

Retirement News for Employers

Information for Sponsors of Retirement Plans

Internal Revenue Service

Tax Exempt and Government Entities

Volume 4, Fall 2007

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Is an Automatic Contribution Feature Right for Your Plan?

Are you looking to increase participation among the rank-and-file employees in your 401(k) plan? Are you concerned about your employees' lack of adequate retirement savings? Do you want to get out from under costly and time-consuming burdens of nondiscrimination testing? If so, a possible solution is to amend your plan to include a "qualified automatic contribution arrangement" (QACA) that first becomes available next year. (The IRS has just released [proposed rules](#) on QACAs for 401(k), 403(b), and 457(b) plans, along with [sample language](#) for the required notice to participants.)

The Pension Protection Act (PPA) added an incentive to encourage plans eligible to use automatic enrollment to adopt QACAs. Under an additional safe harbor, plans that by design satisfy conditions relating to employee elections and deferral amounts, employer contributions, and participant notifications will generally not have to perform the nondiscrimination tests and will satisfy the "top-heavy" rules that generally prohibit owners and key employees from disproportionately benefiting under the plan.

Key conditions for a QACA are:

- *Coverage* – New employees must be automatically enrolled but given an opportunity to affirmatively elect out of the plan. An employer may optionally set up automatic enrollment for current employees.
- *Notification* – A plan sponsor must notify employees about their right to opt out of the plan or to change their deferral amounts from the default contribution percentages. In plans that offer investment alternatives, the notice must also state how contributions will be invested, subject to DOL requirements, if the employee fails to direct his or her investments. The notice must be given at least 30 (and no more than 90) days before the plan year in which the automatic enrollment takes effect.
- *Employee default contribution percentage* – The plan's employee elective deferral must be set at a minimum of 3% of pay (and not more than 10%) for the initial period, escalating by at least 1% per year to 6% after the third year following the initial period (assuming that the initial default contribution is 3%).
- *Employer contributions* – An employer must make either: **a)** nonelective contributions of at least 3% of pay for nonhighly compensated employees (NHCEs); or **b)** matching contributions of at least 100% of the NHCEs' contributions that do not exceed 1% of pay and 50% of the NHCEs' contributions beyond that up to 6% of pay. The rate of match for the highly compensated employees cannot be greater than that for NHCEs. Employer contributions must be fully vested after no more than two years of service, and such amounts may only be distributed upon the participant's termination of employment, death, or disability.



New on the Web

Here are the latest postings to the “[Retirement Plans Community](#)” web page:

- “[401\(k\) Plan Potential Mistakes](#)” provides tips for plan sponsors in identifying, correcting, and avoiding 11 common errors. Check them out at www.irs.gov/ep by selecting “Correcting Plan Errors” in the left pane.
- The “[Pension Protection Act of 2006](#)” web page now includes two handy charts, listing each PPA provision section, description, relevant IRC/ERISA section, applicable published guidance, and if available, other information sources. One chart is sorted by “topic,” the other by “Code/ERISA section.” The charts are updated periodically.
- “[Tax Issues on Distributions from Retirement Plans](#)” and “[Automatic Enrollment and Other Need-to-Know Provisions of the Pension Protection Act of 2006](#),” which are speakers’ slides and notes from their presentations at the 2007 IRS Nationwide Tax Forums, can be found at www.irs.gov/ep by selecting the “Benefits Practitioner” tab, then “Educational Services & Products.”

As in the case of any plan with automatic enrollment, a QACA may permit an employee to withdrawal his or her elective deferrals (with earnings) within 90 days of first contributing. The withdrawn amounts are taxable income in the year distributed, are not subject to an early distribution tax, and are not eligible to be rolled over. If elective deferrals are withdrawn, employees will forfeit the employer matching contributions. •

Desk Side Chat with Monika Templeman:

Common Errors Uncovered in Audits of SEP and SIMPLE IRA Plans

In each issue, Monika Templeman, Director of EP Examinations, responds to questions and offers insights on retirement plan topics uncovered during audits. You may provide feedback or suggest future topics for discussion by e-mailing her at: RetirementPlanComments@irs.gov.

