ADMINISTRATION HISTORY APPENDIX
CHAPTER FOUR: INCREASING ECONOMIC OPPORTUNITY

EARNED INCOME TAX CREDIT (EITC)

2000-SE-002521

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

March 7, 2000

MEMORANDUM FOR SECRETARY SUMMERS

FROM: Bob Cumby RCC

SUBJECT: EITC Study

You asked that we work with the CEA to put together a study that focuses on this Administration's policies to raise employment among low-income individuals. I have attached a draft for your review.

We decided to focus on the employment effects of these policies for the targeted groups. At one point we thought we should tie it into broader macroeconomic developments (rapid non-inflationary growth) but decided against that for two reasons. First, the numbers are small – added employment plausibly attributed to these policies is small relative to overall employment gains. Second, because the largest impact has been to move individuals from out of the labor force into jobs, the effect on the NAIRU is not particularly large.

Please let us know what changes you would like to see and how you would like to use the study. Jason Furman has expressed some interest in using the paper for a White House event. That interest and the possible event remain vague, but knowing your plans for the study will help us know how to respond.

Attachment

Making Work Pay: The Role of Policy in the Expanding Employment in Low Income Families

A Report Prepared by the Council of Economic Advisers
and the Office of Economic Policy, Department of the Treasury

ROUGH DRAFT
March 7, 2000

Introduction

Employment among several groups that have traditionally been underrepresented in the workforce has expanded notably over the course of the current economic expansion. Despite its obvious importance, this trend has garnered little attention in an economy in which the unemployment rate has declined to its lowest level in 30 years, more than 20 million jobs have been created in just seven years, and labor productivity has surged to a 2.9 percent growth rate over the past four years.

In this paper we present persuasive evidence that key policies have played a crucial role in increasing employment rates among low-income workers, especially single women with children. The Earned Income Tax Credit has been effective in improving the economic well being of the working poor and their families.[1] By increasing the rewards to labor market activity among workers in low-income households, an expanded EITC has increased incentives to work for many single mothers who previously were not employed. Similarly, the 1996 Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA), as President Clinton said, "provides an historic opportunity to end welfare as we know it and transform our broken welfare system by promoting the fundamental values of work, responsibility, and family." The provisions of the legislation were intended to increase the relative returns to work for former welfare recipients, and in so doing resulted in an expansion of employment for these individuals.

The general strength of the U.S. economy has contributed also to this growth. But because the employment rate for single mothers has increased relative to other groups that have also benefited from the strong economy, it appears that overall economic growth alone cannot be the explanation. The policies we discuss and a strong overall economy are best viewed as complimentary, not competing, explanations of the remarkable growth in employment among individuals affected by these measures. Labor market policies have increased the incentive individuals have to work and the strong economy has provided the opportunity for them to work. And by increasing the Nation's labor force, these programs have contributed to the remarkable non-inflationary growth in the U.S. economy during this expansion.

We begin by presenting, in the next section, general trends in the labor force over the past several decades. We then evaluate the EITC, PRWORA, and a small number of other programs in affecting labor supply. We provide concluding remarks, and an overview of several new proposals that hold promise for further increasing work incentives.

Recent Trends in Employment

As the current economic expansion, the longest in our Nation's history, continues, employment indicators remain very strong. In January 2000 there were almost 141 million Americans in the labor force, a new record. The labor force participation rate was 67.5 percent, also a new record. Employment was at a record high of 135 million, and the employment-to-population ratio of 64.8 percent was also the highest on record. Labor force growth, along with productivity growth, is an important factor in overall economic growth; as more individuals flow into the labor force Gross Domestic Product (GDP) rises. Statistics cited in the Council of Economic Advisers'

[1] See Council of Economic Advisers (1998).

Economic Report of the President (2000) indicate that about one-third of the growth in real GDP over the past decade came from the increase in the labor force. Labor force growth will continue to be an important component of economic growth in the future—through the current expansion and beyond.

Since 1975 more than 70 percent of the growth in U.S. employment has come from groups that had previously been underrepresented in the labor market. The most dramatic shifts in employment have been for women. Since the beginning of 1975, the employment-to-population ratio for individuals age 16 or older has declined slightly for men, to 72.2 percent, while rising by nearly 16 percentage points for women, to 57.9 percent (Chart 1). At the same time the employment-to-population ratio has risen slightly for black men, increased markedly for black women, and also increased for Hispanics generally. All of these groups were at (or very near) record-high employment rates in January 2000. In fact, the employment-to-population ratios for these groups are approaching the national ratio.

