

The Earned Income Tax Credit: Overview and Findings of Its Impacts & Consequences

V. Joseph Hotz
hotz@econ.duke.edu

Duke University

Learning about the Earned Income Tax Credit

West Virginia Center on Budget & Policy

Federal Reserve Bank of Richmond

Charleston, West Virginia

January 11, 2016

Introduction

- 1 Provide brief overview of **Earned Income Tax Credit (EITC)** at **Federal & State** levels.
- 2 Summarize findings on effects of EITC on **employment, poverty & other outcomes**.
- 3 Discuss **non-compliance issues** in administration of EITCs & at least one potential of their **unintended consequences**.

Overview of EITC at Federal & State Levels

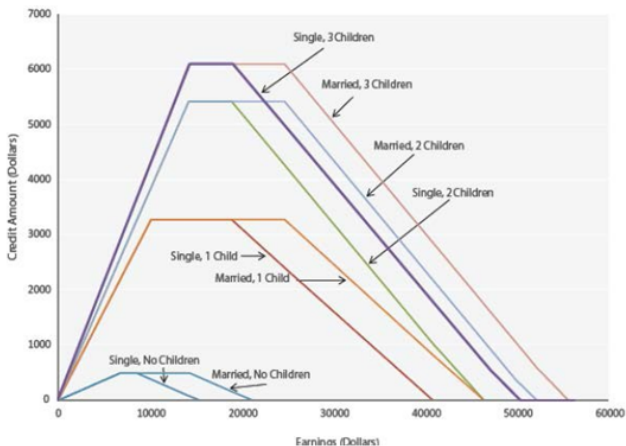
Overview of Federal EITC

- **Refundable tax credit** for working, low-income tax filers.
- Federal EITC **administered** by **Internal Revenue Service (IRS)** as part of federal income tax.
- Designed to:
 - **encourage & reward work**
 - **offset federal payroll & income taxes**¹
- Amount of credit received not only varies with filer's **earned income**, but also with **number of children & marital status**.

¹**Refundable credits** can **more than offset** filers' federal income & payroll tax liabilities.

Current EITC Structure

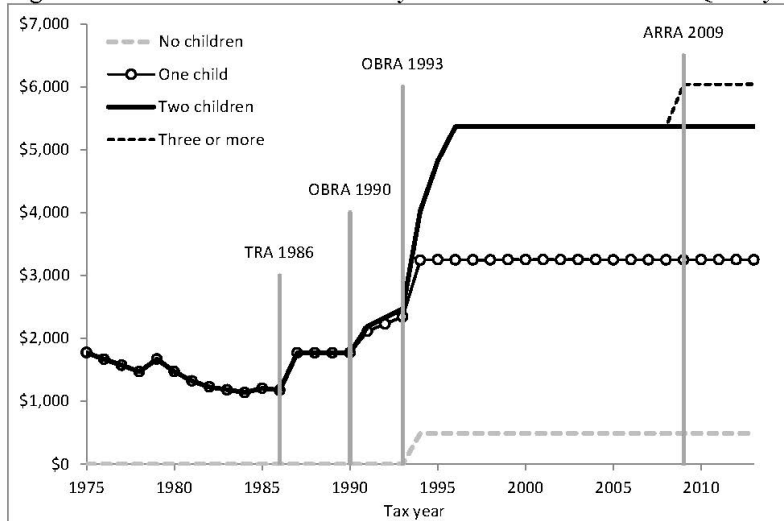
Earned Income Tax Credit by Number of Children and Filing Status, 2014



- Eligibility extends well into moderate earning ranges. Median household income for 2013 was about \$52,000 (US Census Bureau, 2014).

