income from \$15,500 to \$15,501. The first bar shows that a single taxpayer with \$15,500 of gross income is entitled to a \$678 Saver's Credit (note that the credit is limited by nonrefundability). If

the taxpayer's gross income increases by \$1, the available Saver's Credit is reduced to \$400 (not affected by nonrefundability). This cliff effect of the Saver's Credit income thresholds highlights the high marginal tax rate that taxpayers face if they have income just above the income thresholds.

Table 4 – Tax Advantages of IRA Contributions, Various Incomes (2007) (Single Individual, No Dependents, Wage and Salary Income Only)					
Gross Income	AGI	Roth IRA Contribution	Current Tax Benefits of IRA Contributions		
			Tax Benefit of Deduction for Traditional IRA Contributions	Saver's Credit	Total 2007 Tax Benefit
\$15,500	\$15,500	\$2,000	0	\$678*	\$678*
\$15,501	\$15,501	\$2,000	0	\$400	\$400

*Credit limited by nonrefundability

Graph 4 Tax Advantages of \$2,000 Traditional IRA Contributions, Increases in Gross Income from \$17,500 to \$17,501, Tax year 2007
(Single Taxpayer, No Dependents, Wage & Salary Income Only)



Graph 4 displays the total tax benefits of a \$2,000 Roth IRA contribution. The tax benefit reflects a taxpayer that is a single filer with no dependents. This graph demonstrates the diminished tax benefits for a \$1 increase in gross income. The first bar shows the impact of the increase from \$17,500 to \$17,501 in gross income for a Roth

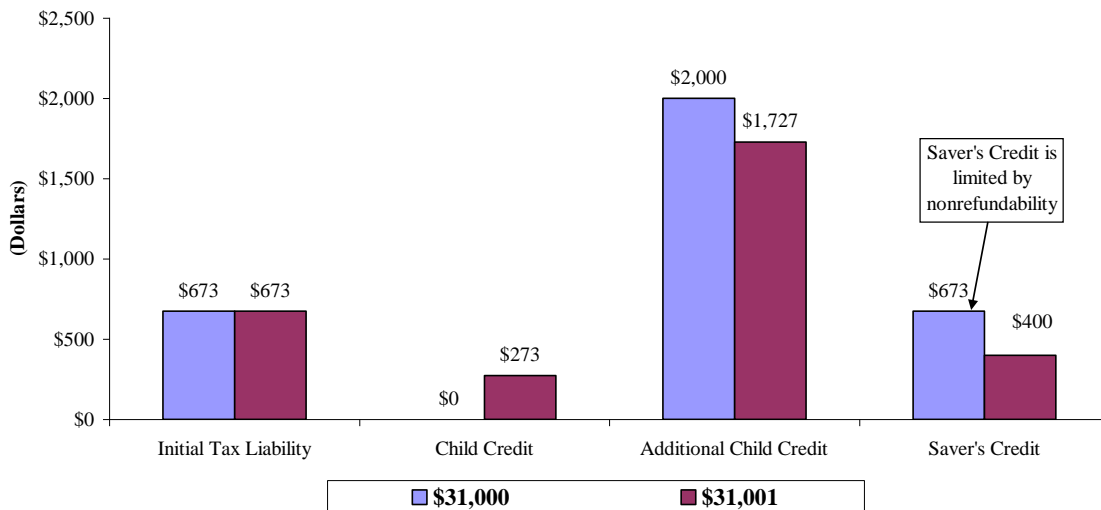
IRA contribution. In the first bar, a taxpayer with gross income of \$17,500, the Saver's Credit is limited by nonrefundability.

Table 5 – Tax Advantages of \$2,000 Traditional IRA Contributions, (2007) (Single Individual, No Dependents, Wage and Salary Income Only)					
			Current Tax Benefits of IRA Contributions		
Gross Income	AGI	Traditional IRA Contribution	Tax Benefit of Deduction for Traditional IRA Contributions	Saver's Credit	Total 2007 Tax Benefit
\$17,500	\$15,500	\$2,000	\$247	\$678*	\$925*
\$17,501	\$15,501	\$2,000	\$247	\$400	\$647

*Credit limited by nonrefundability

**Graph 5 Tax Advantages of \$2,000 Roth IRA Contributions,
Increases in Gross Income from \$31,000 to \$31,001,
Tax year 2007**

(Married Couple Filing Jointly, Two Dependent
Children, Wage and Salary Income Only)



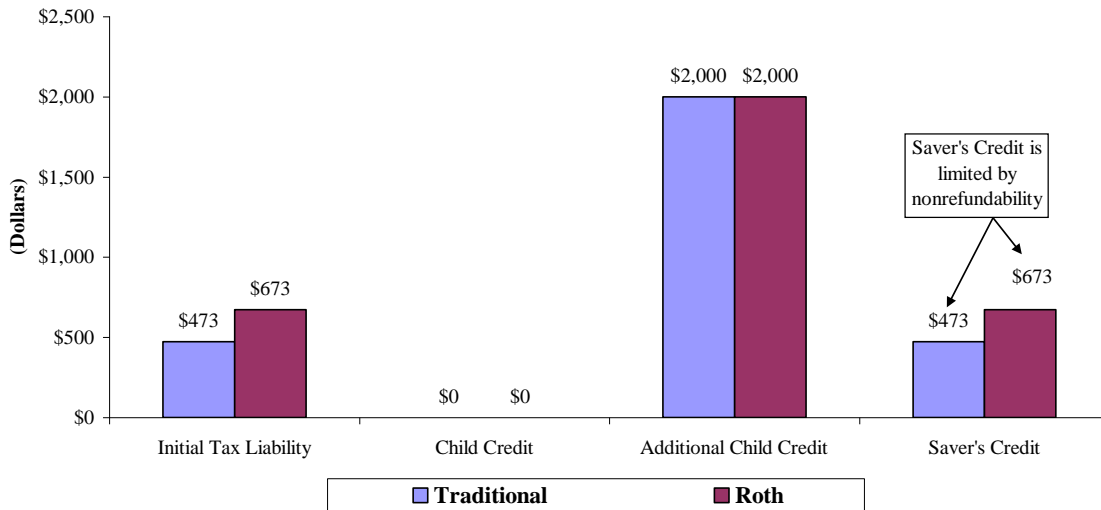
Graph 5 displays the total tax benefits of a \$2,000 Roth IRA contribution for a married taxpayer that files jointly with two dependent children under the age of 17. This graph demonstrates the diminished tax benefits for a \$1 increase in gross income. The first bar shows the impact of the increase from \$31,000 to \$31,001 in gross income for a Roth IRA contribution.