Single mothers have traditionally had low employment rates, but the Federal government, working with the States, has implemented a number of policies to increase their labor supply. One way to judge the effectiveness of these policies is to compare the employment rate of single mothers over time to that of another group relatively unaffected by these policy changes, which can be studied as a "control" group. Chart 2 compares the employment-to-population ratios of single women with children and single women without children, a plausible control group, since 1980. After narrowing in the early 1980s, the difference in employment for single women with children compared to single women without children increased rapidly, particularly in the mid-1990s. This paper will discuss policies that appear to have contributed to this rapid growth in employment for single mothers.

The Earned Income Tax Credit

The earned income tax credit is a refundable tax credit aimed at raising the after-tax income of low- and middle-income working families. Because it is refundable, families whose credit exceeds their Federal income tax liability receive a refund from the Internal Revenue Service; thus its benefits extend to those whose income is so low, they pay no Federal income tax.

EITC benefits rise with a worker's income until a specified maximum benefit level is reached. Both the maximum benefit level and the size of the supplement increase with the number of children the worker is supporting. In 1999 (tax return filed in 2000), workers with no qualifying children receive a credit of 7.65 percent of their labor income up to a maximum benefit of $347 (reached at an income level of $4,500). Those with one child receive a supplement of 34 percent up to a maximum benefit of $2,312 (reached at an income level of $6,800). Those with two or more children receive a supplement of 40 percent up to a maximum benefit of $3,816 (reached at an income level of $9,540).

Once the maximum credit is reached, the size of the credit remains constant as income rises until a phase-out point is reached. In 1999, the credit begins phasing out at income levels of $5,700 for workers with no qualifying children and $12,500 for workers with children. Once the phase-out point is reached, the size of the credit declines by 7.65 cents for each additional dollar of income for workers who do not reside with children, 16 cents for workers with one child, and 21 cents for workers with two or more children. The credit is fully phased out at income levels of $10,200 for workers with no qualifying children, $26,928 for workers with one child, and $30,580 for workers with two or more children. Chart 3 shows how the value of the EITC varies by income level and type of household.

The EITC is now among the largest Federal programs benefiting low- and moderate-income families. Earned income tax credits were claimed by almost 19.4 million households and amounted to nearly $30.4 billion in 1997. Unmarried heads of households received more than two-thirds of these dollars, with the bulk of the remaining one-third going to married taxpayers. This tax provision has been effective in alleviating poverty. It has been estimated that in 1998, 4.3 million people, including 2.3 million children, were lifted out of poverty by the EITC (see the 2000 *Economic Report of the President*).

The earned income tax credit was first enacted in 1975 as part of a tax package aimed at stimulating the economy. It gave taxpayers with children a 10 percent refundable credit on the first $4000 of income (a maximum credit of $400), which was then phased out over the next $4000 of income. Over the next 10 years the EITC remained a relatively small Federal program, and despite small expansions in 1979 and 1985 the real value of the credit eroded slowly.

The Tax Reform Act of 1986 significantly expanded the credit and indexed it to inflation. Credit rates, phase-in ranges, and phase-out ranges were expanded considerably. The 1990 budget act (OBRA90) increased credit amounts for families with two or more children and expanded eligibility. And starting January 1991, the EITC was not counted as income in most means-tested programs, a change that increased its value to low-income families.

President Clinton proposed a substantial expansion of the EITC in 1993 to help meet his goal that no four-person family with a full-time worker should fall below the poverty line. The 1993 expansion in credit rates and the maximum credit were phased in between 1994 and 1996. The maximum credit for families with two or more children was raised by 69 percent. In addition, workers with no qualifying children and incomes below $9500 became eligible for a small credit. The cumulative effect of the expansions in the EITC has been remarkable: credits in real dollars increased by twelve-fold between 1984 and 1997.[2] Chart 4 shows how the number of taxpayers receiving the EITC and the total value of EITC benefits (in constant 1999 dollars) have increased over time.

Effects of EITC on Employment and Labor Force Participation of Single Mothers

The EITC, by raising the after-tax return to work, unambiguously encourages single parents to enter the workforce. In this regard, the EITC is unlike other means-tested programs. The work incentives provided by the EITC have been associated with a significant increase in labor force participation and employment.

[2] The expansion of the EITC also increased its effectiveness in alleviating poverty; in 1998 twice as many people were lifted out of poverty because of the EITC as in 1993.

