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The Initiative on Financial Security at the Aspen Institute is a leading policy program focused on bold solutions to help all Americans at every stage of life to save, invest, and own.

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The Freedom Savings Credit:
A Practical Step to Build Americans' Household Balance Sheets

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Executive Summary

The imbalance of too much debt and not enough assets fuels financial insecurity in many American households. Building Americans' household balance sheets should start with making savings and asset-building incentives more efficient and equitable. Although millions of working Americans currently receive little or no tax incentive to save, modest reforms to our tax code have the potential to dramatically improve their financial futures. The Aspen Institute Initiative on Financial Security (Aspen IFS) proposes the *Freedom Savings Credit* to create a more equitable and economically efficient savings system that will benefit millions of American households and the nation as a whole.

The *Freedom Saving Credit* would replace the current Retirement Savings Contribution Credit (Saver's Credit), which promotes asset building through saving for retirement. The *Freedom Savings Credit*, deposited directly into qualified savings accounts, would provide each qualified saver with a $1 refundable tax credit for every $2 saved in a 401(k), Individual Retirement Account (IRA), or other qualified savings account. The *Freedom Savings Credit* would give a taxpayer the opportunity to receive up to $500 as a single filer or $1,000 as a married couple filing jointly. President Obama's Fiscal Year 2011 budget included a proposal to start this expansion, scoring a refundable Saver's Credit at $29.8 billion over 10 years.[1] While the *Freedom Savings Credit* would be initially directed at retirement savings, Aspen IFS believes that the credit could be expanded to savings for education, home buying, and healthcare, as well as for family economic emergencies.

Currently, millions of Americans work for years towards financial security without making significant headway. While income keeps workers secure on a day-to-day basis, savings and assets are what move American households and the nation to a stronger, financially secure future. Federal tax incentives to encourage saving and asset building currently do not touch millions of Americans who need these assets the most. The *Freedom Savings Credit* is designed to address their needs.

The Great Recession has exposed deep fault lines in American households' financial security. In 2007, Americans in the bottom 50 percent of the income distribution had an average net worth of approximately $28,370.[2] For years, rising home values and access to easy credit led to debt-fueled consumption, but when the housing bubble collapsed and credit contracted, millions of Americans were caught short, facing serious financial stress, reduced savings, and diminished prospects.

Making saving and investing easier and more rewarding will help move the nation from an economy focused on borrowing and spending to one that promotes financial security for all Americans. Enacting the *Freedom Savings Credit* would transform savings opportunities and outcomes for millions of Americans, helping to build household financial security and grow our nation's economy. America is the country of freedom, but today the freedom to build assets is a near impossibility for millions of Americans. The *Freedom Savings Credit* can change that and put our country back on a path to prosperity.

The Growing Wealth Divide: Americans Living on Borrowed Time – and Borrowed Money

The Great Recession dealt a devastating blow to the financial security of millions of American households. For years, borrowed money substituted for higher wages and household savings. With the collapse of asset prices and the slowdown of the broader economy, many American households faced the loss of both income and assets.

Over the past decade, illusory wealth gains and mortgage abuses driven by the housing bubble encouraged millions of American households to spend more of their incomes and reduce their personal savings rates.[3] For the vast majority of American middle-income households – all but the top 20 percent – their primary residence has remained their single largest asset, representing on average 65.1 percent of household net worth.[4] Consequently, with few other assets, many Americans experienced a sharp decline in their overall net worth when home prices fell by 32 percent from 2006 to 2009.[5] Conversely, wealthier Americans tended to hold a majority of their net worth in financial securities and business equity. By early 2012, financial markets have largely recovered while home values continue

[1] *Budget of the U.S. Government Fiscal Year 2011*, p. 160. Available at http://www.gpo.gov/fdsys/pkg/BUDGET-2011-BUD/pdf/BUDGET-2011-BUD.pdf.

[2] Values updated from computations using the 2004 Survey of Consumer Finance data, which found that the bottom 50 percent of households (ranked by net worth) in 2004 had an average net worth of just $23,000. Eugene Steuerle and Sisi Zhang of the Urban Institute updated data using the 2007 Survey of Consumer Finance. Steuerle and Zhang computed that the bottom 50 percent of households had a mean net worth of $28,370 (undeflated, in 2007 dollars), or $23,160 in 2004 dollars. *See* Suzanne Nora Johnson, Lisa Mensah, and Eugene Steuerle, *Savings in America: Building Opportunities for All,* Goldman Sachs and the Aspen Institute Initiative on Financial Security, Spring 2006, p. 13. Available at: http://www.aspeninstitute.org/sites/default/files/content/docs/initiative%20on%20financial%20security/IFSSAVINGSINAMERICAWHITEPAPER.PDF. *See also* Federal Reserve Board, *2007 Survey of Consumer Finance*. Available at: http://www.federalreserve.gov/econresdata/scf/scf_2007.htm.