Monika, many employers who read this newsletter have SEP or SIMPLE IRA plans for their employees. Could you please share your latest examination results?

I would be happy to. I think it is important for plan sponsors to know that my goal is to diversify our audit presence, continually examining and providing outreach to all types of retirement plans. These IRA-based plans are no exception. To date, we have examined over 100 SEP plans and have found about 50% to have operational errors, which means that every other plan audited is noncompliant. In the SIMPLE IRA area, we’ve completed more than 400 audits and have found 61% to have operational errors.

What are the main problems found?

The biggest error for both SEP and SIMPLE IRA plans is the failure to amend the plan for the new EGTRRA limitations. About one of every five SEP and one of every four SIMPLE IRA plans audited have this mistake.

For SEPs, the next most occurring error is the violation of the plan’s participation and eligibility requirements. Our examiners find that employees who are eligible to participate are not included. We also have found contribution allocation errors and instances of employers making contributions over the allowable limits to employees. Excess contributions also raise issues with the contribution deduction.

For SIMPLE IRA plans, we are finding that many employers are making late deposits of employees’ elected deferrals. For plans with common-law employees, the Department of Labor regulations require deposits of salary deferrals as soon as such contributions can reasonably be segregated from the employer’s general assets. Depositing these deferrals quarterly or twice a year does not meet this requirement.

Recent Guidance

- [Notice 2007-86](#) provides additional transitional relief, to December 31, 2008, for nonqualified deferred compensation plans to comply with the April 2007 final regulations under §409A.
- [Announcement 2007-102](#) contains corrections to final 403(b) regulations published July 26, 2007.
- [Proposed Regulations](#) on restrictions on benefits in underfunded single-employer defined benefit plans.
- [Revenue Ruling 2007-67](#) contains a mortality table that defined benefit plans must use to calculate minimum lump-sum distributions during plan years beginning in 2008. •

How can employers correct a failure to amend their plan?

To facilitate correction, employers that adopted the IRS Model 5305-SEP or a financial institution prototype SEP that contained the pre-EGTRRA provisions should adopt the most current [Form 5305-SEP](#) at www.irs.gov/ep. Similarly for SIMPLE IRA plan sponsors, there are two models that can be adopted to correct the problem: IRS Model [5304-SIMPLE](#) and [5305-SIMPLE](#). Employers would use Form 5304-SIMPLE if they allow *each plan participant* to select the financial institution to receive his or her SIMPLE IRA plan contributions. They would use Form 5305-SIMPLE if they require that all contributions under the SIMPLE IRA plan be deposited initially at an employer-designated financial institution.

Our Voluntary Correction Program is available for this and other errors. A description of the Voluntary Correction Program can be found [here](#).

Do you have any tips to help ensure successful plan operation?

We are finding — in all plan examinations, not just for SEPs and SIMPLE IRAs — that employers are operating their plans differently from the way the plan document specifies. If plan sponsors or administrators would take the time to review their plan documents, many of the errors could be avoided. For instance, my examiners have found employers using a different definition of compensation than that specified in the plan and using a different matching contribution formula than the one written in a plan. There are many other examples, but my point is: employers need to read their plan. It could save them money for the aspirin they may need when we come to examine the plan.

We also have web pages devoted to [SEPs](#) and [SIMPLE IRAs](#). These pages include tips on establishing and operating a plan, as well as checklists containing the top errors we are finding on examination. The checklists are designed as a diagnostic tool to help employers keep their plans in compliance with important tax and qualification rules.

I would also recommend that plan sponsors uncovering a mistake in plan operation visit our [Correcting Plan Errors](#) web page. This will provide them with the steps they should take next when an error is found in their plan.

I look forward to keeping the flow of information coming by sharing additional audit insights in the next edition. •

Form 5500

Did You Receive a Form 5500 Delinquency Notice?

Please help us update our records, identify and correct employer identification (EIN) and plan numbers, and resolve other discrepancies, but more importantly, obtain delinquent or missing Forms 5500/5500-EZ from employers.

