

The Saver's Bonus

Encouraging and Facilitating Savings by Working Families at Tax Time

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What is the Saver's Bonus?

The Saver's Bonus is a policy proposal that would reward low- and moderate-income individuals and families who save at tax time. Every dollar deposited in a designated savings product would be matched with an additional dollar from the federal government, up to a \$500 annual maximum. Participants would make or report contributions to an eligible account on their federal income tax return, and the bonus would then be transferred directly to the designated account. The bonus could go toward a variety of restricted savings products and those without a designated savings product would be able to open an account directly on their federal income tax return.

Why is it Needed?

Savings is an essential element of financial stability. It provides an important safety net when there is a job loss, drop in income or emergency expense. Additionally, savings can help families move up the economic ladder by facilitating productive investments, such as in postsecondary education or for a downpayment on a home.

Despite the importance of savings and a recent, recession-induced rise in the personal savings rate, Americans, particularly those with lower incomes and fewer resources, are not saving enough for their future needs. According to the Federal Reserve's 2007 Survey of Consumer Finances, 77 percent of American families are carrying debt with a median value of \$67,300. Furthermore, the poorest fifth of American families are carrying a median debt value of \$9,000, with a median income of only \$12,300. When savings are not available, families often turn to alternative and more expensive sources of funding, such as payday loans and credit cards that potentially lock families in a cycle of debt rather than savings.

The federal government has a long history of encouraging families to save and build assets. Each year it provides hundreds of billions of dollars in incentives (over \$400 billion in FY09) through the tax system to support a range of wealth building activities, including retirement savings and homeownership. But households with incomes over \$50,000 a year receive 90% of these tax benefits, while low- and moderate-income families are largely left out. The Saver's Bonus would provide an accessible savings incentive specifically targeted to the low- and moderate-income families excluded from existing tax benefits, creating a path for them toward greater savings, financial security and economic advancement.

How Would it Work?

Each year eligible low- and moderate-income individuals and families could receive the bonus in two different ways. They could either direct a portion of their income tax refund into a designated savings product of their choice using the Internal Revenue Service (IRS) split refund form, Form 8888, or they could report previous contributions to a designated savings product from that tax year. If the tax filer does not have an account, he or she could open one directly on the federal income tax form and deposit all or part of their refund into this newly-opened account. The bonus would then be delivered into the designated savings product by the IRS.

Designated savings products that would qualify for the Saver's Bonus include IRAs, 401(k)s, 529 College Savings Plans, Coverdell Education Accounts, U.S. Savings Bonds and certificates of deposit (minimum 6 month term). Households with incomes of up to 120 percent of eligibility for the Earned Income Tax Credit (approximately \$46,000 for a family of four) would be eligible for the bonus.

What are the Benefits of the Saver's Bonus?

The Saver's Bonus takes advantage of several unique aspects of tax time to both encourage and facilitate savings by low- and moderate-income individuals and families. One is the vast reach of the tax system, since the majority of working Americans must complete and file their federal income tax forms every year with the IRS. The Saver's Bonus would also leverage the extensive infrastructure behind the tax filing process to quickly and easily open accounts and direct monies into them. At the same time, many low- and moderate-income working tax filers receive relatively large tax refunds. For tax year 2008, the average refund was \$2,700, and approximately 24 million EITC recipients received refunds as large as \$4,824. This presents these families with one of the best opportunities during the year to set aside a meaningful amount of savings. For all of these reasons, tax time represents an ideal time and place to encourage and help most low- and moderate-income Americans to save.

The Saver's Bonus itself has several mechanisms that both incentivize and facilitate savings. Research has demonstrated that savings outcomes increase when the savings process is made easier and supported by incentives, such as matching deposits. The dollar-for-dollar match of the Saver's Bonus, available directly on the tax form, can motivate individuals to start saving and save more than they otherwise would or could.

What is the difference between the Saver's Bonus and the Saver's Credit?

The Saver's Credit is a tax credit created in 2001 that incentivizes retirement savings by low- and moderate-income Americans at tax time. President Obama (in his FY10 budget proposal) and some members of Congress have recently proposed several improvements to the Saver's Credit that would make it similar to the Saver's Bonus, including making it refundable so that households without tax liabilities could receive benefits. However, important distinctions remain between the two policies that are described below. Overall, the Saver's Bonus would have a broader impact on facilitating and encouraging savings by low- and moderate income individuals and families than even the reformed Saver's Credit.

Greater Flexibility through More Savings Product Choices

The Saver's Bonus allows tax filers to receive matching funds for savings in a variety of different restricted savings products, from IRAs to U.S. Savings Bonds. In contrast, only retirement savings products such as 401(k)s and IRAs are eligible for the Saver's Credit. The Saver's Bonus recognizes that households have savings needs beyond just retirement. Giving tax filers more savings product choices helps meet the diverse savings needs of low- and moderate-income individuals and families, and may increase the likelihood that they will make the choice to save.

Encourages New Accounts and Savers

The Saver's Bonus would allow tax filers to use their tax refund to open a new account directly on the federal income tax form, as opposed to the Saver's Credit which is only available to tax filers who already have an existing account. As a result, the Saver's Bonus would help facilitate the entry of new savers into the marketplace by making it easier for low- and moderate-income households to get into the habit of saving. In the process it would also create a bridge to bring more unbanked taxpayers into the financial mainstream.

Targeted to Those Who Need the Most Help Saving

The Saver's Bonus would be available to low- and moderate-income households, those with incomes below approximately \$46,000. These households need the most assistance with saving given their lower incomes and are the ones who are most likely to see the biggest benefits from saving in terms of both financial security and economic mobility. These tax filers would also be eligible for the reformed Saver's Credit, but it would also apply to households with annual incomes that reach up to \$85,000. As a result, the total cost of implementing the Saver's Bonus would likely be less than that of the reformed Saver's Credit.