1. EARNED REPUTATION

The Earned Income Tax Credit

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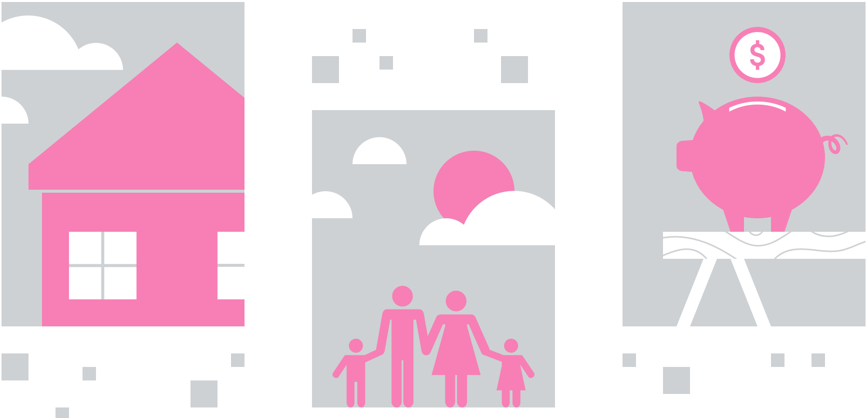

The Earned Income Tax Credit (EITC) is one of the premier pro-work and anti-poverty programs in the United States. Roughly 27 million low-income taxpayers receive the credit annually, with an average benefit of around $2,500. Since its introduction in 1975, dozens—if not hundreds—of researchers have evaluated the EITC, giving it a near-uniform consensus that it boosts labor supply, reduces poverty, and contributes to the long-term well-being of recipient families.

The EITC is a tax-based wage subsidy for low-income workers. Its value is based on a complicated series of factors, including household filing status, earnings, income, and number of children.[1] For each filing status and number of children, the credit features three separate income ranges: (1) a phase-in range, whereby the value of the credit grows with each additional dollar of earnings; (2) a plateau, under which taxpayers receive the maximum credit but don't earn an additional subsidy for more earnings; and (3) a phase-out range, whereby the value of the credit declines with higher earnings.[2]

While the fundamental structure of the EITC is the same for all eligible taxpayers, the particular subsidy rates, income ranges, and maximum credits differ substantially by filing status and number of children. Notably, the credit is worth very little to taxpayers without children, with a maximum credit in 2018 of just $519 for childless households.[3] Meanwhile, the credit to taxpayers with three or more children was as high as $6,431 in 2018.

A few other characteristics of the EITC bear mentioning. It is only available to workers ages 25 to 64 in large part to address concerns about the scope of the recipient pool; college students and Social Security beneficiaries, for example, may have temporarily low-earnings but may not be considered low-income. The credit is also refundable, meaning that taxpayers with no or little income tax liability will still benefit. Like other tax credits, the EITC pays out annually, with taxpayers generally receiving benefits in late winter or early spring in the form of an income tax refund.

The credit is not without shortcomings. The EITC suffers from error rates of between 22 and 26 percent, which are high relative to other tax expenditures received by low- and middle-income households.[4] Also, the phase-out rate effectively creates an implicit tax on workers, which can have the opposite impact than intended for this group. The EITC is also complicated for many taxpayers, who often chose to use a paid-preparer—diminishing the net value of the credit. Lastly, the EITC's once-a-year delivery has been criticized by those who argue that it would be more effective if taxpayers could claim a portion of the credit throughout the year.

Perhaps due to the positive evaluations, the federal government has periodically expanded the EITC, with major expansions in 1994 and 2009. A host of other expansions have been proposed, including by the Barack Obama administration, Donald Trump's presidential campaign, and think tanks like the American Enterprise Institute, the Brookings Institution, and the Urban Institute. Despite bipartisan support for expansion, the credit was not directly changed in the 2017 tax bill that overhauled the individual income, corporate, and estate tax codes. And because that tax legislation slowed the rate of inflation for tax parameters, the value of the EITC will decline over time. To many observers, the lack of a 2017 EITC expansion was a curious and unfortunate omission given the sizable evidence of its positive impact and the Trump campaign's plan for a substantial EITC expansion.

Notwithstanding congressional actions in 2017, most policymakers recognize the EITC as one of the great applications of evidence to improve economic security. In particular, the EITC is an example of the potential power of evaluating the $1.6 trillion tax expenditure budget—which typically escapes scrutiny within the federal budget system. Indeed, introducing regular and formal evaluations to tax expenditures can markedly improve the application of trillions of dollars in tax expenditure spending to improve the lives of American families.