Chart 5 compares the maximum benefit received under the EITC and the difference in employment-to-population ratios of single mothers and single women without children.[3] This comparison, similar to one by Berkley economist Nada Eissa and Harvard economist Jeffrey Liebman (1996), is instructive because the EITC substantially affects the first group but not the second. Prior to the 1986 EITC expansions, the employment-to-population ratios of these two groups moved roughly in parallel. Since then, and especially since 1995, employment of single mothers has risen dramatically while that of single women without children has been roughly unchanged. As Chart 5 demonstrates, expansions in the EITC have been followed by increases in the employment of single mothers, relative to single women without children.

A number of studies have examined labor force participation and employment of unmarried mothers and EITC benefits to determine if the close association exhibited in Chart 5 might be due to other factors. In a 2000 study, Bruce Meyer of Northwestern University and Dan Rosenbaum of UNC-Greensboro show that employment rates for single mothers rose during periods of EITC expansion relative not just to single women without children but also relative to two other groups less affected by changes in the EITC, black men and married mothers. They also find that employment increases were especially large for single mothers with a high school degree (a group likely to be disproportionately affected by the EITC) during periods of EITC expansion. Perhaps most strikingly, they find that employment rates among single mothers with more than one child relative to single mothers with only one child were steady or falling until 1993, then rose sharply when EITC benefits were increased for those with more than one child.

In an earlier paper, Meyer and Rosenbaum (1999) control for characteristics (such as age, education, and wages) that may differ across groups and lead to different labor force behavior. They find that employment of single mothers (relative to that of single women without children) increased even more when controlling for these characteristics than without controls. In addition, they consider the labor supply impact of changes in a number of social policies in addition to the EITC (including AFDC waivers prior to the 1996 Personal Responsibility and Work Opportunity Reconciliation Act, Food Stamps, and Medicaid expansions). Using individual data from the Current Population Survey (CPS) for 13 years, they conclude that the EITC accounts for more than 60 percent of the increase in employment of single mothers between 1984 and 1996.[4]

Harvard economist David Ellwood (1999) also looks at a number of controls to determine if policy changes, especially the EITC, are responsible for the dramatic changes in employment of single mothers. He finds that the rise in relative employment rates is especially dramatic for those most affected by the EITC increases—the lowest skill/lowest wage workers—consistent with the findings of Meyer and Rosenbaum (1999, 2000) and Eissa and Liebman (1996). In addition, he finds that employment rates for single mothers increased especially rapidly in States aggressively pursing welfare reform.

Effects of EITC on Hours Worked of Single Mothers: Theory

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[3] Since 1990, the maximum benefit is the average of the maximum for families with one child and those with two or more children.

[4] The CPS is a nationwide monthly survey of households that collects information on labor supply, wages and income, and participation in public assistance programs.

The effects of the EITC on hours worked by those who would chose to work without the EITC is less clear than its effect on labor force participation for single parents. For workers in the phase-in range of the EITC, the "substitution effect" is positive—the EITC raises the after-tax return to working an additional hour and induces a worker to substitute from non-work activity into additional work. But for these workers and for those in the flat range of the EITC, the "income effect" is negative; these workers now have higher incomes, and this may marginally weaken work incentives. (There is no substitution effect for workers in the flat range.) And for workers in the phase-out range, both the income and substitution effects are negative. Thus, in theory, the effect of the EITC on hours for single parents in the phase-in range is ambiguous while the effect those in the flat and phase-out ranges is negative.[5]

Effects of EITC on Married Parents: Theory

Unlike single parents, married parents who are secondary earners can face a disincentive to enter work as a result of the EITC. In addition, the EITC can theoretically reduce hours worked for married workers (both primary and secondary earners). When the primary earner receives earned income tax credits, the income effect discourages labor force participation by secondary household earners. In addition, earnings by a secondary earner can place the family in the phase-out range of the EITC, thus reducing the after-tax wage and providing a further disincentive for a secondary earner to work. But, for some very low-income families, the primary earner's income is so low that the secondary earner can actually raise the family's EITC benefits. The President has proposed changes in the EITC that would alleviate some of these effects; they are discussed in the final section of this paper.

Effects of EITC on Hours Worked and Household Labor Supply: Evidence

How large are these potentially negative work incentive effects of the EITC? The empirical literature on labor supply suggests that participation in the labor force is more responsive to wage and income changes than are hours worked for those already in the labor market.[6] We thus focus first on labor force participation effects.