**Table 6 – Tax Advantages of IRA Contributions for Married Couples (2007)
(Married Couple Filing Joint Return, Two Dependent Children Under Age 17,
Wage and Salary Income Only)**

Gross Income	AGI	Initial Tax Liability	Child Credit	Additional Child Credit	IRA Contribution	Saver's Credit
\$31,000	\$31,000	\$673	\$0	\$2,000	\$2,000 (Roth)	\$673*
\$31,001	\$31,001	\$673	\$273	\$1,727	\$2,000 (Roth)	\$400

*Credit limited by nonrefundability

**Graph 6 Tax Advantages of \$2,000 IRA Contributions for
Taxpayers with \$31,000 in Gross Incomes, Tax year 2007
Roth v. Traditional IRA Contributions
(Married Couple Filing Jointly, Two Dependent
Children, Wage and Salary Income Only)**



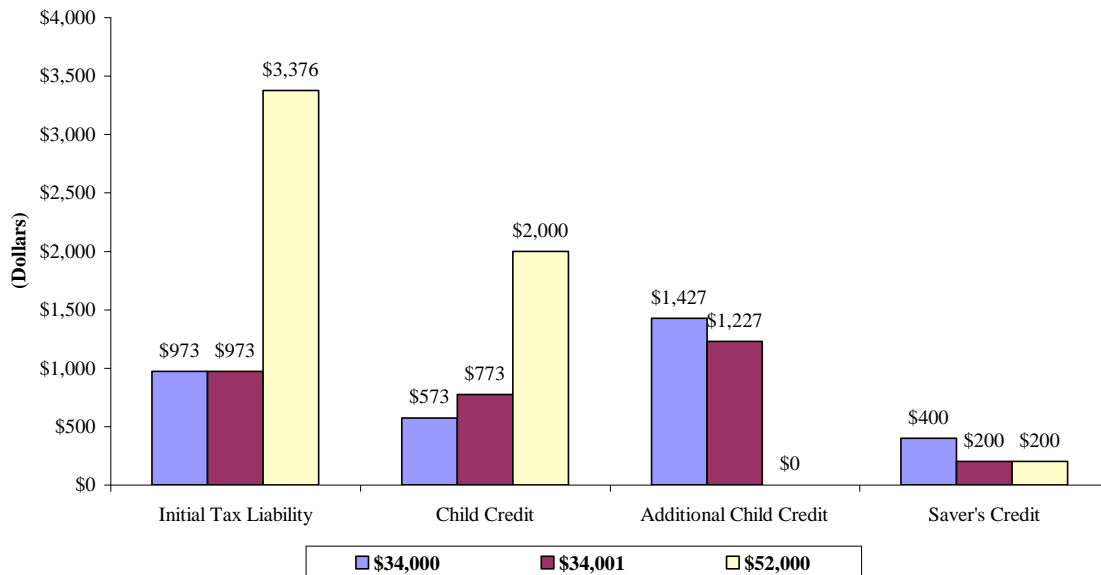
Graph 6 displays the total tax benefits of IRA contributions for a taxpayer with \$31,000 of gross income. The tax benefit reflects a married taxpayer that files jointly with two dependent children under the age of 17. The bars show the tax benefits of a Roth and a traditional IRA contribution of \$2,000. In both cases, the credit amount is limited by the nonrefundability of the credit.

**Table 7 – Tax Advantages of IRA Contributions, Traditional v. Roth IRA (2007)
(Married Couple Filing Joint Return, Two Dependent Children Under Age 17,
Wage and Salary Income Only)**

Gross Income	AGI	Initial Tax Liability	Child Credit	Additional Child Credit	IRA Contribution	Saver's Credit
\$31,000	\$29,000	\$473	0	\$2,000	\$2,000 (Trad.)	\$473*
\$31,000	\$31,000	\$673	\$0	\$2,000	\$2,000 (Roth)	\$673*

*Credit limited by nonrefundability

**Graph 7 Tax Advantages of \$2,000 Roth IRA Contributions,
for Taxpayers with Various Gross Incomes, Tax Year 2007**
(Married Couple Filing Jointly, Two Dependent Children, Wage and Salary Income Only)



Graph 7 displays the total tax benefits of IRA contributions for taxpayers with various amounts of gross income. The tax benefit reflects a married taxpayer that files jointly with two dependent children under the age of 17. The bars show the tax benefits of Roth IRA contributions of \$2,000.

**Table 8 – Tax Advantages of IRA Contributions for Married Couples,
Various Incomes (2007)
(Married Couple Filing Joint Return, Two Dependent Children Under Age 17,
Wage and Salary Income Only)**

Gross Income	AGI	Initial Tax Liability	Child Credit	Additional Child Credit	IRA Contribution	Saver's Credit
\$34,000	\$34,000	\$973	\$573	\$1,427	\$2,000 (Roth)	\$400
\$34,001	\$34,001	\$973	\$773	\$1,227	\$2,000 (Roth)	\$200
\$52,000	\$52,000	\$3,376	\$2,000	0	\$2,000 (Roth)	\$200

*Credit limited by nonrefundability

III. UTILIZATION OF THE SAVER'S CREDIT UNDER CURRENT LAW

A. Evidence on the Demographics of Taxpayers Claiming the Saver's Credit during the First Year of the Credit

One in-depth study has been done on the utilization of the Saver's Credit. This study, by Joint Committee on Taxation economists Gary Koenig and Robert Harvey, examines use of the Saver's Credit in the first year of availability (2002).⁵ The study highlights certain problems with the current law Saver's Credit.

Failure to claim the credit

Koenig and Harvey found that a significant percentage of taxpayers who were eligible for the Saver's Credit in the first year of eligibility failed to claim it. Overall, they found that 34 percent of all eligible taxpayers (2.7 million taxpayers) failed to claim nearly \$500 million of Saver's Credit despite the fact that they made retirement savings contributions that were eligible for the credit. The average credit for these taxpayers was \$184. Table 9, below, shows the amount of the Saver's Credit that went unclaimed in 2002.

Table 9 – Amount of the Saver's Credit Unclaimed by Qualified Taxpayers			
Credit Rate	Returns (thousands)	Potential Credit (\$ millions)	Average Credit
10 percent	1,888	245	130
20 percent	168	32	193
50 percent	640	219	342
Total	2,696	496	184

Source: Koenig and Harvey, 2005.

Taxpayers eligible for the Saver's Credit who did not claim it in the first year of availability were more likely to have made contributions to an employer retirement plan than to an IRA. Nearly 80 percent of the taxpayers who failed to claim Saver's Credits to which they were eligible made a contribution to an employer plan (such as elective deferrals to a 401(k) plan). 15 percent made contributions to IRAs only and four percent made contributions both to an employer plan and to an IRA.

Taxpayers eligible for the 50 percent credit lost nearly 44 of the foregone Saver's Credit and were eligible, on average, for \$342 of credit that they did not claim.

Koenig and Harvey found that taxpayers were much more likely to claim the Saver's Credit if they used a professional tax return preparer or a computer software program to help them prepare their taxes. Interestingly, they found that nearly 25 percent of

⁵ Koenig and Harvey, 2005.

taxpayers eligible for the Saver's Credit who either used a professional return preparer or a computer software program failed to claim the credit that they were eligible to receive.

Nonrefundability of the credit

Consistent with the examples presented in section II, above, Koenig and Harvey found that many taxpayers are ineligible for the full 50-percent Saver's Credit rate because of nonrefundability of the credit. They found that 43 percent of taxpayers claiming the Saver's Credit in 2002 had the amount of their credit limited by nonrefundability. Further, they estimated that 89 percent of taxpayers who made Saver's Credit contributions would have had their credit limited by nonrefundability if they had made the maximum contribution permitted.

According to Koenig and Harvey's calculations, taxpayers claimed \$1.058 billion in Saver's Credits for 2002, but were eligible to claim \$1.752 billion. This translates to a claimed rate of 60 percent.

Cliff effects of the Saver's Credit

Koenig and Harvey did not directly study the cliff effect of the Saver's Credit in the first year of availability. However, some of their data helps to highlight the potential problems with the credit cliffs. Table 8 shows the number of taxpayers claiming the Saver's Credit by credit rate, the amount of credits claimed, and the average credit and contribution amounts.

