Enhancing and Expanding the EITC for Low-Wage Workers

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EITC: The Most Effective Anti-Poverty Tool

The Earned Income Tax Credit (EITC) is both a powerful income and wealth-building tool. Last year, 27 million tax filers claimed the EITC, receiving an average benefit of $2,454. A married couple with two children and an income of $40,000 for the year qualified for an EITC of $2,142—meaning their EITC benefit was the equivalent of 5% of their annual income. Although it is structured as a wage subsidy, the EITC actually functions as a lump-sum payment received at tax time. Studies and reports from practitioners that serve EITC filers reveal that the vast majority of EITC recipients prefer the forced savings mechanism of the EITC to an alternative monthly wage boost. EITC claimants interviewed for the book It’s Not Like I’m Poor primarily used their tax refunds to save, pay down debt, and invest in long-term assets. Researchers for the book concluded that these EITC-eligible families used their tax refunds to “build their aspirations for upward mobility.”

The positive impact of the EITC reaches well into adulthood. The unique lump-sum form of tax-time support may be partly responsible for the overwhelmingly positive impact that these programs have on workers and their children. Children in families that receive tax-time benefits like the EITC experience improved outcomes from early childhood all the way through retirement. This means better infant health, improved test scores in school, boosted college enrollment, increased earnings as adults and, finally, higher Social Security benefits in retirement. This long-term impact is quantifiable: children in families that earned an extra $3,000, roughly the size of a typical EITC, worked 135 hours more per year once they reached adulthood.

The EITC enjoys strong bipartisan consensus

The EITC began under a Republican president and was expanded by both parties. It was originally enacted during the Ford Administration in 1975 as a stimulus measure. President Reagan proposed expanding the credit and increasing the income level at which it phases out in his 1982 budget, and he eventually signed an expansion into law as part of the 1986 Tax Reform Act. Most recently, as part of bipartisan tax legislation passed in December 2015, Congress made temporary expansions of the EITC permanent. Originally part of the 2009 American Recovery and Reinvestment Act, the permanent expansions ensure that approximately 16 million families—including 8 million children—won’t be pushed deeper into poverty. Speaker of the House Paul Ryan has continually endorsed EITC expansion, most recently in his 2016 “Better Way” plan.

The specter of “fraud” persists even though other factors contribute to overclaims. As the Center on Budget and Policy Priorities points out, “the EITC’s ‘improper payment rate’ is not a ‘fraud rate’ and shouldn’t be characterized as such.” Currently, one out of every five individuals or families eligible to claim the EITC doesn’t claim it—a problem that would be worsened by proposals to make eligibility more complex. The IRS estimates that up to a third of EITC overclaims may be related to what the National Taxpayer Advocate calls “more factually complex sources of error.”

Key Recommendations for Congress

1. Expand EITC eligibility to workers not raising children.
2. Simplify EITC eligibility by relying on other programs’ “qualifying child” determinations.
3. Increase the accuracy of EITC returns by establishing minimum competency standards for paid tax preparers.
4. Empower taxpayers to save for emergencies by establishing a Rainy Day EITC program.
Attributed in part to the fluid nature of many family structures that are not reflected in IRS guidelines, these include competing claims for the same child and the residency requirement for qualifying children. These factors create confusion—not fraud. In addition, unenrolled paid tax preparers have the lowest accuracy rate of any type of preparer and are not required to earn or maintain any type of minimum competency credential, which leads to inaccurately filed returns. Nevertheless, proposals to undermine the EITC continue to circulate in the name of reducing fraud within the program. Perhaps most troubling is that these “fraud reduction” measures boil down to making the credit more difficult to claim, reducing the level of benefit to filers who claim it, or both.

Congress Can Strengthen the EITC and Reduce Overclaims Now

Expand EITC eligibility to workers not raising children. So-called “childless workers” are the only class of workers taxed further into poverty. A single worker with no qualifying children living right at the poverty line in 2016 qualified for a credit of just $215, boosting their income by less than 2%. If this worker was younger than 25 or older than 65, then they were ineligible entirely. (Compare this to a single worker with one child filing as a head of household, whose credit would be $3,373 in 2016.) The Earned Income Tax Credit Improvement and Simplification Act, sponsored by Congressman Richard Neal (D-MA), was introduced in February 2017 and would expand eligibility and increase the amount of the credit. This approach to expanding the EITC still enjoys bipartisan support—Speaker Ryan also supports it. Increasing the level of EITC benefit for workers not raising children would provide a stronger work incentive, a larger benefit, and would reduce improper payments.

Simplify eligibility by relying on “qualifying child” determinations of other programs. The definition of qualifying child for the EITC is complex. A child must pass four tests in order to qualify: relationship, age, residency, and joint return status. To satisfy the residency test, a child must live with the filer in the US for more than half the year. Of these four tests, it is the residency requirement that comprises the largest percentage of overclaims. Given that the National Taxpayer Advocate finds that low-income taxpayers have “considerable difficulty” substantiating the residency test if required, Congress should reject proposals requiring paperwork that would be virtually impossible to produce in order for filers to substantiate residency. Instead, IRS could rely in part on the simpler residency determinations of other federal programs like TANF, Housing Choice Voucher Program, or SNAP, or the residency determinations of state benefit programs, reducing confusion over eligibility that contributes to improper payments.