ISSUE BACKGROUND

In 1975, legislators passed the EITC as a response to a growing concern over the number of families receiving welfare benefits, which had risen from 1.1 million to 3.1 million over a few years. Senator Russell Long, concerned about the disincentive effects of unconditional cash transfers, proposed a "work bonus" plan that would provide a modest subsidy on low levels of earnings. The first iteration of the EITC was a nonrefundable credit equal to 10 percent of a low-income taxpayer's first $4,000 in earnings, with a maximum credit of $400 (or about $1,800 in 2018 dollars). The credit phased out between $4,000 and $8,000 in income. The credit was also justified as a way to help boost consumption in the face of the 1974 recession.[5]

The policy goals of the EITC have historically helped the tax credit to enjoy bipartisan support. The progressive structure of the program—which raises living standards by offsetting taxes based on a taxpayer's ability to pay—tends to appeal to Democrats. Meanwhile, Republicans (as well as many Democrats) tend to value the program's design to encourage and reward work. President Ronald Reagan called the program "the best anti-poverty, the best pro-family, the best job creation measure to come out of Congress."[6] President Barack Obama called for an expansion for childless workers in his 2016 State of the Union address: "America is about giving everybody willing to work a chance, a hand up, and I'd welcome a serious discussion about strategies we can all support, like expanding tax cuts for low-income workers who don't have children."[7] Today, politicians ranging from former House Speaker Paul Ryan to Senator Sherrod Brown support the credit's expansion to achieve certain policy goals.[8]

Policymakers expanded the EITC periodically between its inception and, most recently, in 2009. These expansions became permanent in 2015. In broad strokes, expansions included both increases to the value of the credit and to those eligible to receive it. At times, Congress also implemented eligibility restrictions, such as the requirement that only those with less than $3,500 in investment income could receive the credit. Notable expansions include increases to the maximum credit in 1978 and 1986; increases to the maximum credit overall, and for larger families in particular, in 1990 and 1993; and a higher credit for large families in 2009.

Various expansions have still left holes in the program, the most glaring of which is for childless workers—who receive a maximum benefit of about $500. There are other eligibility concerns, such as a lack of benefit for older and younger workers, and a lack of equity for one-child households. On the latter concern, for example, equalizing the one-child EITC with the two-child EITC in "equivalence scale-adjusted terms" would require boosting the credit for one-child families by about $1,000.[9]

Compliance and administration have also been a persistent concern, as noted above. Some conservative politicians and analysts cite a high rate of fraud in the program, including, for example, providing false income or filing status information.[10] Progressives often worry about the low rate of claiming among eligible households, with about 20 percent of eligible taxpayers choosing to forgo their credit. Policymakers and analysts across the ideological spectrum also cite concerns around complexity, including the high rate of unintentional errors in filing, the widespread need for paid preparers, and the subsequent relatively high levels of enforcement resources the IRS devotes to the EITC. Much of this administrative error is due to the difficulty taxpayers have claiming the correct number of dependents. For example, parents filing separate returns can make errors when indicating the number of children in a given household.[11]

EVIDENCE AVAILABILITY

The EITC is exceptionally well-evaluated. Dozens of high-quality studies in peer-reviewed journals have reached a near-consensus about the positive impacts of the EITC. Researchers and evaluators generally agree that the credit boosts labor supply (especially among single parents), lowers poverty rates, and contributes to the long-run well-being of households. Points of disagreement tend to center around the EITC's net cost in terms of lost revenue, drawbacks related to improper claiming, and, more fundamentally, whether it makes sense to address progressivity concerns through tax-based subsidies.

The plethora of studies devoted to EITC evaluation is due to a host of factors, including differential treatment among similar families (for example, two-child versus three-child families), periodic changes in the program parameters, and state-level variation—all of which allow researchers to identify the causal impacts of the program. In addition, widespread availability of microdata on the labor market and tax returns have enabled researchers to conduct several high-quality studies on the relationship between the EITC and changes in work patterns. In many cases, some of the most convincing and robust studies on the EITC arose from securely linking administratively collected tax records with confidential data from large, representative surveys.