[3] Dean Baker and David Rosnick, "7 Things You Need to Know About the National Debt, Deficits, and the Dollar," Center for Economic and Policy Research, June 2011, p. 5. Available at: http://www.cepr.net/documents/publications/debt-2011-06.pdf. Additionally, data show that not only did mortgage brokers promote mortgages that people could not afford, but also mortgage brokers discriminated against borrowers based on race, rather than on credit scores. *See* Algernon Austin, "A Good Credit Score Did Not Protect Latino and Black Borrowers," EPI Economic Snapshot, January 19, 2012. Available at: http://www.epi.org/publication/latino-black-borrowers-high-rate-subprime-mortgages/.

[4] Edward N. Wolff, "Recent Trends in Household Wealth in the United States: Rising Debt and the Middle-Class Squeeze – an Update to 2007," Levy Economics Institute of Bard College, Working Paper No. 589, March 2010. Available at: http://www.levyinstitute.org/pubs/wp_589.pdf.

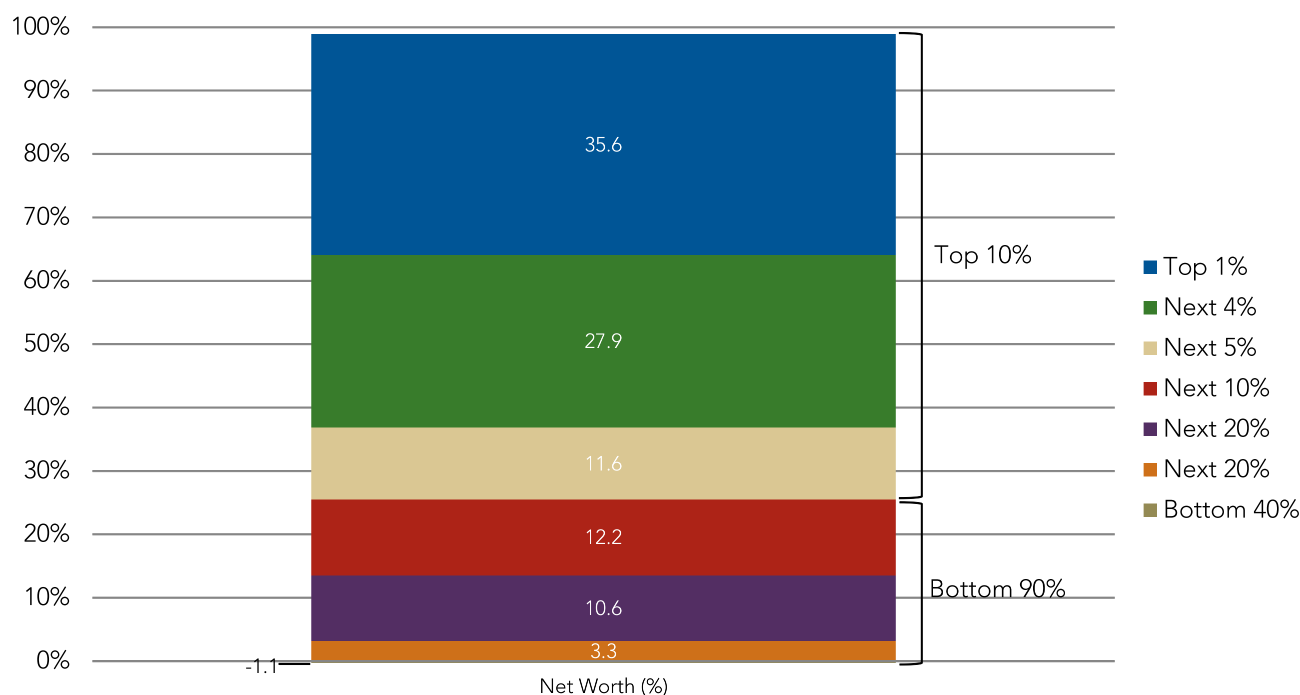
[5] Sylvia A. Allegretto, "The State of Working America's Wealth, 2011," Economic Policy Institute, March 2011, p. 2. Available at: http://www.epi.org/page/-/BriefingPaper292.pdf. Home prices remain low and are unlikely to soon return to their peak values. *See* "Home Prices Weaken as the Third Quarter of 2011 Ends According to the S&P/Case-Shiller Home Price Indices," S&P Indices Press Release, November 2011. Available at: http://www.standardandpoors.com/servlet/BlobServer?blobheadername3=MDT-Type&blobcol=urldocumentfile&blobtable=SPComSecureDocument&blobheadervalue2=inline;+filename%3Ddownload.pdf&blobheadername2=Content-Disposition&blobheadervalue1=application/pdf&blobkey=id&blobheadername1=content-type&blobwhere=1245324826867&blobheadervalue3=abinary;+charset%3DUTF-8&blobnocache=true.

...the "wealth gap" in America is at historic high levels.

to decline. Therefore, households at the upper end of the wealth distribution have significantly recouped their losses, while some households have lost their homes entirely, as homeownership rates declined to 67.2 percent by 2009.[6] Millions more low- and middle-income Americans – who had been largely excluded from homeownership and the nation's savings system – have been pushed further to the margins, struggling in the face of persistent unemployment and anemic economic growth.