Stacy Dickert, Scott Houser, and Karl Scholz (1995) use estimates of labor supply elasticities to simulate the effect of the 1993 EITC expansion on both participation and hours. Consistent with the results discussed above, they find that the EITC expansion should raise participation by single parents. Their simulations show a smaller increase in participation by primary earners in two-parent families (because most primary earners in these families were already working). And consistent with the theoretical arguments we just outlined, there is a drop in employment of secondary workers in two-parent families. However, this decline is small relative to the large increases in employment of single parents and primary earners. Berkeley economists Eissa and Hilary Hoynes (1999) find a small increase in the labor force participation of married men with less than 12 years of education from the EITC. Ellwood (1999) presents evidence that the EITC

[5] Finally, even workers initially outside the range of the EITC could at least theoretically be affected. For example, a worker whose income was marginally higher than the range for which EITC holds might reduce work effort so as to benefit from the EITC.
[6] Heckman (1993).

lowers labor force participation among married women. Eissa and Hoynes (1999) also find that the EITC reduces participation by married women, but only by about one percentage point. Table 1 summarizes results of several academic studies on the effect of the EITC on employment and labor force participation.

Results of research on the effect of EITC on hours are summarized in Table 2. Simulations by Dickert, Houser, and Scholz (1995) indicate that the impact of the EITC on hours worked for those already in the labor force is relatively small. (On net, their simulations predict a positive effect of the EITC on labor supply – the positive effect on participation outweighs the negative effect on hours.) Empirical analysis by Meyer and Rosenbaum (1999) of EITC expansions from 1984 to 1996 suggests that the net effect of EITC changes on hours worked is positive for single mothers who are already in the labor force.

Other evidence also suggests that the impact of the EITC on hours for those already in the labor force is negligible or small. Eissa and Liebman (1996) examine taxpayers already in the labor force when the 1987 extension of the EITC expanded the phase-out range to additional workers and observe no decline in hours worked. In addition, Liebman (1998) argues that if workers respond to EITC phase out, there should be a bunching of taxpayers near the beginning of the phase-out range and few workers near the end of the range. He presents evidence from 1992 tax returns that shows little or no bunching at the beginning of the phase-out range and no sign of the predicted shortage of workers at the break-even point. Eissa and Hoynes (1999) find a 2 percent decline in annual hours worked (45 hours) for married men because of the 1986-1993 EITC expansions, and a decline of 1-6 percent in annual hours (13 to 93 hours) for married women, depending on the specification. Again, all of these effects are for workers *already in the labor force*. The large net increases in employment from the EITC greatly outweigh the small declines in hours for those who would have worked even without the EITC.

Table 1 Studies of Effects of EITC on Employment/Labor Force Participation				
Study	**Data**	**Time Period Studied**	**Groups Studied**	**Effect of EITC**
Dickert, Houser, and Scholz (1995)	Simulation based on after-tax wages and labor supply parameters	1993 expansion	Single parents	+72.8 million annual hours from new labor force participants
			Primary earners	+12.1 million annual hours from new labor force participants
			Secondary earners	-10.4 million annual hours from new labor force participants
Eissa and Liebman (1996)	CPS	1986 expansion (Includes other effects from 1986 tax reform)	Single mothers (Relative to single childless women)	Up to +2.8 percentage point in labor force participation
Eissa and Hoynes (1999)	CPS	1986, 1990, and 1993 expansions	Married men (Less than HS education)	+0.2 percentage point in labor force participation
			Married women (Less than HS education)	-1 percentage point in labor force participation
Meyer and Rosenbaum (1999)	CPS	1984-1996	Single mothers	EITC responsible for 60 percent of increase in employment
Ellwood (1999)	CPS	1980-1998	Low-income single mothers	EITC responsible for 20-30 percent of increase in employment
			Low-income married mothers (Includes policies other than EITC)	4-8 percentage point decline in employment

Table 2
Studies of Effects of EITC on Hours Worked for Labor Force Participants/Workers

Study	Data	Time Period Studied	Groups Studied	Effect of EITC
Dickert, Houser, and Scholz (1995)	Simulation based on after-tax wages and labor supply parameters	1993 expansion	Single parents	-10 hours annually per worker
			Primary earners	-8 hours annually per worker
			Secondary earners	-30 hours annually per worker
Eissa and Liebman (1996)	CPS	1986 expansion	Single mothers (Relative to single childless women)	No change
Eissa and Hoynes (1999)	CPS	1986, 1990, and 1993 expansions	Married men (Less than HS education)	-45 hours annually per worker
			Married women (Less than HS education)	-13 to -93 hours annually per worker
Meyer and Rosenbaum (1999)	CPS	1984-1996	Single mothers	Increase in EITC increases hours worked

The Personal Responsibility and Work Opportunity Reconciliation Act

In 1996, the President signed the Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA), changing the Nation's welfare system into one that requires work in exchange for time-limited assistance. The law contains strong work requirements, and provides performance bonuses to States that succeed in moving welfare recipients into jobs. Even before PRWORA became law, many States were well on their way to changing their welfare programs to jobs programs. By granting Federal waivers prior to 1996, the Administration allowed 43 States to establish work requirements, time-limit assistance, or improve child support.