The sheer number of studies makes it difficult in this short brief to summarize the key economic findings.[12] Some of the more important results include findings that the EITC significantly increases labor force participation among unmarried women, but can discourage work among married women.[13,14] The EITC has a positive impact on infant-birth indicators, such as low birth weight and premature birth, and maternal well-being, such as decreased risk factors for strokes and heart disease.[15] Vis-à-vis the long-term impacts of childhood exposure, the EITC significantly boosts high school and college completion rates, as well as the likelihood of employment in adulthood.[16] Also, a recent working paper estimates that 87 percent of the gross costs of the EITC are offset through higher tax receipts and reduced expenditures for public services.[17]

EVIDENCE USE

The EITC has enjoyed consistent support and periodic expansions over the past half-century. This is due to the program's broad, bipartisan appeal and its demonstrated positive and sustained impact on increasing labor force participation and decreasing poverty, among other outcomes of national interest. As noted above, the EITC has enjoyed regular expansions since its inception in the 1970s.

Due to the EITC's positive impact, documented through numerous rigorous evaluations, policy discussions about the EITC most often revolve around how to enhance its reach and impact. For example, an especially popular proposal to enhance EITC suggests addressing the disparity in the value of credits for childless workers. In recent years, this approach has been endorsed by President Obama, former Speaker Ryan, and a bipartisan panel of experts commissioned by the Brookings Institution and the American Enterprise Institute to propose solutions to lack of opportunity in America. Other notable proposals include a 10 percent increase in the value of the credit, a $1,000 increase for single-child families, and a plan to make older workers eligible for the credit.[18,19,20]

More recently, in the absence of federal action, state and local policymakers found ways to expand the EITC's impact. There are many subnational efforts to provide state and local tax relief through state and local EITCs. To date, 29 states, the District of Columbia, Guam, Puerto Rico, and some municipalities adopted a state or local EITC credit. The first state EITC was enacted in 1986 in Rhode Island.[21] These state or local programs typically use federal eligibility rules, and policymakers structure them as some percentage of the federal credit, with five states offering nonrefundable credits and 24 states and Washington, D.C., offering refundable credits. The generosity of the credit varies substantially among states. For example, Maine provides a nonrefundable 5 percent state EITC in addition to the federal credit, while New Jersey offers a 37 percent refundable credit. In recent years, many states have been expanding their EITC programs, with plans that range from higher credits to increased access, to switching from a nonrefundable to refundable credit.[22]

The connection between the EITC and the use of evidence is not all positive. First, for example, in contrast to direct and mandatory spending, the $1.6 trillion tax expenditure budget—including the EITC—is subject to almost no formal review.[23] Thus, while evaluators have provided extensive evidence on the merits of the credit, there is limited knowledge about how it interacts with other tax expenditures or how it compares with different tax-based approaches for achieving social objectives. Second, the recent Tax Cuts and Jobs Act of 2017 failed to expand the EITC, despite having granted $2 trillion in net cuts to taxpayers—including the expansion of many provisions that have limited or no evaluations. Legislators prioritized many other approaches with few or no evaluations over the EITC, leading many observers and advocates to question why policymakers did not include the credit's expansion—especially given the credit's well-documented impact on labor supply in a time of widespread labor shortages.

In sum, the EITC has enjoyed regular bipartisan support throughout its near half-century of existence. It has been expanded at the federal level in every decade since its creation. It has been adopted by the majority of the states. And several policymakers have proposed expansions in the program to address shortcomings with the U.S. economy. These regular and widespread expansions coincide with decades of positive evaluations of the program's impact and cost-effectiveness. While it is impossible to state how the EITC may have fared in the absence of existing evaluations, it appears to be one of the great success stories in evidence-based policy.

LESSONS

- ***Evidence of impact sustained the program.*** A wide body of rigorous evidence demonstrating the positive impact of the EITC on labor force participation, reducing poverty, improving maternal and infant health, and enhancing adult earnings has helped sustain and expand the program over the past 40 years. The broad and consensus research around the EITC appears to have helped propel its federal and state expansion and led to many calling for more resources devoted to the credit. In particular, policymakers from across the aisle often agree that they should sustain, an even expand, the EITC to enhance credits for childless workers.

- ***Bipartisanship affects perceptions.*** The broad bipartisan support of the EITC's policy goals—encouraging and rewarding work while raising living standards for the poorest workers—also contributes to the program's popularity.