As a result, as demonstrated in Figure 1, the "wealth gap" in America is at historic high levels. The bottom 90 percent of Americans hold a mere 30 percent of all household wealth and the bottom 40 percent hold -1.1 percent. At the same time, public policy continues to encourage debt-fueled consumption and has not devoted enough attention to broad-based policies that encourage greater household savings and investment across the income distribution. While consumer spending and government stimulus can help drive economic growth, long-term growth requires policies that stimulate savings and investment.

Figure 1. The Size Distribution of Net Worth, 2009



Source: Edward N. Wolff, "Recent Trends in Household Wealth in the United States: Rising Debt and the Middle-Class Squeeze--an Update to 2007," Levy Economics Institute of Bard College, Working Paper No. 589, March 2010. Original source data from 2007 Survey of Consumer Finances. 2009 update based on changes in asset prices between 2007 and 2009 using Federal Reserve Flow of Funds data.

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[6] Homeownership rates fell from a peak of 69.0 percent in 2004 to 67.2 percent in 2009. *See* footnote 5 *supra,* Allegretto. Among the least-wealthy quartile, the homeownership rate is less than 20 percent. *See* J. Bricker, B. Bucks, *et al.*, "Surveying the Aftermath of the Storm: Changes in Family Finances from 2007 to 2009," Federal Reserve Board, March 2011, pp. 13-14. Available at: http://www.federalreserve.gov/pubs/feds/2011/201117/201117pap.pdf.

Savings: Necessary for Growth

A sound national savings policy is essential to empowering more Americans to succeed – to achieve major life goals, to maintain financial security, and to do better than the previous generation. Also, increased savings can foster economic opportunity through enhanced investment, both at the national and household levels.

In 2009, speaking on the future of the American economy, President Obama affirmed, "We cannot rebuild this economy on the same pile of sand. We must build our house upon a rock. We must lay a new foundation for growth and prosperity – a foundation that will move us from an era of 'borrow and spend' to one where we save and invest."[7]

Similarly, in his book *It Takes a Family*, former Senator and 2012 Republican Party presidential primary candidate Rick Santorum asserts –

> What Americans really need are more public policies that free us from "treadmill economics," policies that allow and encourage families, especially low-income families, to build up economic capital, a family nest egg…. Assets are what help build families, and building families is what our economic policies must do.[8]

To adhere to this bipartisan value to promote savings, it is time to give priority to policies that emphasize personal savings as a key component of any household's financial security.

At the macroeconomic level, savings provides domestic money for businesses to borrow and invest, to increase capital, and ultimately to increase productivity – all of which, in turn, lead to more job opportunities, higher wages, and higher standards of living. Without increased national savings, the only recourse to increasing national investment has been to borrow someone else's savings – that is, to rely on foreign countries to finance investment in the United States. This is the course that we have been pursuing as a nation. As of January 2011, nearly 50 percent of the federal government's public debt was held in foreign countries.[9] While personal savings is only one component of overall national savings, an analysis of 2005 data found that increasing the personal savings among the bottom 40 percent of households by only about $10 per week ($500 per year) would increase overall net national savings by 26 percent.[10] Though personal savings rates increased after 2008, moving from 1.3 percent in January of 2008 to 4.0 percent in December of 2011, they remain too low to improve both overall macroeconomic health and American households' financial security.[11]

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[7] President Obama's Address, Georgetown University, April 14, 2009. Available at: http://www.whitehouse.gov/blog/09/04/14/The-House-Upon-a-Rock/.

[8] Rick Santorum, *It Takes a Family: Conservatism and the Common Good,* Intercollegiate Studies Institute: Wilmington, DE, 2005, p. 150.

[9] U.S. Treasury, "Major Foreign Holders of Treasury Securities," as of January 2011. Available at: http://www.treasury.gov/resource-center/data-chart-center/tic/Documents/mfh.txt.

[10] *See* footnote 2 *supra,* Johnson, Mensah, and Steuerle, p.13.

[11] U.S. personal savings rates available at: http://research.stlouisfed.org/fred2/data/psavert.txt.

[12] Jennifer Brooks and Kasey Wiedrich, *Assets & Opportunity Scorecard: A Portrait of Financial Insecurity and Policies to Rebuild Prosperity in America,* CFED, January 2012, p.3. Available at: http://assetsandopportunity.org/assets/2012_scorecard.pdf.

[13] Michael Sherraden, *Assets and the Poor*, M.E. Sharpe, Inc: Armonk, NY, 1991, p. 7.

[14] Trina R. Williams, *The Impacts of Household Wealth on Child Development* Working Paper 04-07, St. Louis, MO: Washington University, Center for

At the household level, savings and assets are the key distinguishing solutions to growing and maintaining a sound middle class. According to a 2012 CFED study, 27 percent of all American households are "asset poor," meaning they lack assets to cover basic expenses for just three months due to unexpected loss of income. This represents a 21 percent increase compared to findings from a 2009-2010 similar study. Additionally, CFED finds that 43 percent of American households are "liquid asset poor," a measure which excludes assets such as a home, business, or car that cannot be easily converted to cash and which therefore provides a more realistic picture of the resources these families have to meet emergency needs.[12] As Washington University Professor Michael Sherraden has noted, "Very few people manage to spend their way out of poverty."[13] It is the accumulation of savings and assets that fosters financial stability, creates economic mobility, and provides the ladders of opportunity for individuals to climb into and remain a part of the middle class.