Source: <http://www.taxpolicycenter.org/briefing-book/key-elements/family/eitc.cfm>

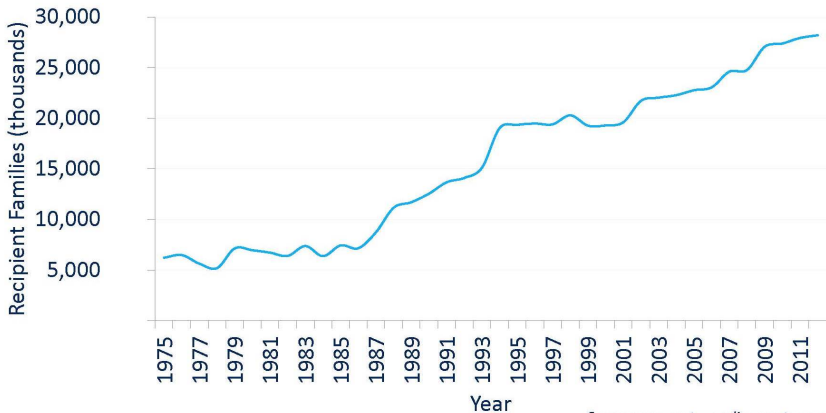
Figure 2: Federal Maximum EITC by Tax Year and Number of Qualifying Children



Notes: Tax Policy Center (2014), 2013\$.

EITC Recipients

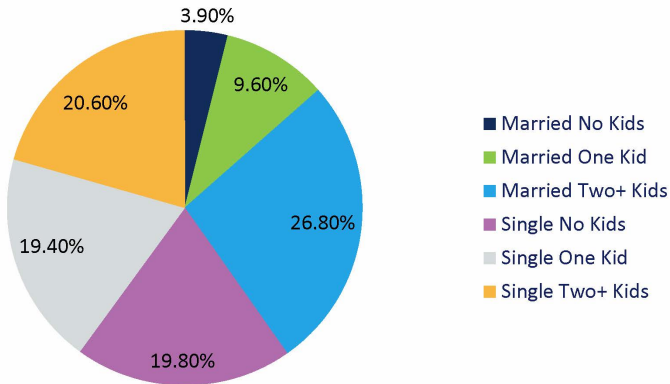
Number of Families Receiving Federal EITC, 1975-2012



Source: www.taxpolicycenter.org

- **27 million** U.S. families **received EITC** (**157,000** in WV) in tax year **2015**.
- **80%** of U.S. families **eligible for EITC** (**82%** in WV) **claimed it**.

Demographic Composition of EITC Recipients

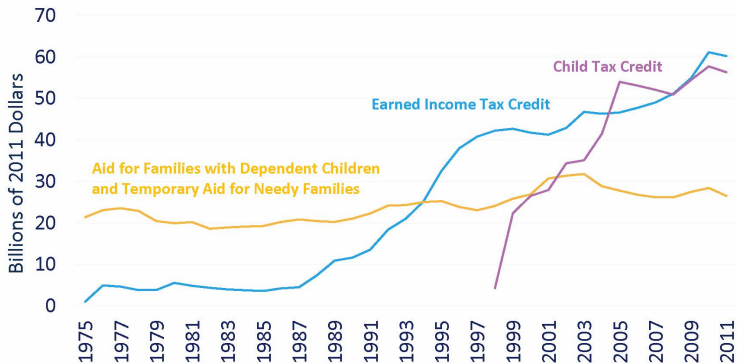


Source: Athreya, Reilly and Simpson (2010)

- 60% of recipients **single-headed households**; 40% **married**.
- 24% have **no children**; 29% have **1 child**; 47% have **2+ children**.

