VITA at Colgate: The Earned Income Tax Credit (EITC)

VITA Presentation
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Overview and Issues

• In the last 15 years, EITC has expanded into the most important government cash program for low income families with children.

• The EITC has relatively wide ranging support because it is shown to transfer resources to low income families while promoting work.

• Review features of the EITC and discuss the implications of hypothetical changes to the program.
Roadmap for the talk

• Brief history of welfare reform
• Operation of the EITC
• Why is there (relatively) broad support for the EITC?
• Expected effects of possible reforms to EITC
• What our clients in central NY look like
Current Welfare Programs

• Cash programs:
  – Welfare
  – EITC
  – Energy assistance (HEAP)

• Non-cash programs:
  – Food stamps (SNAP)
  – Medicaid
Brief History of Welfare Reform

• Previously AFDC (Aid to Families of Dep Children)
• Clinton –‘Welfare to Work’ in 1996:

Personal Responsibility & Work Opportunity Act of 1996 (PRWOA96)

Four goals:

1. End dependence of needy parents upon government benefits by promoting job preparation, work, and marriage;

2. Aid needy families so that children may be cared for in their homes or those of relatives;

3. Prevent and reduce out-of-wedlock pregnancies and establish goals for preventing and reducing their incidence;

4. Encourage formation and maintenance of two-parent families
Implications of welfare reform

- Welfare rolls declined nationally by 50%
History of EITC

• Started in 1975 as modest “work bonus”; made permanent in 1978
• Substantial expansions have taken place:
  – 1986 Tax Reform Act: general expansion and indexed for inflation
  – 1990 OBRA: general expansion and added separate schedule for families with 2 or more children
  – 1993 OBRA: general expansion (larger expansion for families with 2 or more children) and added EITC for childless filers
• Many states now offer “add on” EITCs
  – In 2008, 26 states had EITCs
  – NY: 30% of Federal credit
Overview of EITC

- Refundable tax credit for working, low-income tax filers with children (much smaller credit for childless)
- Credit available to childless, single parent and two parent families.
- The value of the credit varies with earned income and number of children—with larger credit amounts for families with children
  - The average credit in 2010 was $2,805
- Total cost of the EITC is $78 billion (compared to $26 billion for TANF and $77 billion for food stamps) making it the largest cash or near cash program for low income families in the US (2011 data).
EITC Eligibility and Payments

- **EITC Eligibility:**
  - *Positive* earned income; below limit

- **Earned income** and adjusted gross income (AGI) must each be less than (in 2012):
  - $13,980 ($19,190 married filing jointly) with no qualifying children
  - $36,920 ($42,130 married filing jointly) with one qualifying child
  - $41,952 ($47,162 married filing jointly) with two qualifying children
  - $45,060 ($50,270 married filing jointly) with three or more qualifying children

- **Maximum credit:**
  - $5,891 with three or more qualifying children
  - $5,236 with two qualifying children
  - $3,169 with one qualifying child
  - $475 with no qualifying children
EITC Eligibility and Payments

• Credit amount depends on *family earnings* and *number of children*:
  – **Phase-in**: credit is flat percentage of earned income
  – **Flat range**: receive maximum credit
  – **Phase-out**: credit is phased out at a flat rate
EITC Benefit Structure, Single mothers in 2007

Eligibility extends well into moderate earning ranges. Median family income for 2006 was $48,000.
EITC Eligibility and Payments

- Until 2001, EITC parameters were identical for single and married filers.
  
  - EGTRRA (Economic Growth and Tax Relief Reconciliation Act of 2001)
  
  - Extended flat/phase-out regions for married couples; now $3100 higher than for singles.
More detail in EITC Schedule – Married couple extensions and credit for childless

Subsidy rate 34%, 40%

Phase-out rate 16%, 21%
Real EITC Benefits Increasing over Time (2+ children)

Credit Amount (2006$)

Earnings 2006$
Tax cost of EITC, 1975-2010

Figure 3. Real Federal Spending on EITC, CTC, and Welfare, 1975-2009

Source: Budget of the United States Government, Fiscal Year 2012, for AFDC/TANF; Internal Revenue Service Statistics of Income, various years for EITC and CTC; Bureau of Labor Statistics for CPI Deflator.

Underlying Data: Download

EITC Recipients, 1975-2009

Number of Families Receiving Federal Earned Income Tax Credit

Source: Tax Policy Center
Why is there (relatively) broad support for the EITC?