To adhere to this bipartisan value to promote savings, it is time to give priority to policies that emphasize personal savings as a key component of any household's financial security.

Studies have shown, for example, that families with greater assets tend to own homes in better neighborhoods for longer periods of time; the assets also promote greater economic mobility, self-confidence, civic engagement, and self-sufficiency.[14] Higher levels of assets also build a more competitive American populace, affording children better and more consistent educational opportunities and resources. Savings are connected to high school graduation, college enrollment, and college graduation, and parental assets have a significant effect on the number of years of education that children complete.[15] In addition, savings make middle-class families less susceptible to financial shocks because of unforeseen developments, such as a medical emergency or the loss of a job. For most middle-class families today, savings can mean the difference between a temporary setback and a plunge into poverty.

As we focus on recovery from the recent financial downturn, it is crucial that we not lose the opportunity to promote greater household savings. Novel approaches to bolster working Americans' balance sheets are needed. The tax code and the potential of refundable savings tax credits offers a way forward.

Revitalizing Our Nation's Savings Policy

Federal policy has long sought to promote household savings and asset building through the tax code. Through a variety of incentives, tax policy is critical in shaping how millions of Americans structure their financial lives.[16] Figure 2 breaks out the Joint Committee on Taxation's estimates for retirement and housing tax expenditures, which account for roughly $375 billion of the $1.1 trillion that the government spends annually on various tax expenditures.

Social Development, 2004. Available at: http://gwbweb.wustl.edu/csd/Publications/2004/WP04-07.pdf. Reid Cramer, Rourke O'Brien, Daniel Cooper, and Maria Luengo-Prado, *A Penny Saved is Mobility Earned: Advancing Economic Mobility through Savings,* Economic Mobility Project, November 2009. Available at: http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Economic_Mobility/EMP_Savings_Report.pdf.

[15] M. Sherraden, J. Stevens, *et al.*, "Lessons from SEED: A National Demonstration of Child Development Accounts," September 2010, p. 9. Available at: http://csd.wustl.edu/Publications/Documents/SEEDSynthesis_Final.pdf.

[16] Types of tax incentives include deferrals, exclusions, deductions, special rates, and credits. For a description of each of these incentives, *see* Daniel Baneman, Joseph Rosenberg, Eric Toder, Roberton Williams, "Curbing Tax Expenditures," Tax Policy Center, January 31, 2012. Available at: http://www.taxpolicycenter.org/UploadedPDF/412493-Curbing-Tax-Expenditures.pdf.

Figure 2. *Estimates for Asset Building Tax Expenditures ($ in Billions)*	2011	2012	2013	2014	2015
Retirement Tax Expenditures					
Net exclusion of pension contributions and earnings*	$115.80	$134.80	$165.20	$184.30	$205
Low and moderate income savers credit	$1.00	$1.00	$1.00	$1.00	$1.00
Total Retirement Expenditures	$116.80	$135.80	$166.20	$1.00	$205.50
Housing Tax Expenditures					
Deductibility of mortgage interest on owner-occupied homes	$77.60	$83.70	$89.60	$99.80	$113.40
Deductibility of state and local property tax on owner-occupied real estate	$24.30	$15.10	$22.80	$27.10	$27.80
Capital gains exclusion/deferral on home sales	$18.40	$22.90	$26.10	$27.20	$28.50
Total Housing Expenditures	$120.30	$121.70	$138.50	$154.10	$169.70
Total	**$237.10**	**$257.50**	**$304.70**	**$155.10**	**$375.20**

*Includes Defined Contribution, Defined Benefit, "Keogh Plans," Traditional IRAs and Roth IRAs

Source: Estimates of Federal Tax Expenditures for Fiscal Years 2011-2015, Joint Committee on Taxation (January 2012).

[17]

For too long, tax incentives have missed many low- and middle-income households. The patchwork of savings plans is far too complex for easy use; existing incentives are disproportionately focused on retirement savings, rather than on saving for important benchmarks throughout the entire lifecycle; and existing savings incentives are redundant, mostly targeting higher income households who are more likely to save regardless, while offering diminutive benefits, if any, for the bulk of the American workforce.

More than 40 percent of Americans have no net federal income tax liability and therefore receive no benefit from nonrefundable tax credits.[18] Those individuals or households with the highest incomes have more disposable income than those lower down the income scale, and are therefore, on balance, least likely to be in need of the extra incentive to save for, for example, purchasing a home or saving for retirement. [19] Due to our nation's progressive system of income taxation, delivering asset-building policies primarily through tax deductions results in a regressive distribution of federal saving and asset-building subsidies.

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[17] U.S. Congress, Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2011-2015*. JCT 1-12, Jan. 17, 2012, Table 1, p. 32 *et seq*. Available at: http://www.jct.gov/publications.html?func=startdown&id=4385.