Increase return accuracy by establishing minimum competency standards for paid tax preparers. Surprisingly, a majority of paid tax preparers are not required to meet basic competency standards. Paid tax return preparers should be required to take a tax education course, pass an initial basic competency test, and engage in continuing education to demonstrate they have an understanding of existing tax filing requirements. The Volunteer Income Tax Assistance
(VITA) program has the highest EITC return preparation accuracy rate (94%) of any type of preparer, and serves as a model for such competency standards. VITA volunteers are required to complete training and certification programs each year.\(^2\) Given that 68% of filers claiming the EITC use a paid preparer,\(^3\) paid preparers should be held to meaningful standards to ensure they know how to accurately complete returns. The IRS implemented such standards in 2012, but a federal court ruled in 2014 the IRS lacked statutory authority to establish them.\(^4\) Congress can increase return accuracy by setting these commonsense standards.

**Empower filers to save by establishing a Rainy Day EITC option.** While many low-income workers use the EITC as a makeshift savings tool, it was not built to function as one. One proposal to help filers build emergency savings, proposed by the authors of *It’s Not Like I’m Poor*, would allow workers to defer a portion of their EITC for future use later in the year. Such a reform would take advantage of the unique “financial slack” afforded at tax time, encouraging workers to build up emergency savings. The Rainy Day EITC program guarantees that workers will have some emergency savings that lasts beyond their initial tax refund. If workers deferred 20% of the average EITC benefit, this would give them a savings of $480 six months after tax time. Given that nearly half of Americans report that they would not have enough liquid savings to cover a $400 emergency expense, this Rainy Day payment represents a solid emergency fund that can be used to cover emergencies later in the year.\(^5\)

**The EITC is Already Subject to Strong Program Integrity Measures**

The EITC improper payment rate has declined, and represents only a small percentage of the tax gap. The IRS estimates that the EITC’s improper payment rate has averaged 24% over the last five years. This represents a decline from earlier years—the IRS estimated an EITC unrecovered overclaim percentage between 27% and 31% in tax year 1999.\(^6\) Moreover, EITC misreporting represents only 6% of the gross tax gap, the difference between the true tax liability for a given tax year and the amount that is paid on time.\(^7\) In part, this is because the IRS already has a system in place that prevents improper payments. Using a risk-based audit model, the IRS prevents $2.1 billion in improper payments each year through existing audit protocols.\(^8\) Congress recently enacted additional program integrity measures. As part of the Protecting Americans from Tax Hikes (PATH) Act of 2015, Congress required the IRS to delay refunds involving the EITC until February 15, providing more time to “help detect and prevent tax fraud.”\(^9\) Senate Finance Committee Chairperson Orrin Hatch (R-UT) called this and other program integrity measures “the most robust improvements to address waste, fraud, and abuse in the tax code in nearly 20 years.”\(^10\) Before implementing additional measures, Congress should rigorously study the effects of these measures to understand the extent to which they reduced overpayments and the effects they had on tax filers, making modifications to lessen burdens on EITC claimants that do not achieve the stated purpose of reducing improper payments.
3 Sarah Halpern-Meekin et al., It’s Not Like I’m Poor, 2015.
11 Ibid.
13 The Heritage Foundation recommends prohibiting receipt of the EITC if families receive certain other federal benefits and eliminating the EITC for workers without dependents, among other policy changes.
14 For more information, see Chuck Marr, Chye-Ching Huang, Cecile Murray, Arloc Sherman “Strengthening the EITC for Childless Workers Would Promote Work and Reduce Poverty,” 2016.
16 “A bill to amend the Internal Revenue Code of 1986 to make improvements to the earned income tax credit.”
20 For more information on the definition of “qualifying child” and the residency test, see National Taxpayer Advocate 2016 Annual Report to Congress. For more information on using SNAP data to verify EITC residency claims, see Elaine Magg, Sara Edelstein, Devlin Hanson, Sarah Minton, Michael Pergamit, and Caroline Ratcliffe, Incorporating Supplemental Nutrition Assistance Program Data in Earned Income Tax Credit Administration: A Florida Case Study.
21 For more information, see Chad Bolt, “The Urgent Need for Basic Competency Standards for Paid Tax Preparers,” 2017.
22 “Quality Statistical Sample Review Results,” IRS SPEC, June 30, 2015.
26 https://taxpayeradvocate.irs.gov/Media/Default/Documents/2016-ARC/ARC16_Volume1.pdf Quoting from https://www.irs.gov/pub/irs-soi/competeit.pdf (“Of the estimated $31.3 billion in Earned Income Tax Credit (EITC) claims made by taxpayers who filed returns in 2000 for tax year 1999, it is estimated that between $8.5 and $9.9 billion (27.0 percent to 31.7 percent) should not have been paid.”)