Table 10 – Use of the Saver's Credit by Credit Rate, 2002					
All Filers					
(Amounts in Millions, Returns in Thousands)					
Credit Bracket	Returns	Amount of Credit Claimed	Average Credit	Average Contribution	Credit Limited by Tax Liability
			Actual \$	Actual \$	%
10 percent	3,619	\$505	\$140	\$1,396	1.1%
20 percent	395	\$93	\$235	\$1,176	3.6%
50 percent	1,293	\$460	\$356	\$712	42.8%
Total All Filers	5,307	\$1,058	\$199	\$1,213	11.5%

Source: Koenig & Harvey, 2005.

Table 10 shows that 4 million taxpayers were in the 10 or 20 percent credit bracket for 2002. These taxpayers will have their effective tax rates affected by the credit cliffs under current law. This occurs because the effective tax rate on a dollar of additional income is increased for taxpayers who are in a credit bracket other than the 50 percent credit bracket. This effective tax rate effect occurs with all income phaseouts; in other words, if the tax benefit of a provision is reduced as income rises, then taxpayers affected by the phaseout face a higher effective tax rate than taxpayers below the phaseout range. Most phaseout provisions include a gradual decline in the tax benefit; the Saver's Credit

provides a cliff at the credit bracket breakpoints, causing taxpayers near the breakpoint to face a much higher effective tax rate than other taxpayers.

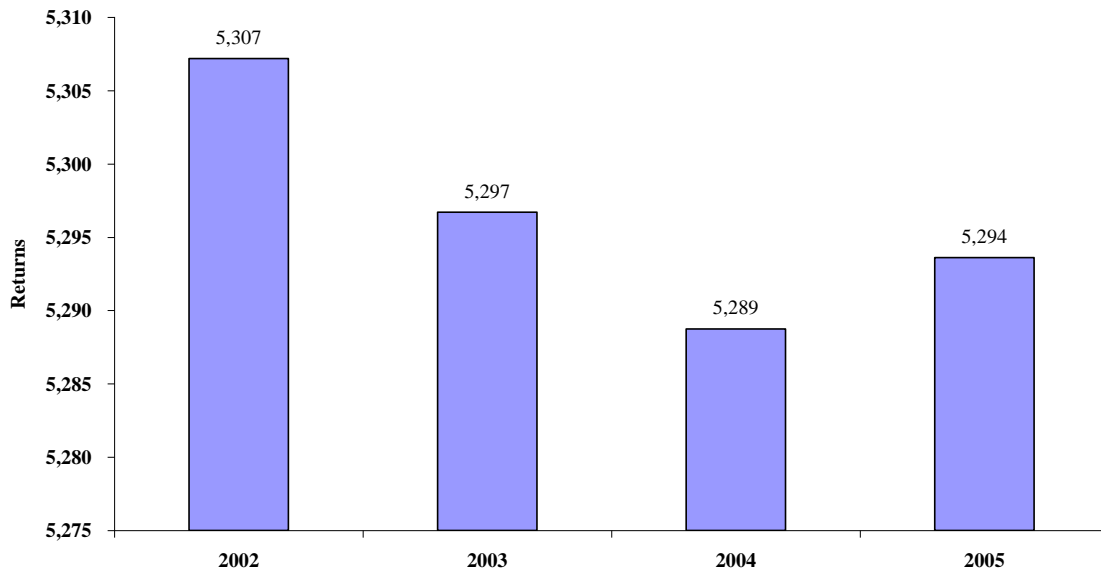
Utilization of the Saver's Credit in its first year of availability may differ from utilization in later years as individuals become more familiar with the credit. In the following section, we explore available data on the utilization of the Saver's Credit year by year since 2002.

B. Utilization of the Saver's Credit by Year

Utilization of the Saver's Credit has declined slightly over the four year period for which data is available. In 2002, the first year that the credit was available, there were approximately 5.3 million returns claiming the credit. The number of returns claiming the credit fell in the two subsequent tax years (5.297 million and 5.289 million, in 2003 and 2004, respectively). However, in tax year 2005, the number of returns claiming the Saver's Credit increased slightly over the 2004 number (5.294 million compared to 5.289). While the number of 2005 represents an increase, in the total number of returns, it did not reach the level of returns claiming the credit in 2002.

Graph 8 Total Returns Claiming the Saver's Credit for Tax Years 2002 to 2005

(Source: IRS SOI Public Use Individual Income Tax Returns Table 3.3)
Returns in Thousands

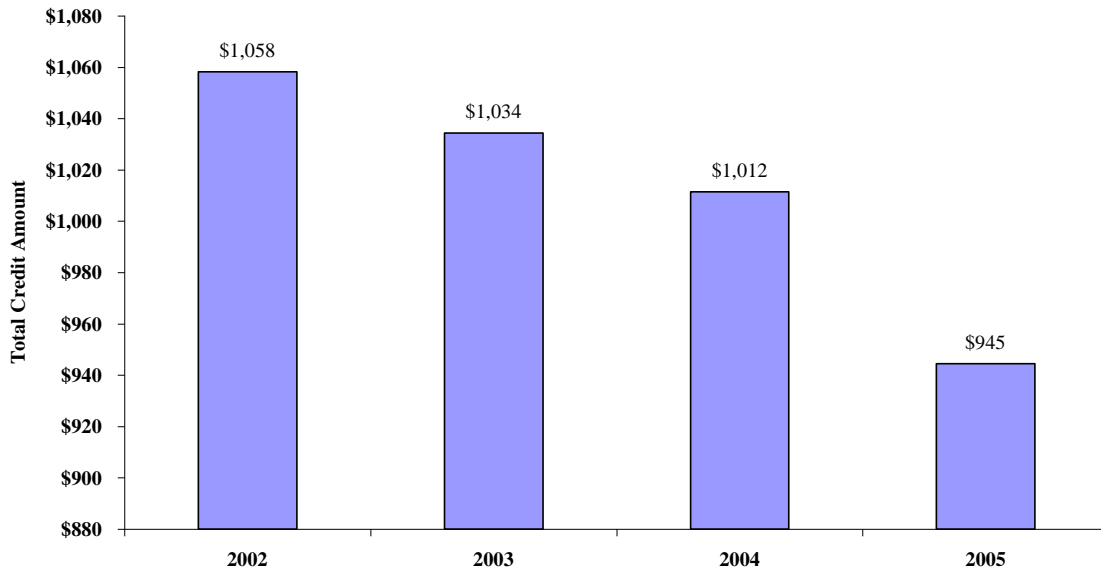


Graph 8 presents the total amount of the Saver's Credit claimed for tax years 2002 through 2005. A similar declining pattern is shown, with one exception. The final year, 2005, demonstrates another decline in the amount of credit. The amount of the Saver's Credit declined from \$1.1 billion in 2002 to \$945 million in 2005.

There are two likely explanations for the gradual decline in the number of returns claiming the credit and the amount claimed. First, for the years in question, the income limits for the Saver’s Credit are not indexed for inflation.⁶ Consequently, with normal growth in taxpayer income from one tax year to another, some taxpayers may find their eligibility is limited in a subsequent year. Second, the Saver’s Credit benefits are available only to those taxpayers with lower incomes. It is likely that, from year to year, taxpayers in lower income classes may experience liquidity constraints that make it difficult to save for retirement.