[18] Tax Policy Center, "Distribution of Tax Units with Zero or Negative Individual Income Tax Liability, under Current Law, by Cash Income Percentile, 2011," July 13, 2011. Available at: http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3057. When all federal, state, and local taxes are taken into account, the bottom fifth of households paid 16.3 percent of their incomes in taxes, on average, in 2010. *See* Chuck Marr & Brian Highsmith, "Misconceptions and Realities about Who Pays Taxes," Center on Budget and Policy Priorities, updated May 31, 2011. Available at: http://www.cbpp.org/cms/index.cfm?fa=view&id=3505.

[19] Analysis from CFED on the federal budget concludes that asset building "policies, administered largely through the tax code, are terribly skewed. They tend to subsidize wealth building for the wealthiest among us, rewarding them for size of their homes and investment portfolios. Low-income households, who don't make enough money to itemize deductions or even to accrue much tax liability, receive next to nothing from these strategies." *See* Beadsie Woo, Ida Rademacher, and Jillien Meier, "Upside Down: The $400 Billion Federal Asset Building Budget," CFED, 2010, p.2. Available at: http://cfed.org/assets/pdfs/UpsideDown_final.pdf.

To demonstrate why many low- and middle-income Americans are missed, consider a simple example. Each $1 of the mortgage interest tax deduction reduces a top-bracket (35 percent) taxpayer's tax liability by 35 cents, but the same deduction of $1 is worth only 10 cents to a taxpayer in the 10 percent income bracket. In short, by effectively linking the size of a given benefit to the tax filer's marginal income tax rate, most asset-building policies grant greater benefits to taxpayers with higher incomes. Conversely, lower-income taxpayers receive a much smaller incentive, if any, to engage in the desired behavior.[20]

Putting aside the question of fairness, the decision to direct the greatest incentive to those at the higher end of income distribution is undesirable as a matter of economic efficiency. Some critics suggest that current retirement savings expenditures have a negligible effect on wealthier households' decisions to save.[21] In that way, critics may argue that a good portion of federal tax dollars designed to incentivize asset building does not result in new asset ownership, but instead encourages the shifting of assets from the "left pocket to the right pocket."[22] Meanwhile, millions of low- and middle-income Americans are excluded from the opportunities of federal asset-building support – representing both inefficient policy design and a missed opportunity for increased economic growth.

Due to our nation's progressive system of income taxation, delivering asset-building policies primarily through tax deductions results in a regressive distribution of federal saving and asset-building subsidies.

A simplified and expanded savings system that revitalizes the reach and efficiency of savings incentives will allow more American households the opportunity to build and grow their household savings and enjoy all of the benefits that come with this increased financial security. Increasingly, tax policy experts favor refundable tax credits rather than deductions to promote asset building and improve the equity and economic efficiency of current asset-building tax expenditures. While the existing Saver's Credit is a step in the right direction, it must be improved to expand its effectiveness in incentivizing low- and middle-income savers.

The Need to Improve the Saver's Credit

It is time to build on past efforts to expand savings and asset-building opportunities to low- and middle-income Americans. The Retirement Contributions Savings Credit (Saver's Credit), first available in 2002, offers certain low-income taxpayers a tax credit to promote retirement savings. Yet, instead of landing directly in the saver's retirement account, the current credit goes back to the taxpayer, functioning as a "refund" rather than a "match," and encouraging consumption rather than asset building. Also, while the Saver's Credit was initially conceived to be refundable, the

[20] A majority of income tax filers do not itemize their deductions, and nearly half of income tax filers do not have any tax liability after various exclusions, so they cannot benefit from nonrefundable tax credits.

[21] Teresa Ghilarducci and Daniela Arias (with Daniel Samaan), "The High Cost of Nudge Economics and the Efficiency of Mandatory Retirement Accounts," presented at the National Tax Association annual meeting, Nov. 10, 2009. Available at: http://www.newschool.edu/scepa/Making_Retirement_Work/Papers/The%20High%20Cost%20of%20Nudge%20Final.pdf.

[22] *See*, e.g., Eric M. Engen, William G. Gale, and John Karl Scholz. "The Illusory Effects of Saving Incentives on Saving," *Journal of Economic Perspectives* 10 (4): 113-38, 1996. It is important to note that certain tax expenditures are well suited for a tax deduction model. As Lily Batchelder, Fred Goldberg, and Peter Orszag wrote in 2006, "[A deduction model] is often appropriate for provisions, such as deductions for business expenses, designed to measure income or ability to pay." *See* Lily Batchelder, Fred Goldberg Jr., Peter Orszag, "Reforming Tax Incentives into Uniform Refundable Tax Credits," The Brookings Institution Policy Brief, No. 156, August 2006. Available at: http://www.urban.org/UploadedPDF/1001020_reforming_tax_incentives.pdf.

final legislation excluded Americans with no federal income tax liability (then about a third of tax filers, now nearly half of all filers). Instead, as demonstrated in Figure 3, those who are eligible can receive a nonrefundable tax credit of 10 percent, 20 percent, or 50 percent for up to $2,000 of their contribution to an employer-sponsored qualified retirement plan or IRA.