These policy changes appear to have dramatically affected welfare caseloads. As of June 1999 the number of welfare recipients—adults and children combined—was 6.9 million, 51 percent fewer than in 1993. This 1999 figure represents 2.5 percent of the total population, the lowest proportion in more than three decades (see Chart 6). A 1999 report by the Council of Economic Advisers examining the welfare caseload from 1996 to 1998 indicated that the single largest identified factor in the decline in recipiency was welfare reform—the change in State welfare programs implemented under the Temporary Assistance for Needy Families (TANF) block grant. Specifically, the report estimates that TANF accounted for about 35 percent of the decline in recipiency. By way of comparison, the strong economy accounted for about 9 percent of the decline.

The drop in welfare rolls has been accompanied by an increase in the number of welfare recipients finding employment. One important confirmation that many welfare recipients are successfully moving to employment comes from the aggregation of recent State reports. As noted above, the 1996 welfare reform legislation included rewards to encourage States to place people in jobs. According to reports filed by the 46 States competing for these bonuses, more than 1.3 million welfare recipients nationwide went to work in just the one year period between October 1997 and September 1998.

Another compelling piece of evidence on this trend comes from the Current Population Survey (CPS). These data provide information on individuals' employment status in the month of the survey (March), as well as information about income sources for the previous year. Chart 7 shows the current employment status in March of each year, from 1988 to 1999, for individuals receiving non-SSI cash welfare in the previous year. The proportion employed held steady at 20 to 21 percent from 1988 through 1992. From 1993 through 1999 there was a persistent increase in employment of these individuals, and more than 36 percent of individuals on welfare in 1998 were employed in March 1999. This upward trend in employment status was observed for Hispanic, non-Hispanic white, and non-Hispanic black individuals alike.

A recent national survey released by the Urban Institute (Pamela Loprest, 1999) provides additional evidence highlighting the importance of work as an alternative for individuals leaving welfare. The study found that 69 percent of individuals leaving welfare did so because of work, and another 18 percent left because they had increased income, no longer needed welfare or had a change in family situation. A second 1999 Urban Institute study (Sarah Brauner and Loprest) reviews evidence from state-level analyses about the employment status of individuals recently leaving welfare. The median of estimates of current employment status for former welfare recipients (from 12 estimates) was 65 percent.

Even among those who remain on welfare rolls, there is an apparent upturn in reported work. According to CPS data, in each year from 1988 through 1993, about one third of individuals who received welfare in March of that year reported having worked some in the previous year. Chart 8 shows a steady increase in this percentage after 1993, so that by March 1999, more than 51 percent of welfare recipients reported work during the previous year.

The detailed analysis of Meyer and Rosenbaum (1999) contributes greatly to our confidence that welfare reform is responsible in substantial measure for the upturn in employment of single women with children. Their evaluation of data from 1992 to 1996 shows that Federal waivers alone were responsible for approximately 20 percent of the sizable increase in employment of single mothers. As previously discussed, reforms to EITC were found to be even more important, and, as we note momentarily, policy innovations in training and child care also contributed.

Similarly detailed research is not yet available for the post-1996 period, but for 1996 through 1999 there has been a clear continuation of the trends that led to the Meyer-Rosenbaum conclusion about the role of EITC expansion and welfare reform in increasing labor supply. Consider, for example, the employment status for low-income mothers with young children. Analysis of CPS data shows that for married women who had children under the age of 6, and who were below 200 percent of the poverty threshold in the previous year, the March employment rate increased gradually, from 35.3 percent in 1992 to 39.0 percent in 1996 and finally to 39.3 percent in 1999. Given that 1992 through 1999 was a period of economic expansion and that employment of women generally has been trending upward over the past several decades, this trend is not surprising. What is notable is the comparison of these married mothers of young children to corresponding single mothers, whose behavior has likely been affected by the change in welfare policy. These latter mothers had virtually the same employment rate as married mothers in 1992, 34.8 percent. By 1996, though, the employment rate for single mothers increased to 42.6 percent, and by 1999, the employment rate among these women had climbed to 54.6 percent.

