A Brief Legislative History of the Earned Income Tax Credit

Margot Crandall-Hollick
Specialist in Public Finance at CRS
Currently on Detail at the IRS Taxpayer Advocate

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The views in this presentation are my own and do not reflect the views of the Congressional Research Service or the IRS Taxpayer Advocate.
The EITC Today
The EITC Today: Overview

- Refundable tax credit available to eligible workers with relatively low earnings.
  - 97% of benefit dollars go to low-wage workers with children.

- The EITC amount is based on formulas that consider:
  - earned income
  - number of qualifying children
  - marital status
  - adjusted gross income (AGI)
The EITC Today: Calculating the Credit

- **Phase-In:** The EITC increases with earned income from the first dollar of earned income up to “earned income amount.”
- **Plateau:** The EITC then remains at its maximum level over a subsequent range of earned income, between the “earned income amount” and the “phase-out amount threshold.”
- **Phaseout:** The EITC gradually decreases in value to zero at a fixed rate (the “phase-out rate”) for each additional dollar of earned income or AGI (whichever is greater) above the phase-out amount threshold.

**EITC parameters** (e.g., credit rate, earned income amount, etc.)
- Vary depending on several factors, including the number of qualifying children and marital status.
The EITC Today: Calculating the Credit

EITC Schedule for an Unmarried Taxpayer with One Child for 2018

Note: In this simplified example, adjusted gross income (AGI) is assumed to equal earned income.
The EITC Today: 2018 Parameters

<table>
<thead>
<tr>
<th>Number of Qualifying Children</th>
<th>0</th>
<th>1</th>
<th>2</th>
<th>3 or more</th>
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<tbody>
<tr>
<td><strong>unmarried tax filers</strong> (single and head of household filers)</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>credit rate</td>
<td>7.65%</td>
<td>34%</td>
<td>40%</td>
<td>45%</td>
</tr>
<tr>
<td>earned income amount</td>
<td>$6,780</td>
<td>$10,180</td>
<td>$14,290</td>
<td>$14,290</td>
</tr>
<tr>
<td>maximum credit amount</td>
<td>$519</td>
<td>$3,461</td>
<td>$5,716</td>
<td>$6,431</td>
</tr>
<tr>
<td>phase-out amount threshold</td>
<td>$8,490</td>
<td>$18,660</td>
<td>$18,660</td>
<td>$18,660</td>
</tr>
<tr>
<td>phase-out rate</td>
<td>7.65%</td>
<td>15.98%</td>
<td>21.06%</td>
<td>21.06%</td>
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<tr>
<td>income where credit = 0</td>
<td>$15,270</td>
<td>$40,320</td>
<td>$45,802</td>
<td>$49,194</td>
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<tr>
<td><strong>married tax filers</strong> (married filing jointly)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>credit rate</td>
<td>7.65%</td>
<td>34%</td>
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<td>$3,461</td>
<td>$5,716</td>
<td>$6,431</td>
</tr>
<tr>
<td>phase-out amount threshold</td>
<td>$14,170</td>
<td>$24,350</td>
<td>$24,350</td>
<td>$24,350</td>
</tr>
<tr>
<td>phase-out rate</td>
<td>7.65%</td>
<td>15.98%</td>
<td>21.06%</td>
<td>21.06%</td>
</tr>
<tr>
<td>income where credit = 0</td>
<td>$20,950</td>
<td>$46,010</td>
<td>$51,492</td>
<td>$54,884</td>
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</table>

Source: IRS Revenue Procedure 2018-18 and Internal Revenue Code (IRC) Section 32.
The EITC Today: 2018 Schedules

Source: IRS Revenue Procedure 2018-18 and Internal Revenue Code (IRC) Section 32.
The EITC Today: Eligibility Requirements

- The tax filer must file a federal income tax return.
- The tax filer must have earned income.
- The tax filer must be a resident of the United States unless the recipient resides in another country because of U.S. military service.
- The tax filer’s children must meet relationship, residency, and age requirements to be considered qualifying children for the credit.
- Childless workers who claim the credit must be between ages 25 and 64 (not applicable to claimants with children).
The EITC Today: Eligibility Requirements (Cont.)