Graph 9 Total Amount of the Saver's Credit Claimed for Tax Years 2002 to 2005

(Source: IRS SOI Public Use Individual Income Tax Returns Table 3.3)
Amounts in Millions

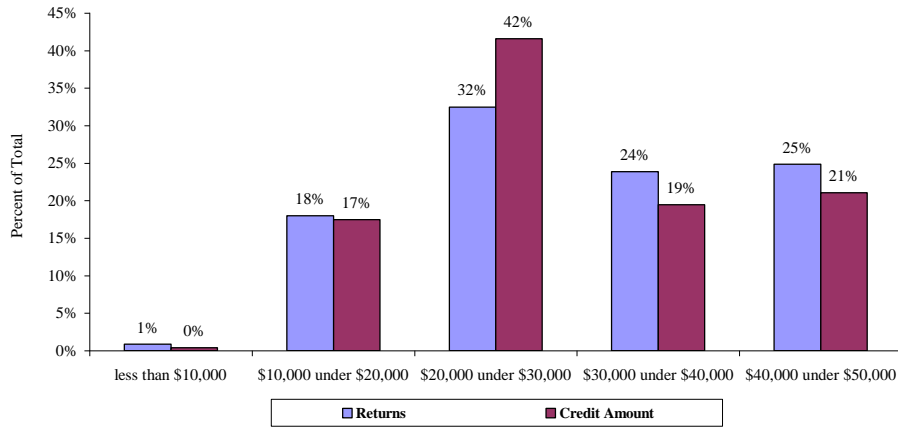


The following four graphs (numbered 10 through 13) show the distribution of taxpayers claiming the Saver’s Credit in tax years 2002 through 2005. Each graph shows the percent of total returns (and the percent of total credits claimed) by adjusted gross income (AGI). The first three years, 2002 through 2004, demonstrates a consistent pattern of taxpayers distributed by income class. However, Graph 13 shows a heavier concentration of taxpayers as well as credit amount for those taxpayers with AGI greater than \$30,000.

⁶ Beginning in 2007, the AGI thresholds are indexed for inflation annually.

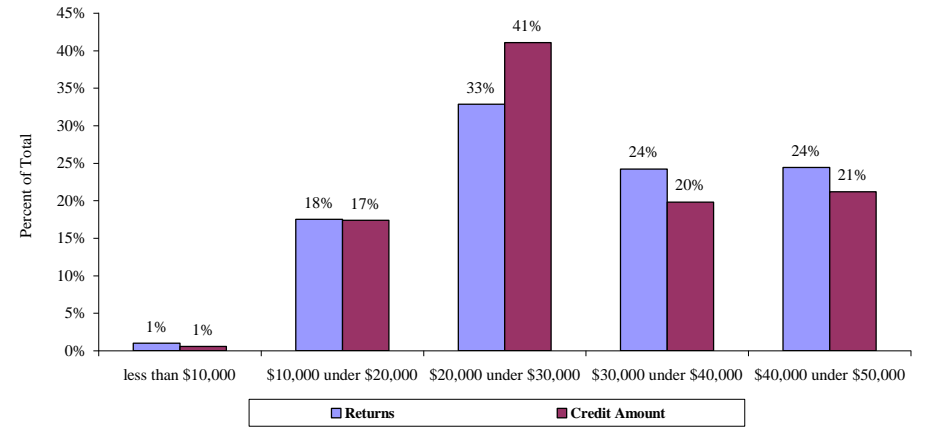
Graph 10 Distribution of Taxpayers Claiming the Saver's Credit, Tax Year 2002

(Source: IRS SOI Public Use Individual Income Tax Returns, Table 3.3)



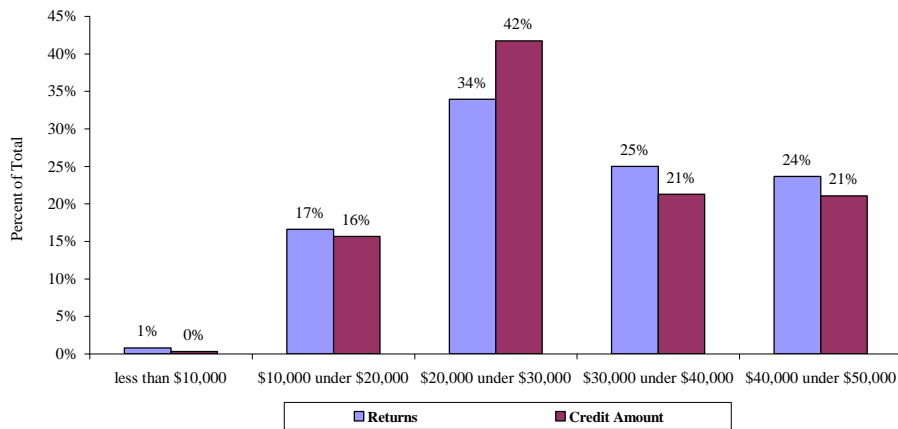
Graph 11 Distribution of Taxpayers Claiming the Saver's Credit, Tax Year 2003

(Source: IRS SOI Public Use Individual Income Tax Returns, Table 3.3)



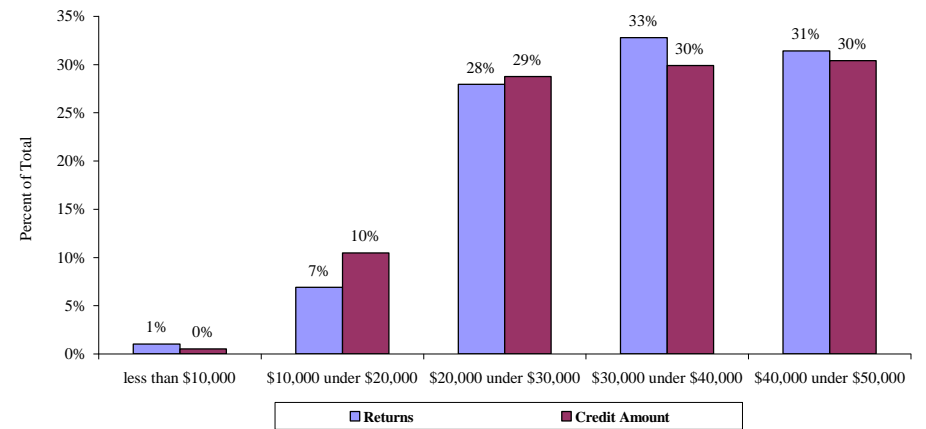
Graph 12 Distribution of Taxpayers Claiming the Saver's Credit, Tax Year 2004

(Source: IRS SOI Public Use Individual Income Tax Returns, Table 3.3)



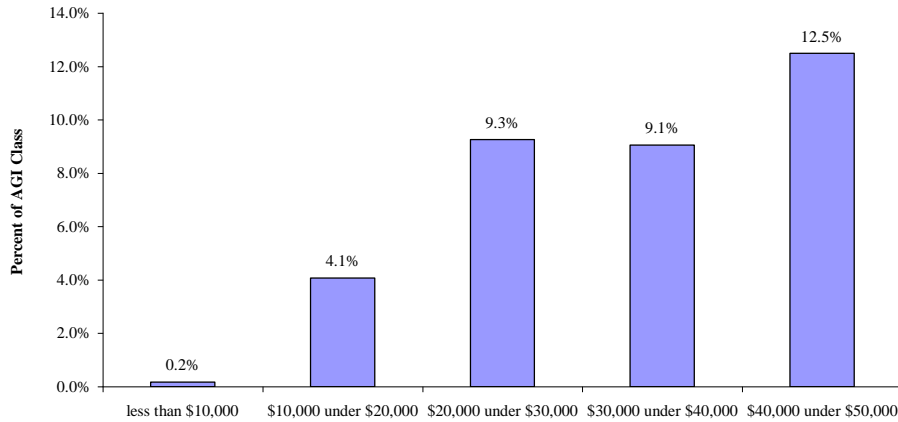
Graph 13 Distribution of Taxpayers a Claiming the Saver's Credit, Tax Year 2005

(Source: IRS SOI Public Use Individual Income Tax Returns, Table 3.3)