Another important policy to move people from welfare to work is the availability of tax credits for employers who hire welfare recipients. The Work Opportunity Tax Credit is 25 percent of wages for employment of at least 120 hours but less than 400 hours and 40 percent for employment of 400 or more hours. The maximum amount of eligible wages is $6,000. The credit is available for hiring members of certain economically disadvantaged targeted groups, including certain welfare recipients. The Welfare to Work Tax Credit is 35 percent of the first $10,000 in wages paid in the first year and 50 percent of wages paid in the second year to certain long-term welfare recipients. Although a detailed evaluation of these provisions is not yet available, a 1998 study by Harvard economist Lawrence Katz on previous wage subsidy programs provides limited evidence that tax credits may play a positive role in increasing the demand for labor services of former welfare recipients.

Other Policy Changes Contributing to Increased Labor Supply

Beyond changes to EITC and welfare policy, there are several additional policy changes that have the potential for increasing labor supply. The 1999 Meyer-Rosenbaum study of single mothers examines labor supply effects of expanded Medicaid eligibility, training expenditures, and child care subsidies. Although they do not find statistically significant effects of Medicaid expansion, Meyer and Rosenbaum do find meaningful effects of training and child care policy. Over the 1992-1996 period they examine, between 5 and 8 percent of the growth in the employment of single mothers can be attributed to training and child care policies combined. The 1996 welfare reform expanded funding for child care, and gave States flexibility to provide both pre- and post-employment training to help welfare recipients find and keep a job. In light of existing research, these provisions can be expected to provide additional work incentives for low-income women.

One group of individuals that has historically had low rates of employment is the disabled. According to 1999 CPS data, for both men and women in the 25-64 age range, individuals with a disability that "prevents them from working or limits the kind or amount of work they can do" are employed at less than one-third of the rate of the non-disabled. There has been very little recent change in the employment rates of these individuals. However, there is considerable variation in employment among the disabled, correlated with education. In the CPS data, among disabled individuals with fewer than 12 years of education, only 12 percent of men and 11 percent of women were employed, while employment rates for the disabled with 16 years of education or more were 47 percent for men and 42 percent for women. This variation in employment rates suggests that policies that encourage human capital development or otherwise increase returns to work might increase the labor supply of the disabled. A recent study of individuals with severe spinal cord injuries by economists Alan Krueger of Princeton and Douglas Kruse of Rutgers reinforces the potential importance of work skills for labor market success among the disabled. Specifically, the authors find that among individuals with these serious injuries, those with computer skills returned to work more quickly and had relatively higher earnings once there.

One recent initiative designed to increase relative returns to work for the disabled is the Ticket to Work and Work Incentives Improvement Act of 1999. The Act provides health insurance protection to the working disabled by giving States new options to allow workers with disabilities to buy into Medicaid. It extends Medicare coverage for an additional 4 ½ years for beneficiaries of disability insurance who return to work. And it provides grants for States to develop infrastructure that will help people with disabilities return to work.

New Policy Initiatives Affecting Labor Supply

The Fiscal Year 2001 budget contains a number of items that may encourage additional labor supply. The first addresses the so-called "marriage penalty." The current tax system can discourage paid work by second earners in a married couple, especially in combination with the indirect costs of working such as child care. The Administration's proposal will increase the return from work for second earners by: (1) effectively exempting up to $1,450 (2001 dollars) of earnings by the spouse with the lower earnings from income tax for couples who use the standard deduction; (2) allowing two-earner couples to earn more before having their EITC reduced; (3) reducing the EITC phase-out rate (and thus the effective marginal tax rate) by two percentage points for taxpayers with two or more children; and (4) increasing the child and dependent care tax credit for low- and moderate-income families.

A second important set of proposals involves the costs of work, especially child care expenses. Not surprisingly, child care expenses can be one of the biggest items in the budgets of poor working mothers. Statistics from 1993 suggest that working mothers with income below the poverty level who purchased child care spent 21 percent of their monthly income on care for their children. If enacted, the Administration's proposals would increase the return to work for many low-income parents by making the Child and Dependent Care Tax Credit refundable, and by increasing the maximum credit rate for the EITC to 45 percent for low-income workers with three or more children. Chart 9 shows the proposed increase in the EITC for *two-earner* married couples with three or more children in 2001.