- The tax filer’s investment income must be below a certain amount ($3,500 in 2018).

- The tax filer must not be disallowed the credit due to prior fraud or reckless disregard of the rules when they previously claimed the EITC.

- The tax filer must provide their Social Security number and their spouse if married, and any children for whom the credit is claimed.
1975-1986: An Earnings-Based Credit for Workers with Children
Negative Income Tax & Work Bonus Plan

- The origins of the EITC can be traced to debate in the late 1960s and 1970s over how to reform welfare—known at the time as Aid to Families with Dependent Children (AFDC).

- Some showed interest in alternatives to cash welfare for the poor, including the “negative income tax” (NIT) concept. Influenced by a NIT, President Nixon proposed in 1971 the “family assistance plan” (FAP).

- Senator Russell Long, then chairman of the Senate Finance Committee, did not support FAP because it provided “its largest benefits to those without earnings.”
Work Bonus Plan to EITC

- Senator Long stated that his proposed “work bonus plan” was “a dignified way” to help poor Americans “whereby the more he [or she] works the more he [or she] gets.”

- The “work bonus plan” was renamed the earned income tax credit and was enacted on a temporary basis as part of the Tax Reduction Act of 1975 (P.L. 94-12).

- The credit was 10% of the first $4,000 in earnings (maximum credit amount was $400.) The credit phased out between incomes of $4,000 and $8,000.
Work Bonus Plan to EITC

- In addition to encouraging work and reducing dependence on cash welfare, the credit was also viewed by proponents as a means to encourage economic growth in the face of the 1974 recession.

- Since the EITC was viewed in part as an alternative to cash welfare, it was generally targeted to the same recipients—single mothers with children.
Senate Finance Committee, 1975:

“This new refundable credit will provide relief to families who currently pay little or no income tax. These people have been hurt the most by rising food and energy costs. Also, in almost all cases, they are subject to the social security payroll tax on their earnings. Because it will increase their after-tax earnings, the new credit, in effect, provides an added bonus or incentive for low-income people to work, and therefore, should be of importance in inducing individuals with families receiving Federal assistance to support themselves. Moreover, the refundable credit is expected to be effective in stimulating the economy because the low-income people are expected to spend a large fraction of their disposable incomes.”

Legislative Extensions from 1976-1986

- The credit was extended several times before being made permanent by the Revenue Act of 1978 (P.L. 95-600), which also increased the maximum credit to $500.

- “Congress believed that the earned income credit is an effective way to provide work incentives and relief from income and Social Security taxes to low-income families who might otherwise need large welfare payments.”

- Subsequent increases in the credit amount in 1984 (P.L. 98-369) and 1986 (P.L. 99-514) were viewed as ways to adjust the credit for increases in cost of living and Social Security taxes. (1986 law permanently adjusted parameters for inflation.)

Source: Joint Committee on Taxation, General Explanation of the Revenue Act of 1978, March 12, 1979, JCS-7-79, p. 51.
1990s: Expanding the Credit Amount While Limiting Eligibility
The EITC as a poverty reduction tool

- Over time, policymakers began to turn to the EITC as a tool to achieve another goal: poverty reduction.

- A 1989 *Wall Street Journal* article described the EITC as “emerging as the antipoverty tool of choice among poverty experts and politicians as ideologically far apart as Vice President Dan Quayle and Representative Tom Downey, a liberal New York Democrat.”

- The formula used to calculate the credit was modified in 1990 to vary by family size to work better as a poverty reduction tool (larger families need more resources to meet their basic needs).

OBRA90 and OBRA93

- The EITC was restructured to vary based on family size beginning with the Omnibus Reconciliation Act of 1990 (OBRA90; P.L. 101-508)
  - The credit was made larger for families with two or more children.

- The credit amounts were increased significantly by the Omnibus Reconciliation Act for 1993 (OBRA93; P.L. 103-66).
  - Max Credit: **OBRA90 in 1992** | **OBRA93 in 1994**
    - 1 child: **$1,324** | **$2,038**
    - 2 + children: **$1,384** | **$2,528**
OBRA93 & The “Childless” EITC

- OBRA93 also—for the first time—extended the credit to childless workers.