Out of those who are eligible, the existing Saver's Credit's reach is further narrowed to couples with adjusted gross incomes (AGIs) under $57,500 and to single filers with AGIs up to $28,750, with the maximum 50 percent match confined to couples with AGIs up to $33,000 and single filers with AGIs up to $16,500. These tiered income limits create "cliffs." For example, under current law, a married couple filing jointly who makes $34,500 in 2012 will be eligible for as much as a $1,000 credit, but a similar couple making $34,501 will be able to claim a maximum credit of only $400. Moreover, from 2002 through 2006, the credit was not indexed for inflation, so the number of those eligible shrunk steadily – although later legislation now provides for indexing the credit.[23]

Figure 3.
2012 Saver's Credit Limits and Rates Miss Middle-Class Savings Opportunities

Income Tax Filing Status			Credit & Effective Matching Rate			
Married Filing Jointly	Head of Household	Single, Married Filing Separately, Or Qualifying Widow(er)	Credit Rate	Tax Credit for $2,000 contribution	After-tax "cost" of $2,000 contribution	Effective After-Tax Match Rate
Up to $34,500	Up to $25,875	Up to $17,250	50%	$1,000	$1,000	100%
$34,501 - $37,500	$25,876 - $28,125	$17,251 - $18,750	20%	$400	$1,600	25%
$37,501 - $57,500	$28,125 - $43,125	$18,751 - $28,750	10%	$200	$1,800	11%
Over $57,500	Over $43,125	Over $28,750	No Credit	$0	$0	0%

Source: William G. Gale, J. Mark Iwry, and Peter R. Orszag, *The Saver's Credit: Issues and Options*, The Retirement Security Project, The Brookings Institution, April 2004. Inflation-indexed thresholds for 2012 retrived from Internal Revenue Service, "Plan Now to Get Full Benefit of Saver's Credit; Tax Credit Helps Low- and Moderate-Income Workers Save for Retirement," IR-2011-121, December 2011.

[24]

But the lack of refundability even more dramatically limits the reach and effectiveness of the current credit. In 2002, 65.4 million American households had incomes qualifying for the Saver's Credit. Of these, 51.4 million met the age, earnings, and student tests. But only 29 million had the requisite tax liability. Of these, only 8.9 million made contributions to qualified accounts, and of these, only 7.3 million had no distribution in the current year or prior two years from a pension or IRA. In other words, the Saver's Credit qualifying rules shrunk the income-eligible pool by

[23] The Pension Protection Act of 2006 (PL 109-280), sec. 833.

[24] William G. Gale, J. Mark Iwry, and Peter Orszag, *The Saver's Credit: Issues and Options,* The Retirement Security Project, The Brookings Institution, April 2004. Available at: http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Retirement_security/RSP_SaversCredit_030105.pdf. Internal Revenue Service, "Plan Now to Get Full Benefit of Saver's Credit; Tax Credit Helps Low- and Moderate-Income Workers Save for Retirement," IR-2011-121, December 16, 2011. Available at: http://www.irs.gov/newsroom/article/0,,id=251338,00.html.

nearly 90 percent (of the winnowed pool, 4.3 million claimed the Saver's Credit). By 2005, even though take-up rates had increased, eligible taxpayers had thinned to 5.4 million because the credit was not indexed for inflation. Similarly, in 2007, of the over 69 million taxpayers with incomes low enough to qualify for the credit, nearly 45 million were ineligible because they had no federal income tax liability.[25]

A ghost of its original intent, the existing Saver's Credit should be reformed to be more inclusive and robust – a critical first step in building a savings society. To that end, Aspen IFS proposes the *Freedom Savings Credit* to provide a more robust, refundable, multi-use savings tax credit to give those Americans who currently lack meaningful access to savings tax incentives the same opportunities that other Americans currently enjoy to save, invest, and grow assets.

The *Freedom Savings Credit*: Paving the Road to a "Save and Invest" Economy

Aspen IFS views the *Freedom Savings Credit* as a smart and simple solution to balance current lopsided asset-building incentives and provide all Americans with an equal opportunity to grow their way to a sounder fiscal future.

The proposed *Freedom Savings Credit* would replace the existing Saver's Credit, and would provide each qualified saver with a $1 refundable tax credit for every $2 saved in a 401(k), IRA, or other qualified savings account. A taxpayer could receive up to $500 as a single filer or $1,000 as a married couple filing jointly, and the credit would be available to joint filers with incomes as high as $85,000, which is the income ceiling that President Obama proposed in his Fiscal Year 2011 budget.[26] Overall, the *Freedom Savings Credit* is estimated to cost about $3 billion a year, based on President Obama's Fiscal Year 2011 budget estimates.[27] As our nation's economy recovers, this expansion of incentives for low- and middle-income Americans would be an important step towards rebuilding household balance sheets and would make retirement saving incentives, as compared to current law, more robust and uniform.

Consistent with its goal to build assets in an automatic fashion, the *Freedom Saving's Credit* would be directly refundable to an individual's qualified savings account.[28] Moreover, by instituting a uniform "match," the proposed credit would ease the precipitous income-eligibility cliffs, smooth phase-outs, and increase fairness and access.