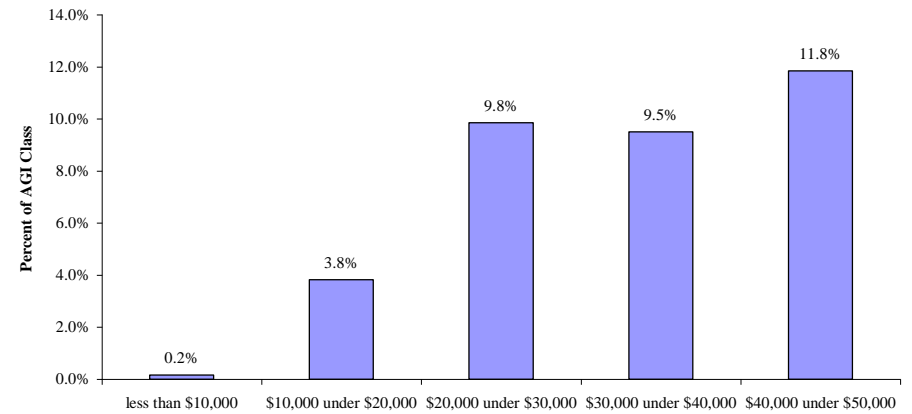
Graph 14 Taxpayers Claiming the Saver's Credit, as a Percentage of All Taxpayers in Adjusted Gross Income Class, Tax Year 2002

(Source: IRS SOI Public Use Individual Income Tax Returns, Table 3.3)



Graph 15 Taxpayers Claiming the Saver's Credit, as a Percentage of All Taxpayers in Adjusted Gross Income Class, Tax Year 2003

(Source: IRS SOI Public Use Individual Income Tax Returns, Table 3.3)



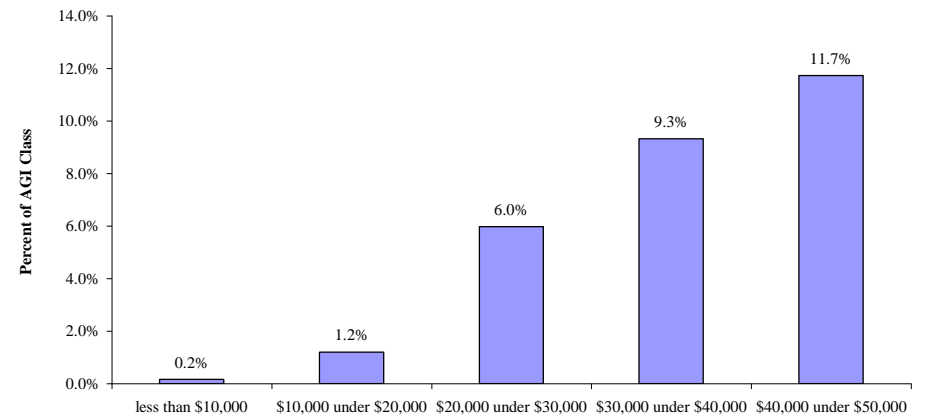
Graph 16 Taxpayers Claiming the Saver's Credit, as a Percentage of All Taxpayers in Adjusted Gross Income Class, Tax Year 2004

(Source: IRS SOI Public Use Individual Income Tax Returns, Table 3.3)



Graph 17 Taxpayers Claiming the Saver's Credit, as a Percentage of All Taxpayers in Adjusted Gross Income Class, Tax Year 2005

(Source: IRS SOI Public Use Individual Income Tax Returns, Table 3.3)



The four graphs (numbered 14 through 17) show the percentage of taxpayers within each AGI class claiming the Saver's Credit for tax years 2002 through 2005. Each bar represents the returns that claimed the credit as a percentage of the total returns in that income class.

Graphs 14 through 17 display a remarkably similar pattern along income classes. For instance, in all the graphs, as income increases, the percentage of taxpayers in each income class increases. In all four years, each graph indicate that nearly 12 percent of taxpayers with AGI of \$40,000 or more and less than \$50,000 and nearly 10 percent of taxpayers with AGI of \$30,000 or more and less than \$40,000 claimed the Savers Credit.

Since savings is positively correlated with income, it is reasonable to expect that the percent claiming the Saver's Credit would decline. This is particularly true in the lowest income class, taxpayers with less than \$10,000 in AGI, where less than one percent (0.2 percent) actually claimed the credit. Lower income individuals face liquidity constraints and generally have a low probability of being able to save.

The remaining two income classes demonstrated consistent patterns until the most recent tax year for which data are available. Approximately 4 percent of taxpayers with AGI of \$10,000 or more and less than \$20,000 claimed the credit in tax years 2002 through 2004. In each year, this represented approximately 1 million returns that claimed the credit (out of 23 million returns filed with incomes in this range). However, in 2005 the percentage falls by nearly 60 percent to 1 percent of taxpayers. In this tax year, approximately 200,000 returns with AGI of \$10,000 or more and less than \$20,000 claimed the credit.

The remaining income class, taxpayers with AGI of \$20,000 or more and less than \$30,000 has a similar decrease in tax year 2005. Approximately 10 percent of taxpayers with AGI of \$20,000 or more and less than \$30,000 claimed the credit in tax years 2002 through 2004. In each year, this represented approximately 1.7 million returns that claimed the credit (out of 18 million returns filed with incomes in this range). However, in 2005 the percentage falls by nearly 40 percent to 6 percent of taxpayers. In this tax year, approximately 1,000,000 returns with AGI of \$20,000 or more and less than \$30,000 claimed the credit.

IV. OVERVIEW OF AUTOMATIC IRAS

A. Structure of Automatic IRAs

Automatic IRAs are intended to bridge the gap in retirement savings for individuals who are not eligible to save for retirement through an employer-sponsored retirement plan. Statistics show that individuals who must take affirmative action to begin saving for retirement are notoriously bad at doing so. Approximately 11 percent of individuals eligible to make contributions to IRAs on their own are doing so. Employees who are eligible to participate in an employer-sponsored 401(k) plan frequently do not take the affirmative action required to being participating in the plan, even when they are faced with generous employer matching contributions.

This phenomenon has been referred to as the power of inertia. Individuals tend not to take the affirmative actions necessary to begin saving, even when there are powerful incentives to do so. However, in recent years, there has been a trend toward automatic enrollment plans, such as automatic enrollment 401(k) plans, in which employees are automatically enrolled to participate unless they elect affirmatively NOT to participate in the plan. Studies have shown that automatic enrollment not only increases the percentages of employees who participate in retirement savings arrangements, but that these employees, once participating, tend to continue to participate in these plans.

With Automatic IRAs, employees who are not eligible to participate in an employer-sponsored retirement plan would be eligible to save for retirement through an Automatic IRA. This retirement saving would be accomplished through regular and automatic payroll deductions from the employee's paycheck.

Employers with a minimum number of employees (e.g., more than 10 employees) who have been in business for at least two years would be required to make Automatic IRAs available to any of their employees not covered under a qualified retirement plan.⁷ Employers would be required to notify their employees of the availability of the Automatic IRA and payroll deduction and would be required to elicit written responses from employees as to whether they want to participate in the Automatic IRAs.

Employers could adopt one of two possible approaches to making Automatic IRAs available. The first approach is the "opt in" approach under which an employee does not participate in an Automatic IRA unless the employee affirmatively elects to participate. The second approach is an "opt out" or "automatic enrollment" approach under which an employee is enrolled in an Automatic IRA and a specified default Automatic IRA contribution is withheld from the employee's paycheck unless the employee affirmatively elects not to participate.