- The EITC targets working families (no earnings = no EITC)
- The EITC targets low-income families
- The EITC targets families with children
- The EITC encourages work
- The EITC reduces poverty
The EITC targets low income families

The graph shows the Earned Income 2006 ($) on the x-axis and Credit Amount (2006 $) on the y-axis. The graph is divided into three regions:

1. **Phase in Region**
   - For one child, the poverty line for a mom with one kid is shown.
   - For two or more children, the poverty line for a mom with two kids is shown.

2. **Flat Region**
   - The credit amount remains constant for a range of income levels.

3. **Phase out Region**
   - The credit amount decreases as the income increases.

The graph uses two lines to represent different scenarios:

- **Blue Line**: One Child
- **Red Line**: Two or more Children

The graph illustrates how the Earned Income affects the Credit Amount for families with different numbers of children.
The EITC encourages work

- Earnings contingent benefit, high subsidy rate (34%,40%) means higher employment rates
- Research shows overwhelming evidence that EITC expansions have increased labor force participation by single mothers with children.
The EITC reduces poverty
Census estimates of poverty reduction due to EITC, 2011

E Earned Income Tax Credit and Child Tax Credit
Lift Millions Out of Poverty
Persons lifted above the poverty line (using the Supplemental Poverty Measure) by the EITC and the CTC, 2011

9.4 million

4.9 million

All Persons  Children

Note: Unlike the Census Bureau's official poverty measure, the SPM poverty measure counts the effect of government benefit programs and tax credits.

Center on Budget and Policy Priorities | cbpp.org
But that is not quite the whole story

Eissa and Hoynes (2005)

• Impacts of EITC on single and married women with children
• Evidence:
  – For single women with children, EITC has encouraged work; no evidence that it has reduced hours
  – For married women with children, EITC has decreased employment and hours worked (at modest levels)
Increase in employment rates for women

Figure V
Annual Employment Rates for Women
By Marital Status and Presence of Children, 1984-2003

Notes: Calculations based on the 1985-2004 March CPS and include women ages 19-44, not in school and not disabled. It also excludes women with positive earnings but zero hours and those with positive hours and zero earnings. Married women include those with spouse present and single women include divorced, widowed and never married women. Figure shows the fraction of women who worked at all in the calendar year.
• Source: Eissa, Kleven and Kreiner (2008)
Recent Changes to EITC

American Recovery and Reinvestment Act 2009

• Expand EITC for families with 3+ children
• Expand eligibility for married couples
  – Expand income eligibility range further for married couples
  – Married couples to receive the credit at even higher income levels than in the past
Expand eligibility for married couples
New EITC Structure

Figure 1. Earned Income Tax Credit by Number of Children and Filing Status, 2012


Underlying Data: Download

<table>
<thead>
<tr>
<th>Taxable Income</th>
<th>But not over ---</th>
<th>Marginal Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Over ---</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$0</td>
<td>$12,750</td>
<td>10%</td>
</tr>
<tr>
<td>$12,750</td>
<td>$48,600</td>
<td>15%</td>
</tr>
<tr>
<td>$48,600</td>
<td>$125,450</td>
<td>25%</td>
</tr>
<tr>
<td>$125,450</td>
<td>$203,150</td>
<td>28%</td>
</tr>
<tr>
<td>$203,150</td>
<td>$398,350</td>
<td>33%</td>
</tr>
<tr>
<td>$398,350</td>
<td>$425,000</td>
<td>35%</td>
</tr>
<tr>
<td>$425,000</td>
<td>and over</td>
<td>39.6%</td>
</tr>
</tbody>
</table>
Marginal Tax Rates with and without EITC
## What do our clients “look” like?

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Age</strong></td>
<td>36.6</td>
</tr>
<tr>
<td><strong>% Female</strong></td>
<td>69%</td>
</tr>
<tr>
<td><strong>% Caucasian</strong></td>
<td>98%</td>
</tr>
<tr>
<td><strong>% Married</strong></td>
<td>29%</td>
</tr>
<tr>
<td><strong>% Employed</strong></td>
<td>76%</td>
</tr>
<tr>
<td><strong>Years of Education</strong></td>
<td>12.8</td>
</tr>
<tr>
<td><strong>% that Receive Govt Assistance</strong></td>
<td>69%</td>
</tr>
<tr>
<td><strong>Income</strong></td>
<td>$13,252</td>
</tr>
<tr>
<td><strong>% In Poverty</strong></td>
<td>56%</td>
</tr>
<tr>
<td><strong>Total Refund</strong></td>
<td>$3,342</td>
</tr>
<tr>
<td><strong>Total EITC Amount</strong></td>
<td>$2,060</td>
</tr>
<tr>
<td><strong>% that Under-predicted Refund</strong></td>
<td>93%</td>
</tr>
<tr>
<td><strong>% that Have Checking Account</strong></td>
<td>74%</td>
</tr>
<tr>
<td><strong>% that Have Savings Account</strong></td>
<td>48%</td>
</tr>
<tr>
<td><strong>% that Have Mortgage</strong></td>
<td>28%</td>
</tr>
<tr>
<td><strong>Unpaid Credit Card Debt</strong></td>
<td>$2,272</td>
</tr>
</tbody>
</table>
What do they plan to spend their tax refund on?