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[25] Peter J. Brady, Emily Y. Lin, and Kathleen A. Toma, "Using Panel Data to Assess the Effectiveness of the Saver's Credit," presentation to the Society of Government Economists Conference, June 2, 2007 (June 2008); William G. Gale and David C. John, "President's Budget Proposal Could Help up to 78 Million More Workers to Save for Retirement," Brookings 'Up Front' Blog, Feb. 22, 2011. The Saver's Credit is a nonrefundable credit on up to $2,000 contributed to an elective deferral plan or IRA. It is available only after calculating any credits for dependent care, children, the elderly and permanently disabled, mortgage interest, Hope and Lifetime Learning, and foreign taxes. Those eligible must be at least 18 years old, must not be eligible to be claimed as a dependent by another taxpayer, must not be a full-time student, must reduce gross contribution by distributions in the current year, two previous years, and up until filing date, including extensions, must have compensation to contribute to a retirement plan, and must have contributed to a qualified plan. The rules are outlined in IRS Publication 590, at http://www.irs.gov/publications/p590/ch05.html.

[26] The matching limits of the *Freedom Savings Credit* are based on the Retirement Security Project's proposal. *See* William G. Gale, J. Mark Iwry, and Peter R. Orszag, "The Saver's Credit: Expanding Retirement Savings for Middle- and Lower-Income Americans," Retirement Security Project, March 2005. Available at: http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Retirement_security/RSP_SaversCredit_030105.pdf. *See also, Budget of the U.S. Government, Fiscal Year 2011*, p. 160. Available at: http://www.gpo.gov/fdsys/pkg/BUDGET-2011-BUD/pdf/BUDGET-2011-BUD.pdf.

[27] *Ibid.* President Obama's 2011 budget estimated the Saver's Credit to cost $29.8 billion over 10 years. The *Freedom Savings Credit* is modeled after the Retirement Security Project's matching limits and President Obama's 2011 Budget's income ceilings, and its estimated cost falls between the two models'. The *Freedom Savings Credit* would replace the current Saver's Credit, which cost $1.04 billion for its 6.25 million recipients in 2009. *See* Justin Bryan, "Individual Income Tax Returns, 2009," *Internal Revenue Service Statistics of Income Bulletin,* Fall 2011, Table 2, p.35. Available at: http://www.irs.gov/pub/irs-soi/11infallbulincome.pdf.

[28] The account information would be provided at filing, but the match would not go into the account until after the tax return is processed.

Making these credits refundable presents an opportune way to correct existing federal saving and asset-building policy inefficiencies that prevent tax incentives from reaching those Americans who most need the encouragement. Unlike a deduction or an exemption, refundable tax credits are not determined by an individual's or a household's marginal income tax bracket. Instead, a tax credit could, for example, be structured to provide $1 of credit for every $2 saved, thus expanding the financial incentive to save to all qualified Americans and making it more robust. Moreover, because the credit would be refundable, those tax filers who in any given year have no federal income tax liability would still receive the "matching" dollars that are currently regressively offered to those Americans who least need an incentive to save.[29] Some critics automatically reject these credits as new costs that are not fiscally affordable, yet a refundable Saver's Credit to build a long-term nest-egg has also garnered prior conservative interest as an investment in self-reliance.

The simplicity of "matching" dollars – as opposed to the tiered credit rate structure currently used – is critical. In 2005, a group of scholars did a randomized test of the effect of matching retirement savings at 0 percent, 20 percent, and 50 percent of contributions using 15,000 clients at 60 H&R Block St. Louis tax-preparation offices. The match boosted savings participation: a 0 percent match resulted in a 3 percent increase; a 20 percent match resulted in a 10 percent increase; a 50 percent match resulted in a 17 percent increase; and average contributions were 4-8 times higher than those of a control group. Presenting the credit as an easily understandable match, which sent funds directly to the taxpayer's new or existing IRA, significantly improved participation.[30]

By embedding a federal "matching" tax provision in the tax code for qualified American savers, the *Freedom Savings Credit* would dramatically bolster the financial security of millions of working Americans.[31] To demonstrate the profound potential of the proposed *Freedom Savings Credit*, Aspen IFS has modeled likely investment returns over 10, 20, and 30 year investment horizons. As Figure 4 demonstrates, with a match of 50 percent, an individual who saves about $13 per week could contribute about $1,000 per year to a retirement savings account. Over 30 years this individual could amass over $150,000.[32] Even under the most conservative assumptions, which suggest a saver invests only in inflation-protected Treasury bonds, a saver would amass over $100,000 over 30 years. The match is the necessary ingredient that elevates modest savings into meaningful savings.

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[29] As with current law, savers who withdraw balances early for unqualified uses will face financial penalties.