⁷ The proposal does not provide a specific minimum size for employers who will be subject to the Automatic IRA requirement, but suggests more than 10 employees as a possible threshold. The introduced bills adopt this more than 10 employee threshold.

B. Demographics of Automatic IRA Eligible Individuals

Overview

In general, the available data suggest that the typical individual who will be eligible for the Automatic IRA proposal will be low or moderate income, younger rather than older, more likely to be a part-time employee, and likely to have higher than average job turnover (which suggests employment in a high turnover industry). We have estimated that approximately 48 million workers will be eligible to participate in Automatic IRAs through their employers. A key question is whether these 48 million will in fact participate and, once saving through an Automatic IRA, whether they will continue to participate. It is helpful to consider the various classes of workers who will be Automatic IRA eligible.

First, some of the 48 million workers who are Automatic IRA eligible may already be saving for retirement on their own or may have already saved for retirement through a qualified plan of another employer. This group has a demonstrated propensity to save. Automatic IRAs may make it easier for this group to save for retirement and may provide a more systematic method for this group to save. While some of the Automatic IRA savings of this group may substitute for retirement savings that would have occurred in any event, Automatic IRAs may also increase the overall amount of retirement savings for this group by making retirement saving more automatic.

A second class of individuals in the 48 million workers who become eligible for Automatic IRAs are those individuals who will begin saving for the first time because of the Automatic IRA program. These workers most likely work for a small employer that does not currently offer a qualified retirement plan, but would like to have a retirement savings program. However, these individuals may have been unable to overcome inertia to begin saving for retirement on their own. Among the eligible Automatic IRA population, it is likely that these individuals will have higher income and greater job tenure; however, these individuals are likely to face lower marginal tax rates than individuals in the first class. This is an important point because, as we have discussed above, the level of tax incentives for retirement saving can have a significant effect on the amount of retirement saving that takes place. Individuals in lower marginal tax rate brackets gain more incentive for retirement savings from the Saver's Credit than from the income exclusion (or deduction) provided with respect to retirement savings contributions.

Finally, there is a class of individuals who are unlikely to become retirement savers even if they are eligible for Automatic IRAs. For example, many of the lowest income workers who will be eligible for Automatic IRAs face liquidity constraints that will hinder their ability to save for retirement through an Automatic IRA. Other workers will be young enough that they may not value retirement savings relative to saving for a first home purchase or current consumption.

The success of an Automatic IRA system will hinge on the ability of Automatic IRAs to improve retirement savings for the middle class of individuals – those individuals who want to save for retirement, but who have not begun to save under current law.

Profile of Likely Automatic IRA Participant

Until recently, with the introduction of the Saver's Credit, policy incentives to encourage lower- and middle-income households to contribute to retirement savings were largely non-existent. As we have discussed above, the incentives from the exclusion from income (or deduction) of retirement savings contributions provides a much greater incentive to higher income taxpayers than lower income taxpayer. But these taxpayers are also more likely to save on their own.

Little is known about the population that does not save, does not contribute to retirement savings, or has not accumulated any other assets. However, this is the population most likely to be eligible to participate in the Automatic IRA program.

Defining this population is much like defining a negative. In other words, we know who is not eligible or likely to participate. We know who saves and approximately how much they save. However, little attention focuses on the non-saver and the characteristics of the non-saver. This analysis describes the process (qualitatively and quantitatively) by which we have identified the demographics of potential Automatic IRA participants.

Qualitative description

Several studies have examined the classes of individuals who had access to qualified plans in the workplace, but did not participate.⁸ Researchers tend to agree on a general set of characteristics – nonwhite, unmarried, and with low educational attainment.

In 2000, the General Accountability Office (GAO) explored the characteristics of individuals in the labor force without pension coverage.⁹ According to the GAO, a few characteristics described the majority of workers who did not have an employer-sponsored retirement plan. These employees were relatively low income, were employed part-time or part of the year, worked for a relatively small employer, or were relatively young. The GAO also examined the four percent of employees who they identified as eligible for an employer-sponsored retirement plan who chose not to participate in the plan. The GAO said that these employees were more likely to have relatively low income, be relatively young, and have less than a year of job tenure.

In addition to the characteristics identified by GAO, individuals who did not participate in an employer-sponsored retirement plan were twice as likely to be African American or Hispanic. Most had never been married. With respect to educational attainment, most typically did not finish high school.

⁸ For example, see EBRI, Issue Brief No. 286, October 2005 and Catherine Montalto for the Consumer Federation of America.

⁹ *Pension Plans. Characteristics of Persons in the Labor Force Without Pension Coverage.* General Accounting Office, GAO/HEHS-00-131, August 2000.

Most studies also find that individuals without employer-sponsored retirement plan coverage are more likely to be from the lowest income classes and are among the lowest wage earners. Further, the EBRI study characterized many without pension coverage as being in poor health compared to those with coverage.

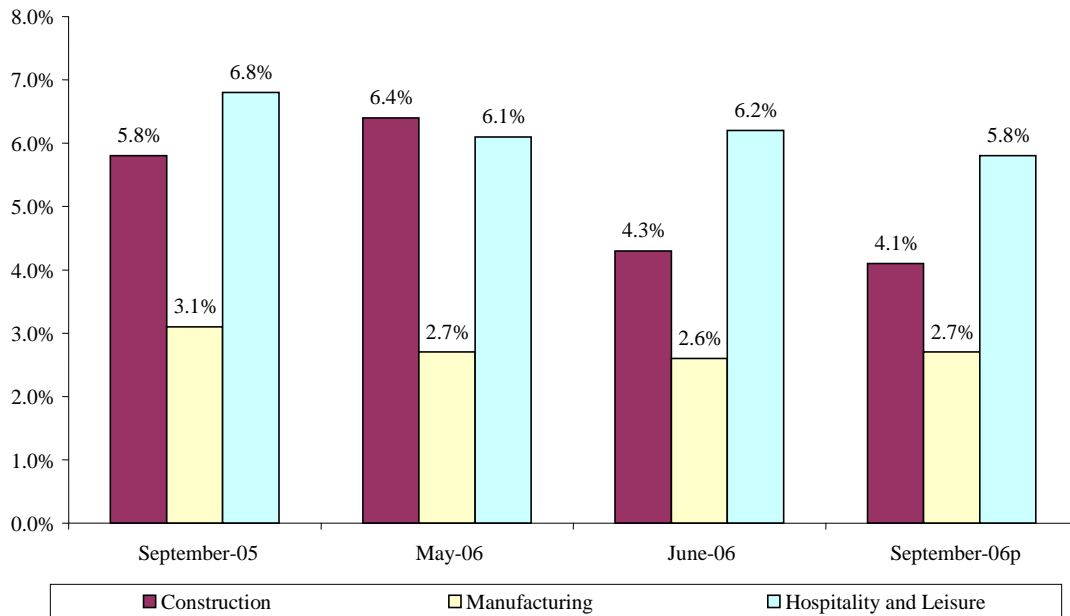
One other characteristic also seems to predict the lack of retirement coverage – being without health insurance. Individuals without health insurance coverage were more likely also to lack any retirement savings. Unlike those without pension coverage, the policy debate has focused a considerable amount of attention on those without health insurance. The likely explanation, one might speculate, is that there is a current public policy problem when an individual lacks health insurance, but the lack of pension coverage is one that takes decades to present.

The correlation between lacking health insurance and lacking pension coverage helps further characterize the population most likely to participate in Automatic IRAs. Research on the uninsured indicates a more balanced racial mix – finding that half of low-income uninsured are white. They further find that the majority of uninsured are in a household with at least one full-time worker. This is an important characteristic, as it suggests that the uninsured without pension coverage will be in the workforce and likely to participate in an Automatic IRA.