Spending on EITC

Real Federal Spending on EITC, CTC, and Welfare, 1975-2011



Source: www.taxpolicycenter.org/briefing-book/key-elements/family/eitc.cfm

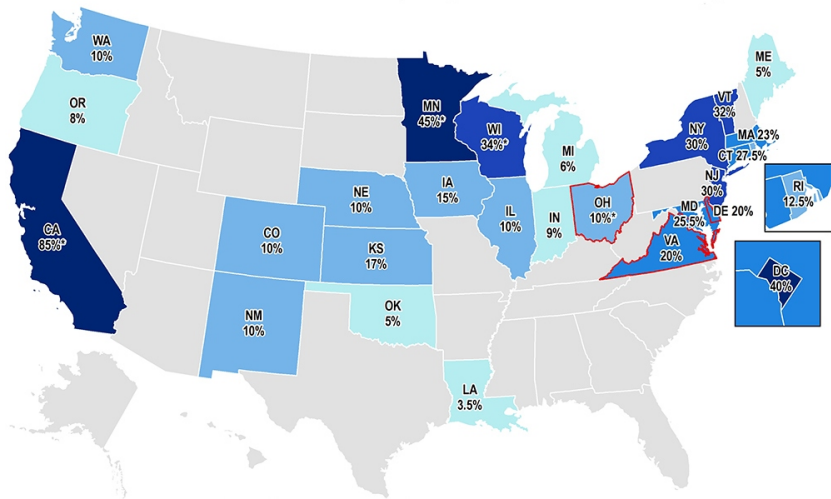
- Total credits to U.S. families was \$65 billion in 2015 (\$351 million in WV)
- Average credit was \$2,407 (\$2,241 for WV).

EITC in the Fifth District (2012)

State	Number of Claims as a Percentage of Returns Filed	Sum of EITC received	Average Amount
District of Columbia	18%	\$116,796,180	\$2,255
Maryland	16%	\$893,185,232	\$2,237
North Carolina	23%	\$2,186,617,908	\$2,416
South Carolina	26%	\$1,190,109,715	\$2,457
Virginia	17%	\$1,332,567,351	\$2,241
West Virginia	21%	\$334,280,994	\$2,158

Source: Author's calculations using data from <http://www.brookings.edu/research/interactives/eitc>

State Earned Income Tax Credits (EITC) as a Share of Federal EITC, 2015



- 26 states plus DC have EITCs. (Washington state's not funded.)
- 3 states (VA, DE & OH) have non-refundable state credits which **only offset** filers' state income tax liabilities.

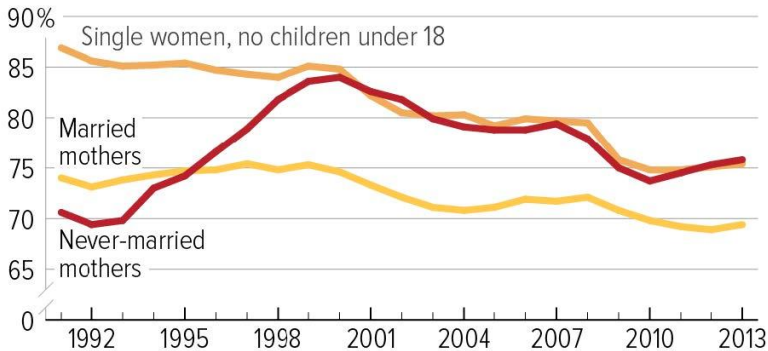
What We Know about Impacts of EITC on Employment, Poverty & Other Outcomes

Impacts on Work/Employment

- Considerable evidence that federal EITC has sizable impacts on **employment rates** of low-skilled, less-educated individuals [Hotz & Scholz, 2003; Nichols & Rothstein, 2015]
 - Especially true for **Single Mothers**.

Single Mothers' Work Rates Jumped Following Earned Income Tax Credit Expansion in 1990s

Percent of women between ages 20 and 49 with any work during the year



Source: CBPP analysis of Current Population Survey

- Meyer & Rosenbaum (2001) document that **expansions of federal EITC** was **primary driver** of improvement in **employment rates** of single mothers.

Impacts on Work/Employment

- Considerable evidence that federal EITC has sizable impacts on employment rates of low-skilled, less-educated individuals [Hotz & Scholz, 2003; Nichols & Rothstein, 2015]
 - Especially true for Single Mothers.
- **Less evidence** that EITC **increases hours of work** of less-skilled individuals work.
- And, **considerable evidence** that EITC actually **reduces likelihood of work** by “**secondary worker**” in married couples.
 - In part result of reduction in amt. of EITC couple receives when both husband & wife work more.
 - Since 2009, this “**marriage penalty**” reduced by setting **higher phase-out thresholds** for married couples [See Slide 5]