The IRS continues to send Taxpayer Delinquency Investigation (TDI) Notices to employers for whom we have no record of a Form 5500 or 5500-EZ filed for the plan year ending December 31, 2004. The first delinquency notice, CP 403, is normally sent 15 months after a Form 5500/5500-EZ was due. A second notice, CP 406, is sent 15 weeks later if a response to the first notice is not received or if a response is insufficient. See our [Frequently asked Questions on CP 403/406 Notices](#) for additional information. •

Form 5500 Filing Relief Due to California Wildfires

An extension to January 31, 2008, has been granted to Form 5500 filers located in the seven California counties identified by the Federal Emergency Management Agency (FEMA) as major disaster areas, according to the Department of Labor's Employee Benefits Security Administration's (EBSA) [October 31 News Release](#). The relief is available for Form 5500-series filings that are required to be filed between October 21, 2007, and January 31, 2008. Form filers entitled to the relief should check Part I, Box D on the Form 5500 or Part I on Form 5500-EZ, attaching a statement to the form in accordance with the instructions.

The extension also applies to filers located outside the affected areas that are unable to obtain the necessary information from service providers, banks, or insurance companies whose operations were directly affected by the fires.

Filers who have additional questions may contact EBSA's EFAST Helpline at (866) 463-3278. •

Determination Letter Program Halted for Some Defined Contribution Plans

Effective December 18, 2007, the IRS will temporarily stop accepting determination letter applications (Form 5307) from adopters of pre-approved defined contribution (DC) plans. In [Announcement 2007-90](#), the Service explained that all pre-approved DC plans will have to be restated to comply with the 2001 tax law (generally referred to as "EGTRRA"), and that the agency in early 2008 expects to open the two-year period for such plans to adopt the EGTRRA-restated amendments.

Pre-approved defined benefit (DB) plan adopters are not affected by the announcement. In addition, pre-approved adopters of DC or DB plans may continue to submit Form 5307 applications for a determination related to the Voluntary Correction Program or as required under the Audit Closing Agreement Program. •

2008 Retirement Plan Limits Announced

The IRS has announced the **cost-of-living adjustments** (COLAs) to retirement plan limits for 2008, with key items shown below:

Limit	2008
Defined Contribution Plan Annual Dollar Limit (The maximum dollar amount that may be contributed to a participant's account under IRC §415(c))	\$46,000
Defined Benefit Plan Annual Dollar Limit (The maximum dollar amount that may be payable to a participant under IRC §415(b))	\$185,000
401(k)/403(b) Elective Deferral Limit (The maximum annual amount of elective deferrals and designated Roth contributions (if permitted under the plan) to 401(k) and 403(b) plans under IRC §402(g)(1))	\$15,500
Governments/Tax-Exempts Deferral Limit (The maximum annual amount of elective deferrals to 457 plans under IRC §457(e)(15))	\$15,500
SEP Minimum Annual Compensation Limit (The least amount an employee must earn in compensation to be eligible to participate in a SEP under IRC §408(k)(2)(C))	\$500
401(k)/403(b)/457 "Catch-up" Limit (The additional amount that a participant age 50 or older may defer to 401(k), 403(b), or 457 plans under IRC §414(v)(2)(B)(i))	\$5,000
SIMPLE Employee Contribution Limit (The maximum annual amount of elective deferrals to SIMPLE plans under IRC §§401(k)(11) and 408(p)(2)(E))	\$10,500
SIMPLE "Catch-up" Limit (The additional amount a participant age 50 or older may defer to SIMPLE plans under IRC §414(v)(2)(B)(ii))	\$2,500
Highly Compensated Employee Compensation Limit (The compensation threshold triggering classification of an employee as "highly compensated" under IRC §414(q)(1)(B))	\$105,000
Annual Compensation Limit (An employee's maximum compensation that a plan may take into account for determining employer contributions and deductions under IRC §§401(a)(17), 404(l), 408(k)(3)(C), and 408(k)(6)(D)(ii))	\$230,000
Top-Heavy Plan's Key Employee Compensation Limit (The definition of "key employee" compensation level triggering the application of top-heavy rules under IRC §416(i)(1)(A)(i))	\$150,000

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For a complete listing of the 2008 limits, refer to our "[COLA Increases for Dollar Limitations on Benefits and Contributions](#)" web page under "Published Guidance." •



The Filing Cabinet

Revised Form 5500 for 2007

The Department of Labor (DOL) issued a [Media Release](#) announcing revisions to the 2007 Form 5500, instructions, and schedules. See [EBSA's web site](#) for the revised Form 5500-series or call (800) TAX-FORM (829-3676) to order paper copies.