Disabled individuals may incur additional costs in order to work and earn taxable income. However, many moderate-income disabled individuals do not benefit from the current-law tax deduction for impairment-related work expenses because they do not have sufficient work-related expenses and other deductions to benefit from itemizing deductions. In addition, disabled individuals may not benefit from the current-law deduction because they incur significant work-related expenses outside the workplace (which do not qualify for the deduction) or rely on unpaid relatives or friends for assistance. For example, they may require personal assistance to get dressed or be driven to work. To aid disabled workers, the FY 2001 budget proposes a tax credit, equal to the lesser of $1,000 or earned income, for workers who have difficulty with at least one activity of daily living.

The evidence is quite compelling in establishing that many policies affecting the well-being of low- and middle-income families—the EITC and reforms to welfare policy, in particular, but also a number of other related recent policy innovations—have been effective in bringing previously marginalized workers in the economic mainstream. Over the course of the current economic expansion, the strong labor market has been an important source of new opportunities for all workers, but these conscious labor policies have also contributed to an increase in the labor supply of single mothers in particular. A number of additional policy proposals by the Administration hold promise for building on previous successes and further reinforcing incentives to work. These proposals are detailed in the Appendix.

New Initiatives

Earned income tax credit (EITC). For families with three or more children, the EITC credit rate would be increased from 40 percent to 45 percent. In 2000, the maximum credit would rise from $3,888 to $4,374, an increase of $486. Two-earner married couples could earn more without having their EITC reduced. The beginning point of the EITC phase-out range would be increased by $1,450. Thus, the EITC would begin to phase out at $14,140 in 2000 for a couple with children. To qualify, each spouse must have earned income of at least $725. The EITC phase-out rate would be reduced by 2 percentage points (from 21.06 percent to 19.06 percent) for taxpayers with two or more children. Nontaxable earned income, such as 401(k) contributions, would no longer be included in earned income. The proposal would be effective beginning in 2000.

Child and dependent care tax credit. The child and dependent care tax credit would be made refundable beginning in 2003. The maximum credit rate would gradually be increased from 30 percent to 50 percent between 2001 and 2005. Beginning in 2001, taxpayers would be eligible for the maximum credit rate if their income is $30,000 or less. The credit rate would be reduced by one percentage point for each additional $1,000 of income in excess of $30,000; the minimum credit rate would be 20 percent. The maximum amounts of qualifying expenses and the income threshold for the maximum credit would be indexed for inflation.

Standard deduction for two-earner married couples. The standard deduction for two-earner couples would be increased to the lesser of double the amount of the standard deduction for single filers or the sum of the standard deduction for one-earner couples and the smaller of the two spouses' earned incomes. Earned income must be positive and would equal the sum of wages, salaries, and net income from self-employment less certain deductions for IRA, Keogh, SEP, and SIMPLE plan contributions, self-employed health insurance, and one-half of self-employment taxes. Beginning in 2001, the increase would be phased in over five years. By 2005, the increase in the standard deduction for joint filers would be $1,450 (2001 dollars). Effectively, up to $1,450 of earnings by the spouse with the lower earnings would be exempted from tax for couples who use the standard deduction.

Disabled workers tax credit. Beginning in 2001, a taxpayer would qualify for a $1,000 tax credit if he or she had earned income and was disabled. The credit could not exceed the disabled individual's earned income during the tax year. The credit (aggregated with the child credit and the proposed long-term care credit) would be phased-out for certain high-income taxpayers--that is, the aggregate credit amount would be phased out by $50 for each $1,000 (or fraction thereof) by which the taxpayer's modified AGI exceeds $110,000 (in the case of a joint return), $75,000 (in the case of a taxpayer who is not married), or $55,000 (in the case of a married individual filing a separate return). A taxpayer with earned income would be considered to be a disabled worker if he or she were certified by a licensed physician (prior to the filing of a return claiming the credit) as being unable for at least 12 months to perform at least one activity of daily living without substantial assistance from another individual, due to loss of functional capacity. Activities of daily living would be eating, toileting, transferring, bathing, dressing, and continence.