Impacts on Poverty & Other Outcomes

- Evidence that expansions of federal EITC reduced **incidence of poverty**.
 - Estimated that EITC expansions **moved 4.3 million** people **out of poverty** in **1990s** [Council of Econ Advisors, 2000] & **4.7 million** in **2013** [Short, 2014]
 - Expansions estimated to have **reduced share of female-headed families living in poverty** by **7.9%** [Hoynes & Patel, 2015]

Impacts on Poverty & Other Outcomes

- Evidence that expansions of federal EITC reduced incidence of poverty.
 - Estimated that EITC expansions moved 4.3 million people out of poverty in 1990s [Council of Econ Advisors, 2000] & 4.7 million in 2013 [Short, 2014]
 - Expansions estimated to have reduced share of female-headed families living in poverty by 7.9% [Hoynes & Patel, 2015]
- Evidence that **increase** in **financial resources** of working poor due to EITC has impacted **other aspects** of their lives & that of their children.
 - Reduced **low birth weights** of **children** [Hoynes, Miller & Simon, 2015] & **health risk factors** of **mothers** [Evans & Garthwaite, 2014]
 - Improved poor children's **cognitive outcomes** [Dahl & Lochner, 2012] & their **educational attainment** [Manoli & Turner, 2014]

Findings on Impacts of State EITCs

More limited evidence on impacts of state EITCs.

- Evidence that state EITCs have **increased employment** of low-skilled single mothers; higher minimum wage enhances this positive effect. [Neumark & Wascher, 2011]
- But, evidence that state ETIC either **reduced** or had **no-effect** on **employment** of (low-skilled) **single men & childless women**. [Neumark & Wascher, 2011]

Findings on Impacts of State EITCs

More limited evidence on impacts of state EITCs.

- Evidence that state EITCs have **increased employment** of low-skilled single mothers; higher minimum wage enhances this positive effect. [Neumark & Wascher, 2011]
- But, evidence that state ETIC either **reduced** or had **no-effect** on **employment** of (low-skilled) **single men & childless women**. [Neumark & Wascher, 2011]
- Evidence that employment effects of state EITCs **increased earnings** & **reduced poverty** [Neumark & Wascher, 2001]

Findings on Impacts of State EITCs

- State EITCs increase **regular employment** of **single fathers** & decreases their **informal employment** [Gunter, 2013]
 - Overall, **no change** in **total employment**.
 - But, increase in “**on the books**” employment has **increased state tax revenues**.

What We Know about EITC Non-Compliance & Its Consequences

EITC Noncompliance

- While EITC is **inexpensive to administer** through tax system, concerns about **non-compliant** tax return filings.
- In 2013:
 - **22% – 26%** of Federal EITC claims had **“improper payments”**.
 - Amounted to between **\$13.3 & \$15.6 Billion**.

Table 2: Estimated EITC Improper Payments for Fiscal Years 2007 – 2013

Year	Minimum Improper Payments %	Maximum Improper Payments %	Minimum Improper Payments (Billions) [†]	Maximum Improper Payments (Billions) [†]
2007	23%	28%	\$11.6	\$13.8
2008	23%	28%	\$12.0	\$14.1
2009	23%	28%	\$12.2	\$14.5
2010	24%	29%	\$16.4	\$19.7
2011	21%	26%	\$14.2	\$17.4
2012	21%	25%	\$11.7	\$13.7
2013	22%	26%	\$13.3	\$15.6

Source: IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns*, August 2014.

[†] All amounts in 2013 constant dollars.

Tax Preparers of EITC Filings

- EITC returns **more likely filed** by **Paid-Preparer** than are non-EITC returns.
- And, **more likely** to be **Tax Preparation Firms** or **“unenrolled return preparers”** than CPAs.

Table 4: Likelihood of Claiming EITC by Type of Preparer, TY 2006-07

	Did not Claim EITC	Claimed EITC
Self-Prepared	43%	29%
IRS Preparer	2%	3%
Paid-Preparer	55%	68%
CPA	16%	6%
National Tax Preparation Firm	5%	21%
Unenrolled Return Preparer	10%	26%
Preparer used, type unknown	18%	8%

Source: See Table 2.