Certain industries are known to have higher turnover rates than others. Two such industries, construction and hospitality (includes food services) have the highest worker turnover rates. Health insurance or pension coverage is typically not available to workers in these industries. Further, high separation rates suggest that Automatic IRAs may be administratively difficult for these employers. The graph below shows the monthly turnover rate in three industries – construction, manufacturing, and leisure and hospitality. The graph shows that the construction and leisure and hospitality industries typically have 5-7 percent of their workforce turn over monthly, whereas manufacturing has a much lower 2-3 percent turnover rate.

Graph 18 Separation Rates for Selected Industries, Seasonally Adjusted

Source: Bureau of Labor Statistics, Job Openings and Labor Turnover, 2006



Automatic IRAs contemplate that individuals who are not currently retirement savers will begin saving for retirement through payroll deduction contributions to IRAs. This proposal targets those people who are least likely to save under current law. The data suggest that the typical individual targeted by the Automatic IRA proposal will be low or moderate income, younger rather than older, more likely to be a part-time employee, and likely to have higher than average job turnover (which suggests employment in a high turnover industry). Each of these characteristics will identify individuals who are less likely to be saving for retirement. Of course, it is also true that the individuals most likely to become retirement savers as a result of the Automatic IRA proposal will be those individuals who are the higher end of income for the nonsaving demographic group, who are older rather than younger, who are more likely to be full time employees, and who are more likely to have some job stability.

Quantitative description

Understanding the general characteristics of individuals without retirement savings is important, but for policy purposes, it is important to estimate the numbers of individuals who are in the likely Automatic IRA population as well as their likely income profile.

Estimating the likely Automatic IRA population begins with the population that is not covered by a qualified plan. The starting point for this is the 2002 IRS Statistics of Income study of individual income tax returns as well as W-2 information filings.

The first adjustment eliminates those individuals reporting pension coverage on their W-2 form. Taxpayers with pension coverage would not be eligible for the Automatic IRA program and were eliminated from the total.

The second adjustment eliminates retired taxpayers from the total. Currently, there are approximately 40 million seniors receiving Social Security and Medicare benefits. Of this number about one-third are non-filers or do not have sufficient income to require them to file a return. The majority of seniors are in lower income classes; however like the general population these individuals are proportionately represented in higher income classes.

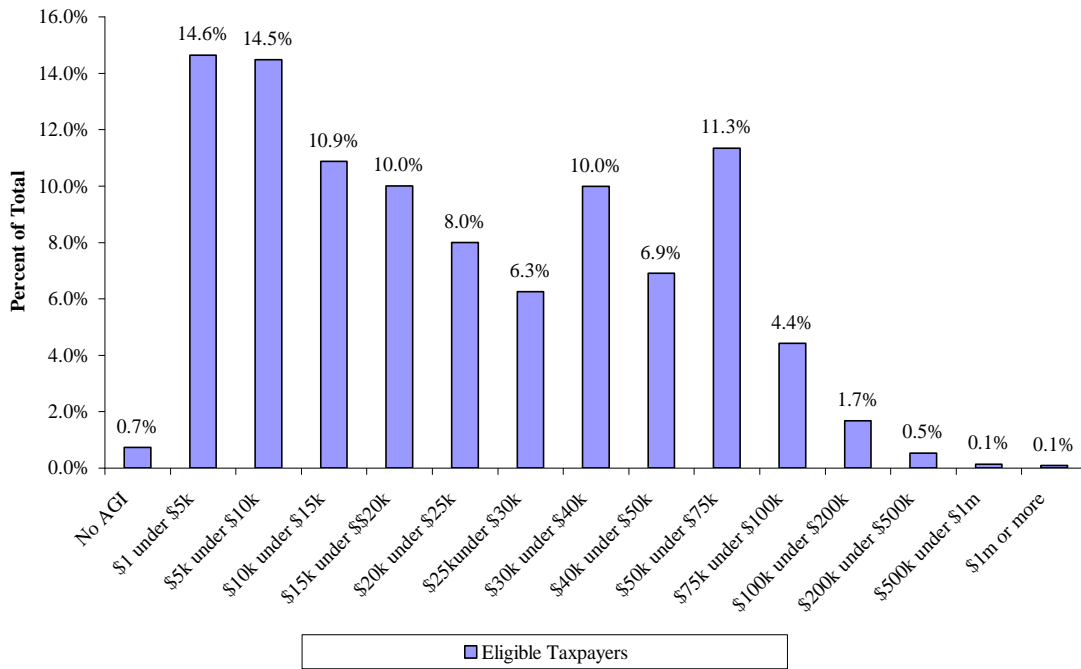
The third adjustment eliminates individuals who currently participate in IRAs or self-employed plans. In the case of IRA contributors, these individuals would most likely opt out of any employer program, as their current level of savings might exceed the Automatic IRA contribution. Self-employed participants in such plans as Keogh, SEP, or SEP-SIMPLE plans would also not participate in an Automatic IRA program.

Finally, minor adjustments consider the portion of the workforce who might be employed for short periods of time or experience consistent job turnover. The difficulty in characterizing this type of worker is fairly evident. A segment of the U.S. workforce includes a small percentage of workers who are new to the workforce or have been employed for a short duration (estimated at about 10 percent). Therefore, these workers would (most likely) not participate in the Automatic IRA.

The graph below shows the income distribution of taxpayers who we estimate will be eligible for Automatic IRAs through their employers based on AGI levels. We estimate that 50 percent of eligible taxpayers will have AGI of no more than \$20,000 per year.

Graph 19 Estimated Taxpayers, Eligible for Automatic IRA

Source: Author's Calculations Based on SOI and CPS data



We have also estimated the number of taxpayers who are eligible to make Automatic IRA contributions through their employers and the average amount of the contributions that is likely to be made. The results are presented in Table 11. This table shows that, for low income taxpayers (below \$20,000 of AGI), the average Automatic IRA contribution will be relatively modest.

Table 11. Estimated Distribution of Taxpayers *Eligible* for Automatic IRA and Estimated Average Contributions

Adjusted Gross Income	Estimated Number of Taxpayers (in thousands)	Estimated Annual Contribution to Automatic IRA (average dollars)
No AGI	350	\$ - 0 -
\$1 under \$5,000	7,010	\$ 75
\$5,000 under \$10,000	6,930	\$ 225
\$10,000 under \$15,000	5,210	\$ 375
\$15,000 under \$20,000	4,790	\$ 525
\$20,000 under \$25,000	3,830	\$ 675
\$25,000 under \$30,000	3,000	\$ 825
\$30,000 under \$40,000	4,780	\$ 1,050
\$40,000 under \$50,000	3,310	\$ 1,350
\$50,000 under \$75,000	5,430	\$ 1,875
\$75,000 under \$100,000	2,110	\$ 2,625
\$100,000 under \$200,000	800	\$ 3,000
\$200,000 under \$500,000	250	\$ 3,000
\$500,000 under \$1,000,000	60	\$ 3,000
\$1,000,000 or more	40	\$ 3,000
Total Eligible (not participants)	47,900	

V. ESTIMATED EFFECTS OF AUTOMATIC IRAS ON USE OF THE SAVER'S CREDIT

Adoption of Automatic IRAs will increase utilization of the Saver's Credit because the Automatic IRA focuses on those taxpayers that are not currently saving. As noted above, we have estimated that approximately 48 million taxpayers will be eligible to participate in an Automatic IRA. Participation in employer-sponsored retirement plans under current law is positively correlated with income. Thus, the higher an individual's income, the more likely the individual is participating in a retirement savings plan. Employees who become eligible to participate in Automatic IRAs are likely to be lower income. Consistent with the pattern for employer-sponsored retirement plans, within the class of Automatic IRA eligible employees, it is likely that participation rates will increase as income increases.

