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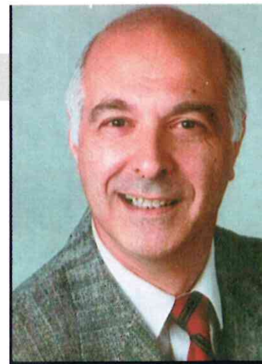
With four specific services, The Center provides complete unbiased planning. The Center does not sell any products; its main purpose is to provide advice. Local experts are retained to implement the plans developed by the Center. The Center for Financial, Legal & Tax Planning is located at 108 E. DeYoung Street, Marion, Illinois 62959-4209. Phone 618-997-3436; Fax 618-997-8370.



Bart A. Basi

Money From The Government?

Introduction

Ah, the Golden Years. So far away, yet so close. It is never too early to think about retirement. But one of the problems with determining how much money to save for a retirement fund is in determining where that money will come from, and whether there is a tax advantage over one plan or another that will provide a larger benefit in the years to come. Imagine getting some of that future benefit right now! Who in the world would give us some of that benefit immediately? Well, you can thank the IRS! In this article you will learn how a portion of your contribution to a retirement fund can actually come from the taxes that you owe the government, dollar for dollar.

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You may ask why the IRS has provided this credit to us. The answer lies in the lack of private savings in the United States. The belief is that providing a tax incentive for retirement savings will encourage the amount of private savings in the United States.

What is the Retirement Savings Credit?

The credit is a temporary nonrefundable income tax credit for contributions or deferrals made to an employer sponsored retirement savings plan, or an individual retirement account (IRA), including a Roth IRA. The amount of the credit depends on the adjusted gross income of the taxpayer, and applies to the tax years beginning after December 31, 2001 and before January 1, 2007. This credit is in addition to any deduction that you may receive from a qualified contribution to a retirement plan. Therefore, a taxpayer may be eligible to take a deduction from his taxable income, and in addition, receive a tax credit for a portion of the contribution to the plan.

What is a qualified retirement savings contribution?

A qualified retirement savings contribution is the amount of a contribution or deferral made to a qualified retirement plan during the year, which includes a Roth IRA. Also included is a 401(k) (including a SIMPLE 401(k)), a section 403(b), annuity, an eligible deferred compensation plan of a state or local government, and many more individual tax qualified retirement plans that are voluntary after-tax employee contribution plans.

However, there are some limits to an eligible contribution from an individual's IRA (not a Roth IRA). If any amount that was contributed to the plan is subsequently removed by the taxpayer before the tax return is filed for the year in which the contribution was made, the amount doesn't count. The balance left in the account is, however, available for the credit. Another limit to an individual's IRA applies if no deduction was taken for the contribution; the credit is not available. And finally, if the distribution includes any income that can be attributable to the contribution itself, the contribution cannot be used for the credit.

These limitations on an individual's IRA may make some taxpayers think a little more about the timing of their withdrawal. Even if they were to avoid an early withdrawal penalty, they may end up losing the Retirement Savings Credit.

Who is eligible to receive the Retirement Savings Credit?

A person eligible to receive the credit is a taxpayer

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who is at least 18 years of age at the end of the tax year, and who is not a dependant on someone else's tax return, and is not a student. A student is defined as an individual who, during five months of the year, is a full time student at an educational organization, or is in pursuit full time in the study of institutional on-farm training supervised by an accredited agent of an educational organization.

In addition, there are phase out levels depending on the taxpayers adjusted gross income (AGI). The phase out levels will reduce the amount of the credit that you may be able to take. For a married couple filing jointly, AGI cannot exceed $50,000. The credit begins its phase out if the AGI exceeds $30,000. For a person who qualifies for head of household, the AGI cannot exceed $37,500, and it begins the phase out at $22,500. For all other cases including filing single, and married filing separately, the AGI cannot exceed $25,000, and the phase out begins at $15,000.

What is the eligible amount I can take for the Credit?

The maximum annual contribution that is eligible for the Retirement Savings Credit is $2,000. However, this amount may be reduced depending upon actions taken by the taxpayer during the year. If the taxpayer were to receive a distribution, or if the taxpayer's spouse received a distribution during the testing period, the maximum amount of $2,000 is reduced by those distributions. The testing period to determine whether to reduce the maximum amount eligible consists of the current tax year, the two years preceding the current tax year, and the period after the tax year and before the due date for filing your return, including any applicable extensions. If an amount is distributed during this period it will reduce the maximum amount of $2,000. In the case of a Roth IRA, in which the distribution is tax free, the reduction still applies.

For example, if an individual contributed $3,500 to a 401(k) during the tax year 2002, and decided to take a distribution from that 401(k) of $1,000. And two years previously had taken a distribution of $1,000, the eligible maximum amount for the credit would be reduced by $2,000 ($3,500 - $2,000 = $1,500). Therefore, the maximum amount that would be eligible for the credit would be $1,500 rather than $2,000.

Be aware that distributions, which are rolled over to a separate retirement fund, do not affect the credit, nor do distributions, which are not included in gross income because of a trustee-to-trustee transfer.

What rate will apply to the eligible contribution?

The chart below describes the applicable percentages that will apply based upon the reported gross income, as well as the previously mentioned phase out rates.

This chart shows us that the maximum amount of the contribution that will be allowed for the credit is 50% up to $2,000 of contribution. For example, if your contribution was $5,500, 50% would be $2,750. However, since the maximum credit is $2,000, you would receive the maximum. Thus your net cost would be $3,500. If your AGI is $30,500 (married filing joint), you would be eligible for a 20% tax credit. The advantage to the Retirement Savings Credit is that regardless of your contributions, your net cost will decrease dollar for dollar by the tax credit you receive.

Will taking the credit change the amount of any refundable credit I receive?

The Retirement Savings Credit is a nonrefundable credit. A nonrefundable credit can be used to offset the amount of a taxpayer's regular and alternative minimum tax liability. A nonrefundable credit cannot be used to provide you with a refund if you did not owe taxes otherwise. However, it does not affect the amount of any refundable credit that you may receive. A taxpayer can still receive refundable credits such as the Child Tax Credit, or the Earned Income Credit, if they meet the necessary requirements.

Conclusion

Whether you are nearing retirement age, or just entering the workforce, the Retirement Savings Plan may affect your tax liability. In addition, the credit may allow you to defer more income into your retirement savings. The credit can have an immediate impact upon your return on investment. This credit is unique in that it not only applies to many traditional retirement accounts, but also to accounts such as the Roth IRA, which up until this year, did not have a tax credit available. Saving for retirement is always a daunting task, but the government has given us a head start down that road, something it doesn't often do.

If you have any questions regarding the Retirement Savings Credit, contact Bart at The Center for Financial, Legal, and Tax Planning, Inc. or visit their website at www.taxplanning.com.

Adjusted Gross Income

Married Filing Joint	Head of Household	All other cases	Credit
$0 - $30,000	$0 - $22,500	$0 - $15,000	50% of contribution
$30,001 - $32,500	$22,501 - $24,375	$15,001 - $16,250	20% of contribution
$32,501 - $50,000	$24,376 - $37,500	$16,251 - $25,000	10% of contribution
Over $50,000	Over $37,500	Over $25,000	credit not available