Revised Publications

The IRS and DOL jointly have revised:

- *Choosing a Retirement Solution for Your Small Business* ([Publication 3998](#)), highlights the types and key features of various retirement plans that small employers or tax practitioners with small business clients that wish to sponsor a plan.
- *SEP Retirement Plans for Small Businesses* ([Publication 4333](#)), provides guidance on Simplified Employee Pension (SEP) plan establishment, operation, and maintenance.
- *SIMPLE IRA Plans for Small Businesses* ([Publication 4334](#)), provides guidance on Savings Incentive Match Plan for Employees (SIMPLE) IRA plan establishment, operation, and maintenance.

Additional forms and publications are available on the "[Retirement Plans Community](#)" [web page](#) by clicking on "EP Forms & Publications" in the left pane. Paper copies can be requested by calling (800) TAX-FORM (829-3676). •

Fixing Common Plan Mistakes:

Correcting a Failure to Effect Employee Deferral Elections

Each issue of the *RNE* looks at a common error that occurs in retirement plans and provides information on fixing the problem and lessening the probability of its recurrence.

The Problem

An employer's failure to execute an employee's election to defer amounts to a 401(k) plan is a relatively common error. Like its cousin – mistakenly excluding an employee from a plan – the problem can be rectified by making a qualified nonelective contribution (QNEC) to the plan on behalf of the employee, and as in the case of other operational problems, the error can be fixed through the Employee Plans Compliance Resolution System ([EPCRS](#)).

The problem to address is one of a missed deferral opportunity: the employee received taxable compensation instead of being able to defer amounts on a pre-tax basis and to accumulate earnings on those deferred amounts tax free until qualified distributions are taken. Let's look at two examples, neither of which entails "catch-up" contributions for employees age 50 or older, after-tax contributions, or "designated Roth" contributions. In both cases, the employees are nonhighly compensated employees (NHCEs).

Situation 1: Amy's elective deferral election at the start of 2006 somehow was never processed by the employer's payroll system. As a result, Amy received taxable compensation amounts that should have been contributed to the plan during the first six months of the year. The facts in this situation include: the plan's actual deferral percentage (ADP) for NHCEs of 5%; Amy's election form agreeing to a deferral of 10% of pay; and her compensation of \$20,000 for the six months that no deferrals were made.

Situation 2: Bob elected to defer 5% of his compensation in 2006. The plan includes bonuses in the definition of compensation that is used for an employee making elective contributions. Although Bob was able to make deferrals on his base compensation, the payroll system overlooked his bonus. The facts here entail an ADP of 3%; Bob's base compensation of \$19,000; and his bonus of \$2,000.

The Fix

As in the case of an erroneous exclusion of an employee from the plan, the remedy requires the employer to make a corrective contribution of 50% of the missed deferral (adjusted for earnings) on behalf of the affected employee. The employee is fully vested in those contributions, which are subject to the same withdrawal restrictions that apply to elective deferrals. However, unlike in the case of mistaken exclusions where the missed deferral amount is

Product Profile – 403(b) Plan Checklist (Publication 4546)



You may put off scheduling your car’s 30,000-mile tune-up, but there’s no need to delay your 403(b) retirement plan check-up. Just like your automobile, your retirement plan needs regular attention and care to keep it operating well. The *403(b) Plan Checklist (Publication 4546)*, is what you need to keep your retirement plan running at peak performance.

The checklist provides 10 “yes/no” questions that will quickly help you review your plan for common mistakes. While this checklist does not cover every possible mistake you could make with your plan, it will let you know if you need to talk with your benefits professional.