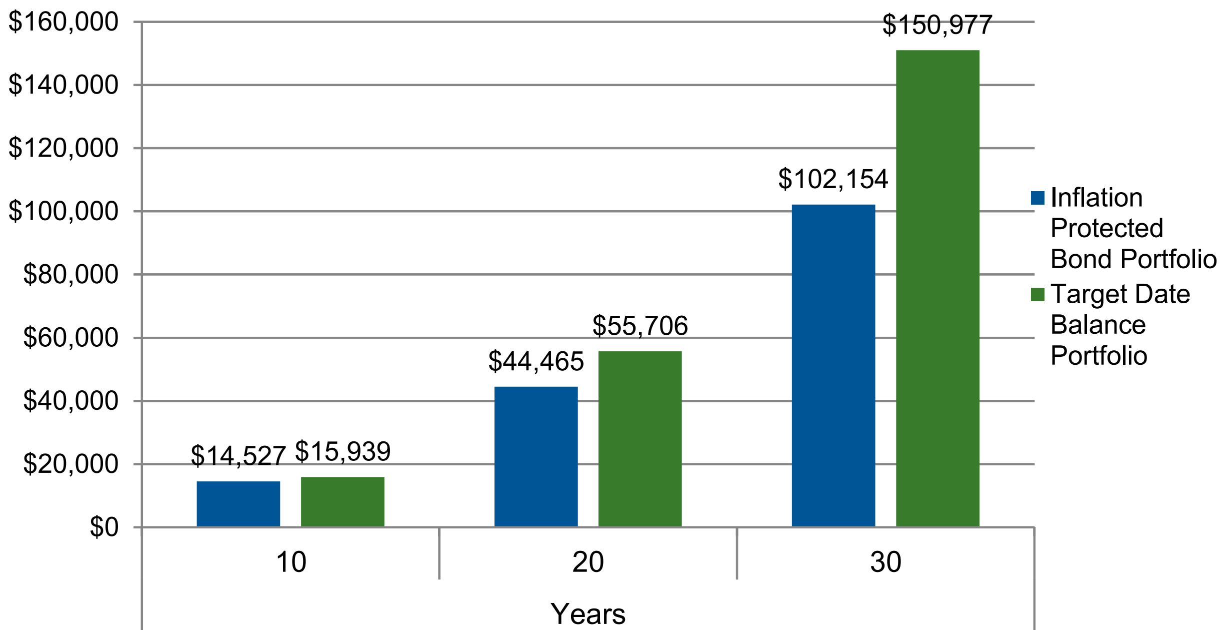
[30] Esther Duflo, William Gale, Jeffrey Liebman, Peter Orszag, and Emmanuel Saez, "Saving Incentives for Low- and Middle-Income Families: Evidence from a Field Experiment with H&R Block." *Quarterly Journal of Economics*, 121(4), 1311–1346, 2006.

[31] The *Freedom Savings Credit* uses the teachable moment of tax filing to more effectively boost savings and create a national savings culture. Tax return preparation is the annual financial check-up for most families, and thus represents a critical opportunity to recalibrate savings for key goals – whether for college, homeownership, healthcare, or retirement, as well as precautionary saving for emergencies. Tax time also provides resources to save. Because of tax cuts, credits, deductions, other exclusions, and over withholding, about 79 percent of taxpayers (111.7 million) received a refund in 2009 averaging $2,859. Moreover, early season filers -- often those who have lower incomes or are EITC recipients and eager to get funds quickly -- tend to have larger refunds: in 2010, the average refund as of Feb. 26 was $3,149, and by March 5, when about half of returns had been filed, $3,082. The tax refund is often the largest single sum a low- income taxpayer will see and thus presents a critical opportunity to bolster saving at the bottom of the economic pyramid.

[32] Analysis assumes that a worker saves $1,000 per year, adjusted annually for inflation. *See* Lewis Mandell, *Real Savings+: A Safer, Simpler Alternative to Target Date Funds,* The Aspen Institute Initiative on Financial Security, 2011. Available at: www.aspenifs.org.

[33] *Ibid.* These values are in nominal terms. The graph assumes that a worker saves $1,000 per year, adjusted annually for inflation. The paper also discusses real returns.

Figure 4. The Power of *Freedom Savings Credit* Over a Lifetime



Lewis Mandell, Real Savings+: A Safer, Simpler Alternative to Target Date Funds, The Aspen Institute Initiative on Financial Security, 2011.

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Conclusion

As we recover from the financial downturn, the *Freedom Savings Credit* offers a cost-effective, sensible, and fair solution to reestablish savings as the foundation for economic success. Replacing the existing Saver's Credit, it would provide qualified savers with a $1 refundable tax credit for every $2 saved in a 401(k), IRA, or other qualified savings account up to a $1,000 credit yearly for joint filers. Overall, the *Freedom Savings Credit* is estimated to cost about $3 billion a year.

Building a sound national savings policy is essential to empowering more Americans to succeed — to achieve major life goals, to maintain financial security, and to do better than the previous generation. Moreover, increased personal savings can foster economic opportunity, both at the household and national levels. Yet the current method of delivering federal savings and asset-building policy through the tax code does not reach those who need it most. Refundable tax credits present an opportune way to correct federal saving and asset-building policy deficiencies, broaden savings incentives, and expand asset-building opportunities to more American households.

The Aspen Institute Initiative on Financial Security recommends a *Freedom Savings Credit* to empower more Americans to build financial security over their lifespans. The *Freedom Savings Credit* would transform savings opportunities and outcomes for millions of Americans, helping to build household financial security, close the widening wealth gap, and grow our nation's economy. By simplifying and expanding incentives to more Americans, the *Freedom Savings Credit* would be a powerful step towards a "save and invest" economy.

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