- ***Continuous and consistent evaluation is needed.*** The lack of formal mechanisms for evaluating tax expenditures is a shortcoming that fails to recognize the EITC as more effective than other expenditures. Evaluations should be formalized into a more coherent and comprehensive review of the $1.6 trillion tax expenditure budget.

- ***Evidence may not change politics.*** The omission of an EITC expansion in the Tax Cuts and Jobs Act of 2017 represents a failure of Congress to use existing evidence to make informed decisions about tax expenditures, as legislators prioritized other tax cuts with few or no evaluations over the EITC. ■

1 For an overview of the mechanics of the EITC, *see*: Gene Falk and Margot L. Crandall-Hollick. *The Earned Income Tax Credit (EITC): An Overview.* Congressional Research Service, R43805, April 18, 2018.

2 To illustrate, consider the value of the credit for taxpayers filing as "heads of households" with three or more children. In 2018, the phase-in range for this household is between $0 and $14,290 in annual income, with these taxpayers receiving an additional wage subsidy of 45 percent on additional earnings. The plateau is between $14,290 and $18,660 in annual income, with taxpayers receiving the maximum credit of $6,431 in this income range. The phase-out range is between $18,660 and $49,194 in annual income, with taxpayers in this range losing 21.06 percent of each dollar earned to a lower credit.

3 The maximum credit is $3,461 for households with one child and $5,716 for households with two children.

4 Importantly, note that these error rates largely reflect taxpayer confusion and misunderstanding, and should not wholly be characterized as "fraud." For a detailed discussion, *see*: Robert Greenstein, John Wancheck, and Chuck Marr. *Reducing Overpayments in the Earned Income Tax Credit.* Center on Budget and Policy Priorities, January 31, 2019. Available at: https://www.cbpp.org/research/federal-tax/reducing-overpayments-in-the-earned-income-tax-credit.

5 Margot L. Crandall-Hollick and Joseph S. Hughes. The Earned Income Tax Credit (EITC): An Economic Analysis, U.S. Library of Congress. Congressional Research Service, R44057, 2018.

6 Chuck Marr. "Reagan's Actions Made Him a True EITC Champion." *Off the Charts*, August 1, 2014. Available at: https://www.cbpp.org/blog/reagans-actions-made-him-a-true-eitc-champion.

7 Chuck Marr. "Obama Wisely Calls for Boosting the EITC for Childless Adults." *Off the Charts*, January 13, 2016. Available at: https://www.cbpp.org/blog/obama-wisely-calls-for-boosting-the-eitc-for-childless-adults.

8 Chuck Marr, Emily Horton, and Brendan Duke. "Brown-Khanna Proposal to Expand EITC Would Raise Incomes of 47 Million Working Households." *Off the Charts*, October 10, 2017. Available at: https://www.cbpp.org/research/federal-tax/brown-khanna-proposal-to-expand-eitc-would-raise-incomes-of-47-million-working.

9 Hilary W. Hoynes. "Building on the Success of the Earned Income Tax Credit." The Hamilton Project, The Brookings Institution, June 19, 2014. Available at: https://www.brookings.edu/research/building-on-the-success-of-the-earned-income-tax-credit/. As Hoynes explains, equivalence adjustments allow for the comparison of standards of living between multi-person households and single-person reference households. In other words, they allow for comparisons in the standard of living among households of different sizes.

10 Chris Edwards and Veronique de Rugy. "Earned Income Tax Credit: Small Benefits, Large Costs." The Cato Institute. *Tax and Budget Bulletin* (73), October 14, 2015. Available at: https://www.cato.org/publications/tax-budget-bulletin/earned-income-tax-credit-small-benefits-large-costs.

11 Janet Holtzblatt and Janet McCubbin. "Whose Child Is It Anyway? Simplifying the Definition of a Child." *National Tax Journal*, 56(3): 701-718, September 2003.

12 For an excellent summary of the evidence on the EITC, *see*: V. Holz and J.K. Scholz. "The Earned Income Tax Credit." In: R. Moffitt (ed.). *Means-Tested Transfer Programmes in the United States* (Chicago: University of Chicago Press, 2003). *See also:* Austin Nichols and Jesse Rothstein. *The Earned Income Tax Credit (EITC).* National Bureau of Economic Research, 2015. Available at: https://www.nber.org/papers/w21211.pdf.

13 Nada Eissa and Jeffrey B. Liebman. "Labor Supply Response to the Earned Income Tax Credit." *Quarterly Journal of Economics*, 11(2): 605-637, May 1996.

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