Reviewing your plan annually can save you time and money. So, visit our [“Retirement Plans Community” web page](#) and click “EP Forms/Publications/Products” and get your 403(b) plan tuned up today!

estimated based on the ADP for the employee category (e.g., NHCE), in both illustrative examples, the employees’ election deferral amount is known. Thus, the missed deferral and the corresponding corrective contribution (50% of the missed deferral) are based on the participant’s actual election instead of the ADP (i.e., 5% or 3%, respectively) of the NHCEs.

Before correcting for the exclusion, however, the plan must evaluate whether, in the event that the employee had made the missed deferral, it would still pass the applicable ADP test. The ADP test should be corrected according to the plan’s terms before implementing any corrective contribution on behalf of the employee. In addition, the missed deferral amount should be reduced, if necessary, to ensure that the employee’s elective deferrals (the sum of deferrals actually made and the missed deferrals, for which a corrective contribution may be required) comply with all other applicable plan and legal limits. Assuming that the plan passes the ADP test and that no changes must be made to the missed deferral amounts on account of plan or legal limits, the fixes for Situations 1 and 2 are determined as follows:

Situation 1: Amy’s missed deferral amount is \$2,000 (i.e., 10% (Amy’s election percentage) multiplied by \$20,000 (her compensation earned during the period in which the employer failed to implement her election)). The amount of the corrective contribution the employer must make on Amy’s behalf is \$1,000 (i.e., 50% multiplied by Amy’s \$2,000 missed deferral amount).

Situation 2: Bob’s missed deferral amount is \$100 (i.e., 5% (Bob’s election percentage) multiplied by \$2,000 (his 2006 bonus from which elective contributions were not made even though he elected to make a contribution of 5% of all compensation, which included bonuses)). The corrective contribution required on behalf of Bob is \$50 (i.e., 50% multiplied by his \$100 missed deferral).

The described correction only applies to missed deferrals. The corrective contribution also must be adjusted for earnings from the date that the elective deferrals should have been made through the date of the corrective contribution.

Making Sure It Doesn’t Happen Again

Employers should establish systems that can help ensure that employees are provided the opportunity to make deferrals/after-tax contributions to the plan according to the plan’s terms. They also should work to ensure that third-party plan administrators have sufficient understanding of the plan’s terms to operate the plan accordingly. This is especially important if there have been plan amendments or changes to either payroll systems or administrators.

Keep in mind that despite all of your good efforts, mistakes happen. In that case, the IRS can help you correct the problem so that you retain the benefits of your qualified plan.



DOL News

The Department of Labor's Employee Benefits Security Administration (DOL/EBSA) announced new guidance and tools to assist plan sponsors in complying with ERISA, including those featured below. You can subscribe to DOL/EBSA's web site [homepage](#) or [PPA page](#) for updates.

Final Rule on Default Investment Alternatives for Participant-Directed Plans

A [final rule](#) published in the *Federal Register* establishing qualified default investment alternatives (QDIAs) makes it easier for employers to automatically enroll workers in their 401(k) and other defined contribution plans. The regulation implements PPA provisions providing relief to plan fiduciaries who invest the assets of participants who do not provide investment direction in QDIAs. The QDIAs described in the rule will encourage the investment of employee assets in investment vehicles appropriate for long-term retirement savings.

Additional Guidance on Timing of Individual Benefit Statements

[Field Assistance Bulletin 2007-03](#) provides that plan administrators of individual account plans that do not provide for participant direction of investments will, in the absence of further guidance, be deemed in good-faith compliance with the law if benefit statements are furnished to participants and beneficiaries on or before the date the Form 5500 annual return/report is filed by plans, but not later than the last date on which the plan administrator is required to file the report, including any extensions.

Online Calculator to Help in Computing Penalties, File Overdue Form 5500 Reports

The EBSA web site now includes an [interactive calculator](#) that makes it easier for employers and plan administrators who are delinquent in meeting annual reporting requirements under ERISA to accurately compute penalties owed under the agency's Delinquent Filer Voluntary Compliance Program (DFVCP).

Interactive Web Tool on Fiduciary Responsibilities under ERISA

The [ERISA Fiduciary Advisor](#) is a new interactive web tool to help employers and service providers to private-sector retirement plans understand their responsibilities and comply with the law.