The Saver's Credit can be an important component of the savings equation for the lower income individuals who are eligible for Automatic IRAs. Thus, in this section, we explore the estimated effects on Federal budget receipts of the interaction of Automatic IRAs and the Saver's Credit, both under current law and assuming certain enhancements to the Saver's Credit.

Several important points must be made about these estimates. First, exact details of the Automatic IRA proposal will affect the number of individuals who are eligible to participate in Automatic IRAs and the likelihood that individuals will actually participate. For example, the size threshold for employers subject to the Automatic IRA requirements may be different than what is currently considered or there may be different treatment of existing employees and new employees. We have made some broad generalizations about the Automatic IRA population for purposes of producing the estimates contained in this section.

Second, depending upon the timing and manner of implementation of an Automatic IRA program, the participation rates may fluctuate fairly significantly in the early years. For example, depending upon the design of an Automatic IRA program, a large number of individuals may participate in Automatic IRAs in the first year of the program, some of these individuals may opt out of the program after their initial period of participation, and then there may be a fairly steady increase in participation for a period of time. For purposes of the analysis below, we have generally assumed a smoothing of these participation patterns with a relatively low initial participation rate and higher rates of participation in later years. Actual participation patterns may be much less smooth from year to year as people become more familiar with the Automatic IRA program.

Finally, the estimates provided below represent the incremental cost of Automatic IRA participants. Thus, with respect to the enhancements to the Saver's Credit in part B, below, there are additional revenue costs to the proposals that will occur in the absence of the Automatic IRA program. Those additional costs are not reflected here.

A. Effects of Automatic IRAs on Utilization of the Current-Law Saver's Credit

Introduction of the Automatic IRA program, even with low participation rates, is likely to nearly double use of the Saver's Credit. This estimate assumes that, in the early years, approximately 10 percent of all eligible Automatic IRA taxpayers participate in the Automatic IRA.¹⁰ Assuming 10 percent (on average) participation, it is estimated that an additional 6.0 million taxpayers would begin saving for retirement through the Automatic IRA. Of these 6.0 million new participants in the Automatic IRA program, it is estimated that 4.9 million would be eligible for some portion of the Saver's Credit.

This empirical estimate excludes taxpayers who have access to an employer plan (regardless of their participation in that plan). In addition, it attempts to eliminate those taxpayers that save for retirement outside of an employer, but that may begin to participate in an Automatic IRA in lieu of saving on their own.

The estimated cost for the Saver's Credit of the additional participation in Automatic IRAs is estimated to be approximately \$500 million in the first year – somewhat less than the cost under current law. There are several reasons for this lower estimate, but generally the reasons rely on the likely design and implementation by employers of the Automatic IRA.

First, the estimate assumes that many early participants in the Automatic IRA will be employees who do not elect to opt-out of the program. For these participants, they are likely to continue to save, but their savings will occur at the default rate. Second, given this assumption about participants, it is assumed that employers will implement the Automatic IRA with low default deferral rates (estimated to be between 3 and 5 percent of pay).¹¹ Consequently, the annual Automatic IRA contributions are likely to be quite small in the early years.

Over the ten-year budget window, it is likely that participation will increase. With this increase in participation, the use of the Saver's Credit will also increase. Assuming that participation in the Automatic IRA program increases to 40 percent over the 10 year Federal budget window, it is likely that an additional 19 million taxpayers will begin saving for retirement. Of this 19 million, it is estimated that approximately 15.5 million will be eligible for some portion of the Saver's Credit.

The estimated cost for the Saver's Credit of this higher level of participation is approximately \$1.2 billion per year. This estimate relies on similar assumptions of design and implementation of the Automatic IRA program, assuming that most participants will elect to save at the rates established by the employer.

¹⁰ This estimate assumes that, on average, ten percent of taxpayers participate in the Automatic IRA. The actual percentages vary by income class, as higher income taxpayers have a greater likelihood of participating in the Automatic IRA program.

¹¹ It is assumed that at a 3 percent default deferral rate, taxpayers would have to have incomes of \$67,000 or greater to defer \$2,000 per year.

B. Effects of Automatic IRAs on the Saver's Credit Assuming Various Enhancements to the Credit

Expanding the Saver's Credit, in light of implementing an Automatic IRA program, would provide greater implicit matching to a greater number of taxpayers. There are two potential changes that would offer a more generous benefit – making the Saver's Credit fully refundable and expanding the income classes to which the Saver's Credit is available.

Fully Refundable Credit – Currently, approximately 43 percent of taxpayers eligible for the 50 percent credit do not receive the full benefit of the credit, since the credit is not fully refundable. If taxpayers made the maximum permitted retirement contributions, nearly 90 percent would have their credit limited by nonrefundability. If the credit were fully refundable, based on current levels of participation, it is estimated that the ten-year budget cost would be approximately \$3 billion over ten years.

If the credit were fully refundable, the one-year cost of the credit for the additional Automatic IRA participants (assuming the 10 percent average participation rate discussed above) would increase from \$500 million to \$850 million. Likewise, assuming participation increases to 40 percent over the budget window, the one-year cost of the Saver's Credit would increase from \$1.2 billion to \$1.7 billion.

Expand Eligibility – Under current law, the Saver's credit is not available for married taxpayers filing jointly with \$52,000 (for 2007) or more of AGI (adjusted gross income). (The credit is not available for single taxpayers and heads of household taxpayers with \$26,000 (for 2007) or more and \$39,000 or more of AGI, respectively.) Increasing the availability of the Saver's Credit to higher income taxpayers would have two effects. One effect would be to encourage savings behavior for those taxpayers that do not currently participate in an employer plan. However, since savings behavior is correlated positively with income, the other effect would be to provide a credit for taxpayers that are saving currently.¹²

We have assumed a modification to the Saver's Credit were modified that would provide a 50 percent credit for married taxpayers with up to \$52,000 of AGI (indexed for inflation) and that would phase out the 50 percent credit ratably over a \$25,000 AGI range (e.g., from \$52,000 to \$77,000). Single taxpayers and heads of households with AGI up to \$26,000 and \$39,000, respectively, would be eligible for the 50 percent credit with a phaseout over a \$12,500 and \$18,750 range, respectively. The estimated cost of expanding eligibility of the Saver's Credit in this manner (without making the credit fully refundable and in the absence of Automatic IRA provisions) is approximately \$4.2 billion

¹² This would add to the cost of the credit, since it is estimated that more than 35 percent of taxpayers with incomes between \$50,000 and \$75,000 save for retirement. As incomes increase above \$75,000, nearly 75 percent of all taxpayers save for retirement.

over ten years.¹³ If the Saver's Credit were also made fully refundable with this expanded credit, there would be significant additional revenue costs.

Introduction of the Automatic IRA (at 10 percent average participation rate) and expanding eligibility of the Saver's Credit to taxpayers with incomes greater than \$50,000 but not more than \$75,000 would increase the cost from \$500 million to \$680 million. If Automatic IRA participation increases to 40 percent and the Saver's Credit is expanded to taxpayers with incomes greater than \$50,000 but not more than \$75,000, the cost of the Saver's Credit for the additional Automatic IRA participants would increase from \$1.2 billion to \$1.6 billion.

¹³ One reason for this dramatic increase is the heavy concentration of taxpayers in the \$50,000 to \$75,000 income class.