Tax Preparers of EITC Filings

- And, **overclaims** are **higher**, on average, for **Paid Preparers**.

Table 5: EITC Non-Compliance by Preparer Type, TY 2006-07 [2008 \$]

Type of Preparer	Percent of overclaims	Dollar overclaim percent [†]
Self-Prepared	47%	39%
IRS-authorized Preparers	26%	13%
Paid Preparer	51%	39%
Attorney	35%	29%
CPA	49%	31%
Enrolled Agent	46%	29%
Employee of Taxpayer	58%	5%
Friend/Relative	37%	19%
National Tax Return Prep Firm	44%	30%
Unenrolled Preparer	54%	40%
Type Unknown	72%	73%

[†] Dollar overclaim % is EITC overclaims divided by total EITC claims.
These are the upper-bound estimates.
Source: See Table 2.

Reasons for EITC Noncompliance

- **Largest share** of improper EITC claims due to “**Qualifying Child**” errors.
- **Income misreporting** is much **smaller**.

Table 6: EITC-Related Errors as Percentage of Total Overclaim Dollars Weighted Population Estimates, Annual Average, TY 2006-2008 NRP

Error type	Percentage of Total Overclaim Dollars
Qualifying child error	42% – 54%
Income misreporting (all types combined)	24% – 32%
Self-employment income alone	15% – 23%
AGI and investment income alone	5% – 8%
Wage income alone	3% – 6%
Filing status error	9% – 17%
Error corrected in processing	3% – 3%
Rules for all taxpayers claiming EITC	1% – 5%
Tiebreaker error	1% – 2%
Rules for taxpayers claiming EITC without children	0% – 1%

Source: See Table 2.

Reasons for EITC Noncompliance

- **Qualifying child errors** are due, in part, to **complexity of definitions**.

Uniform Definition of a Qualifying Child

Relationship	Residency	Age	Support	Joint Return
Client's son, daughter, stepson, stepdaughter, adopted child, foster child, brother, sister, half-brother, half- sister, stepbrother, stepsister or a descendent of any of them	Same principal residence as your client for more than half the tax year	* Under age 19 at the end of the year * Under age 24 if a full- time student for at least five months of the year * Permanently and totally disabled during the year	Did not provide more than one-half of own support	Did not file a joint return (other than only to claim a refund of withheld taxes) with the child's spouse

Source: Working Families Tax Relief Act of 2004 amended in 2008.

An Unintended (Positive) Consequence of Noncompliance?

- Hotz & Scholz (2008) found sizable fraction of **non-custodial fathers** in Wisconsin claimed EITC but **did not meet** qualifying child requirement.

An Unintended (Positive) Consequence of Noncompliance?

- Hotz & Scholz (2008) found sizable fraction of **non-custodial fathers** in Wisconsin claimed EITC but **did not meet** qualifying child requirement.
- But, as a result of claiming EITC, their labor earnings were **“captured”** in state’s Child Support Case Registry & **more likely to make** court-ordered **child support payments**.

An Unintended (Positive) Consequence of Noncompliance?

- Hotz & Scholz (2008) found sizable fraction of **non-custodial fathers** in Wisconsin claimed EITC but **did not meet** qualifying child requirement.
- But, as a result of claiming EITC, their labor earnings were **“captured”** in state’s Child Support Case Registry & **more likely to make** court-ordered **child support payments**.
- **Policy Trade-off:** Greater non-compliance with EITC provisions (qualifying child), can **increase compliance** with child support awards.

An Unintended (Positive) Consequence of Noncompliance?

- Hotz & Scholz (2008) found sizable fraction of **non-custodial fathers** in Wisconsin claimed EITC but **did not meet** qualifying child requirement.
- But, as a result of claiming EITC, their labor earnings were **“captured”** in state’s Child Support Case Registry & **more likely to make** court-ordered **child support payments**.
- **Policy Trade-off:** Greater **non-compliance** with EITC provisions (qualifying child), can **increase compliance** with child support awards.
- **Note:** Proposed expansion of EITC for **childless individuals/households** could **reduce/eliminate** this trade-off.

Thank You!