Rules on Selecting Annuity Providers for Benefit Distributions from Pension Plans

An [interim final rule](#) was published in the *Federal Register* that amends Interpretive Bulletin 95-1 to limit the application of the bulletin to the selection of annuity providers for benefit distributions from defined benefit plans.

A [proposed rule](#) was also published to provide guidance, in the form of a safe harbor, for the selection of annuity providers by fiduciaries for benefit distributions from individual account plans, such as 401(k) plans. These rules are being issued pursuant to the PPA. •

Retirement News for Employers

Retirement News for Employers (RNE) is a free, quarterly newsletter aimed at keeping employers informed about retirement plan sponsorship. *RNE* is prepared by the IRS's Employee Plans (Tax Exempt and Government Entities) office.

For your convenience, *RNE* includes Internet links – identified by the blue underlined text – to referenced materials.

How to Subscribe

RNE is distributed exclusively through IRS e-mail. Sign up for your free subscription by going to the “[Retirement Plans Community](#)” [web page](#) and selecting “Newsletters” in the left pane. Prior editions of the *RNE* are also archived there.

Send Comments/Suggestions to:

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E-Mail: RetirementPlanComments@irs.gov

Have a Question?

For taxpayer assistance with retirement plans technical and procedural questions:

Please call (877) 829-5500 or visit the “Contact EP/Services” section at www.irs.gov/ep.

For questions relating to retirement income, IRAs, Roth IRAs, educational IRAs, medical savings accounts, and section 125 cafeteria plans:

Please call (800) 829-1040. •

Upcoming Conferences and Key Dates

Meeting deadlines is a sometimes cumbersome part of operating your retirement plan. To help, we've listed some upcoming important dates and deadlines. Please note that the filing dates are for calendar-year plans.

- Dec. 13:** DOL Seminar: Fiduciary Education Seminar – Tucson, AZ.
- Dec. 31:** Deadline for: making 2007 required minimum distributions; and distributing 2006 401(k) excess contributions (including income or losses) without jeopardizing a plan's tax-qualified status.
- Jan. 15:** Fourth quarterly contribution due date for 2007 defined benefit plans.
- Jan. 31:** Deadline for: filing [Form 945](#), *Annual Return of Withheld Federal Income Tax*; and giving recipients of 2007 retirement plan distributions [Form 1099-R](#), *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*

For a comprehensive list of upcoming EP Educational Events, visit the “[Retirement Plans Community](#)” [web page](#), select “Plan Sponsor/ Employer,” then “Questions: Where to Get Answers” and click on “Upcoming EP Educational Events.” •



Department of the Treasury
Internal Revenue Service

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www.irs.gov

Timing is Everything



Some helpful retirement planning tips from the IRS for 2008...

How much can you contribute to your retirement plan?

If you are a 401(k), 403(b), or governmental 457 plan participant:

- You can make up to \$15,500 in elective contributions. (Roth 401(k) or Roth 403(b) plan participants can defer a combined maximum of \$15,500 in after-tax and pre-tax elective contributions.)
- Over age 50? You may be eligible to make “catch-up contributions” of up to an additional \$5,000. (457 plan participants may make larger catch-up contributions during the three years before retirement.)

If you are a SIMPLE IRA or SIMPLE 401(k) plan participant:

- You can make up to \$10,500 in pre-tax contributions.
- Over age 50? You may be eligible to make “catch-up contributions” of up to an additional \$2,500.

Are you entitled to a tax credit for your contributions?

Low- and moderate-income taxpayers can save on taxes by saving for retirement. The Saver’s Credit provides a tax credit of up to \$1,000 (\$2,000 if filing jointly) if you contribute to a traditional or Roth IRA, 401(k), 403(b), governmental 457, SARSEP, or SIMPLE plan.

To qualify for the credit, adjusted gross income from IRS Form 1040, 1040A, or 1040EZ (federal income tax return) cannot be more than:

- \$53,000, if married filing jointly;
- \$39,750, if head of household; or
- \$26,500, if single, married filing separately, or qualifying widow(er).

File Form 8880, *Credit for Qualified Retirement Savings Contributions*, to calculate the credit.

Talk to your employer or visit www.irs.gov/ep for additional information on these items.