- The main rationale for this “childless EITC” was not poverty reduction. Instead the credit was intended to partly offset a gasoline tax increase included in OBRA93.

- The credit for childless workers was smaller than the credit for individuals with children—a maximum of $323 as opposed to $2,152 for those with one child and $3,556 for those with two or more children in 1996.
OBRA93 & The “Childless” EITC (Cont.)

- The childless EITC was only available to adults aged 25 to 64 who were not claimed as dependents on anyone’s tax return.

- Aside from inflation adjustments, the formulas for the childless EITC and the EITC for individuals with one or two children have remained unchanged since OBRA93.
PRWORA & TRA97: Targeting the Credit

- The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA; P.L. 104-193) and the Taxpayer Relief Act of 1997 (P.L. 105-34) included modifications intended to:
  - Limit eligibility to individuals authorized to work in the United States by requiring SSNs associated with work authorization;
  - Prevent certain higher-income taxpayers from claiming the credit by
    - Expanding the definition of investment income and
    - Expanding the definition of income used in phasing out the credit, by including additional categories of passive (i.e., unearned) income;
PRWORA & TRA97: Targeting the Credit (Cont.)

- Improve administration of the credit
  - Created penalties for taxpayers who claimed the credit incorrectly.
2000s-Today: More Recent Legislative Changes
The Bush Tax Cuts: Reducing the Marriage Penalty

- For low-income taxpayers with little or no tax liability, a marriage penalty is said to occur when the refund the married couple receives is smaller than the combined refund of each partner filing as unmarried.

- In 2001, the JCT identified the structure of the EITC as one of the primary causes of the marriage penalty among low-income taxpayers.

- The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA; P.L. 107-16) reduced the EITC marriage penalty by increasing the income level at which the credit phased out for married couples.
The 2009 Stimulus/ARRA
Expanding the Credit for Larger Families

- The American Recovery and Reinvestment Act (ARRA; P.L. 111-5) temporarily created a larger credit for families with three or more children by increasing the credit rate for these families from 40% to 45%.

- ATRA also temporarily increased EITC marriage penalty relief from $3,000 to $5,000.

- The American Taxpayer Relief Act [ATRA; P.L. 112-240]), extended these modifications for five years, through the end of 2017. The Protecting Americans from Tax Hikes Act (PATH Act; Division Q of P.L. 114-113) made these changes permanent.
The PATH Act: Reducing Improper Payments

- The Protecting Americans from Tax Hikes Act (PATH Act; Division Q of P.L. 114-113) included a variety of provisions intended to reduce improper payments of refundable credits, including improper payments of the EITC, including:
  - A provision that would prevent retroactive claims of the EITC after the issuance of SSNs.
  - A provision requiring the IRS to hold income tax refunds until February 15 if the tax return included a claim for the EITC (or the additional child tax credit, known as the ACTC).
  - The PATH Act required employers to file W-2s by January 31. Prior to the PATH Act, employers had until March 31 to file W-2s if they filed them electronically or February 28 if they filed them on paper.
## Review: Major Legislative Changes to the EITC

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<tbody>
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<td>Maximum statutory credit</td>
<td>$400</td>
<td>$500</td>
<td>$550</td>
<td>$800</td>
<td>one, $1,057</td>
<td>none, $323</td>
<td>same</td>
<td>0-2, same</td>
</tr>
<tr>
<td>for eligible taxpayers</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>$1,114</td>
<td>$2,152</td>
<td></td>
<td>$4,001</td>
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<tr>
<td>including variation based</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>two or more,</td>
<td>one,</td>
<td></td>
<td></td>
</tr>
<tr>
<td>on the number of qualifying</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>$1,114</td>
<td>$2,152</td>
<td></td>
<td></td>
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<tr>
<td>children</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>same</td>
<td></td>
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</tbody>
</table>

### Credit Formula Based on:

- **Earnings**: $\times$$\times$$\times$$\times$$\times$$\times$$\times$$\times$$\times$$\times$
- **Number of Children** (i.e., credit based in part on family size): $\times$$\times$$\times$$\times$$\times$
- **Marital Status**: $\times$$\times$
- **Credit Available to Childless Workers**: $\times$$\times$$\times$$\times$
- **Credit Adjusted Annually for Inflation**: $\times$$\times$$\times$$\times$$\times$

Note: Maximum statutory credit amounts do not reflect annual adjustments for inflation.