- Pay bills
- Purchase items
- Housing costs
- Save
- Entertainment
- Education expenses
- Other

Percent of Respondents
- First Priority
- Second Priority
- Third Priority
## Labor Market Characteristics of EITC Recipient vs. non-Recipient Households

<table>
<thead>
<tr>
<th></th>
<th>All</th>
<th>Married, no kids</th>
<th>Married, 1 kid</th>
<th>Married, 2+kids</th>
<th>Single, no kids</th>
<th>Single, 1 kid</th>
<th>Single, 2+kids</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>EITC Recipients:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mean Household Income</td>
<td>$15,194</td>
<td>$8,325</td>
<td>$18,700</td>
<td>$21,212</td>
<td>$7,024</td>
<td>$15,761</td>
<td>$17,421</td>
</tr>
<tr>
<td>% of High School or Less</td>
<td>61.5%</td>
<td>70.5%</td>
<td>64.1%</td>
<td>68.5%</td>
<td>60.0%</td>
<td>54.1%</td>
<td>58.3%</td>
</tr>
<tr>
<td>% with Two Earners</td>
<td>26.3%</td>
<td>9.6%</td>
<td>24.6%</td>
<td>30.1%</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>Average EITC</td>
<td>$1,782</td>
<td>$495</td>
<td>$1,812</td>
<td>$2,623</td>
<td>$423</td>
<td>$1,808</td>
<td>$2,728</td>
</tr>
<tr>
<td>EITC as % of Income</td>
<td>11.7%</td>
<td>5.9%</td>
<td>9.7%</td>
<td>12.4%</td>
<td>6.0%</td>
<td>11.5%</td>
<td>15.7%</td>
</tr>
<tr>
<td><strong>Non-EITC Recipients:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Mean Household Income</td>
<td>$47,235</td>
<td>$68,549</td>
<td>$83,372</td>
<td>$94,271</td>
<td>$23,696</td>
<td>$32,125</td>
<td>$31,723</td>
</tr>
<tr>
<td>% of High School or Less</td>
<td>39.7%</td>
<td>36.1%</td>
<td>34.2%</td>
<td>29.6%</td>
<td>43.4%</td>
<td>46.6%</td>
<td>48.3%</td>
</tr>
<tr>
<td>% with Two Earners</td>
<td>65.1%</td>
<td>56.8%</td>
<td>70.5%</td>
<td>71.3%</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
</tr>
</tbody>
</table>

Table 4a, Athreya, Reilly and Simpson, 2010
## Assets, Debt and Net Worth of EITC Recipient vs. non-Recipient Households

<table>
<thead>
<tr>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mean Net Worth</td>
<td>$103,753</td>
<td>$284,403</td>
<td>$204,918</td>
<td>$118,468</td>
<td>$67,574</td>
<td>$56,102</td>
<td>$49,837</td>
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<tr>
<td>Mean Assets</td>
<td>$149,507</td>
<td>$359,963</td>
<td>$255,239</td>
<td>$179,050</td>
<td>$86,545</td>
<td>$89,365</td>
<td>$96,465</td>
</tr>
<tr>
<td>Mean Debt</td>
<td>$45,755</td>
<td>$75,560</td>
<td>$50,321</td>
<td>$60,582</td>
<td>$18,971</td>
<td>$33,263</td>
<td>$46,628</td>
</tr>
<tr>
<td><strong>Non-EITC Recipients:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mean Net Worth</td>
<td>$580,245</td>
<td>$803,447</td>
<td>$621,345</td>
<td>$737,654</td>
<td>$275,437</td>
<td>$351,416</td>
<td>$223,309</td>
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<tr>
<td>Mean Assets</td>
<td>$708,564</td>
<td>$929,270</td>
<td>$790,176</td>
<td>$933,762</td>
<td>$334,930</td>
<td>$448,206</td>
<td>$296,280</td>
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<tr>
<td>Mean Debt</td>
<td>$128,319</td>
<td>$125,823</td>
<td>$168,830</td>
<td>$196,108</td>
<td>$59,493</td>
<td>$96,790</td>
<td>$72,971</td>
</tr>
</tbody>
</table>

Table 4a, Athreya, Reilly and Simpson, 2010