QUESTIONS?
CONTACT INFORMATION

Margot Crandall-Hollick
mcrandallhollick@crs.loc.gov
202-707-7582
EITC as a Benefit

Why (and Where) Does it Matter?
EITC as a Benefit: Difference in Enforcement

• Policy Effects: EITC is “Different” from Other Tax Expenditures, Justifying Higher Audit Rate
  • As “Payment” and “high priority program” falls under Executive Order 13520, IPERA (Pub. L. 111-204, 123 Stat. 2224) and IPERIA (Pub. L. 112-248, 126 Stat. 2390) which require increased reporting and oversight

• “Public Benefit” Style Penalties: IRC 32(k)
  • Apart from refundable credits, difficult to find “bans” in other areas of tax law
  • See also felony drug offense provisions of IRC 25A(b)(2)(D)
EITC as a Benefit: Interplay w/Other Benefits

EITC and Navigating Means Tested Public Benefits

• Exempt as Asset - SSI
  • Tax refund is exempt as asset in bank account for 12 months
  • See Pub. L. 112-240 “American Taxpayer Relief Act of 2012”

• Not Treated as Income and 2 month asset exclusion: IRC 32(l)
  • Most housing benefits
  • Food and Nutrition Act of 2008

• “Hidden” From Calculations for Other Benefits
  • EITC is wage subsidy, but tax refunds are part of most “income” calculations
  • See, E.g. Minnesota Medicaid Assistance, Minn. Stat. 256B.055 and .056
EITC as Benefit: Interplay w/Other Law

EITC and Bankruptcy

• Specific Statutory Exception for EIC

• Exempt Because EITC is a “Public Benefit”
  • In Re Fish, 224 B.R. 82 (Bankr. S.D. Ill. 1998) Chapter 7 Case: IL Law Exempts “debtor’s right to receive [...] public assistance benefit”
  • Flanery v. Mathison, 289 B.R. 624 (W.D. Kent. 2003) “[...] the modern trend among courts is that the EITCs fall within the classification of public assistance.”

• Not Exempt In Many Jurisdictions/Dif. Treatment for Ch. 13
  • In Re Parker, 352 B.R. 447 (N.D. Ohio 2006) (no general public assistance exemption in Ohio law)
  • In Re Thompson, 336 B.R. 800 (D. Nev. 2005) (Nevada law has narrower definition of benefits, only includes benefits paid under a certain chapter)
  • In Re Blake, 565 B.R. 871 (Bankr. N.D. Ill. 2017); Chapter 13 Case which does not extend exemption to current monthly income calculation (i.e. EITC prorated over 12 months)
EITC as Benefit: Interplay w/Other Tax Law

• **Innocent Spouse**
  • Treas. Reg. 1.6015-2(d) “significant benefit” from understatement inquiry: did taxpayer get EITC that they wouldn’t have qualified for absent understatement?
  • IRC 6015(f) Cases:
    • Brooks v. C.I.R., T.C. Memo. 2003-166 (Among other factors, petitioner didn’t demonstrate that they did not benefit from EITC claimed on return)

• **Excluded (Otherwise) “Earned” Income**
  • Medicaid Waiver Payments: Notice 2014-7
  • Combat Pay: IRC 32(c)(2)(B)(vi) and IRC 112
  • Foreign Income Exclusion Election: IRC 32(c)(1)(C)

• **Not “Earned” Income**
  • Work as inmate (IRC 32(c)(2)(B)(iv))
  • Sheltered workshops (IRC 32(c)(2)(B)(v))
QUESTIONS?