References

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Chart 1. Employment to Population Ratio: Women, Blacks, Hispanics

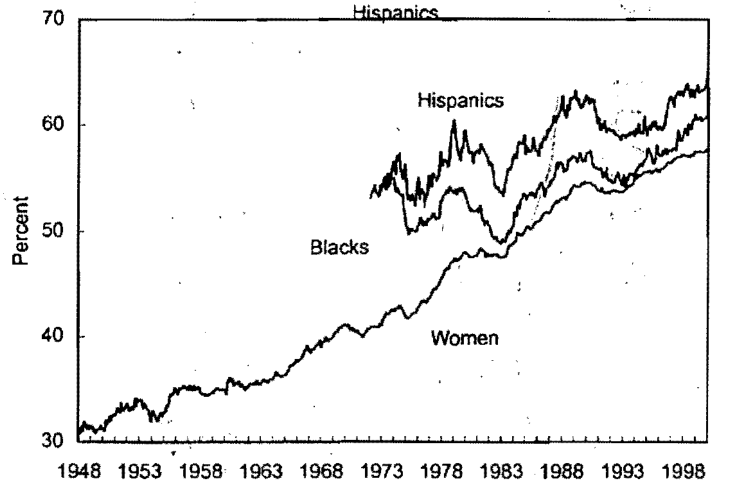


Chart 2. Labor Force Participation Rates for Single Women Ages 16-45

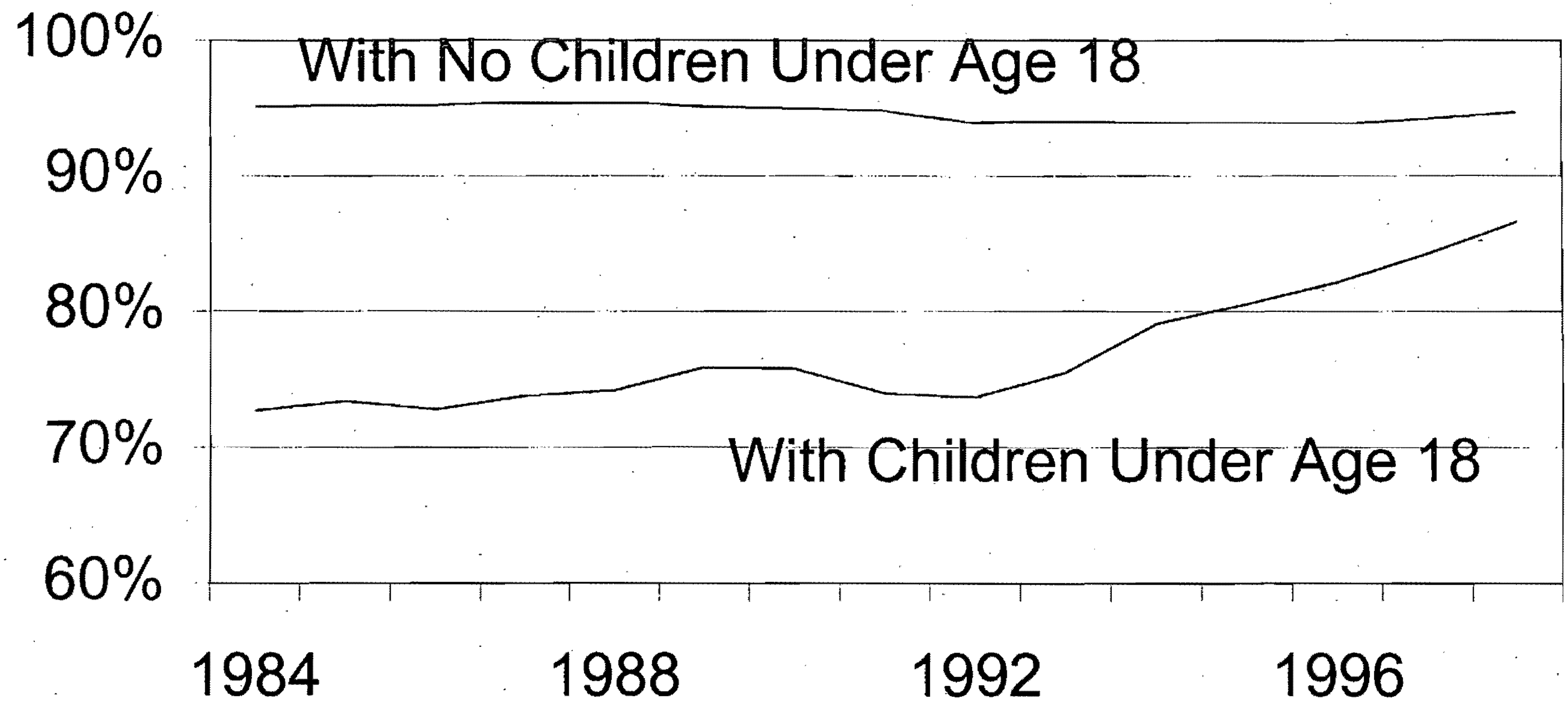


Chart 3. Earned Income Tax Credit (1999)

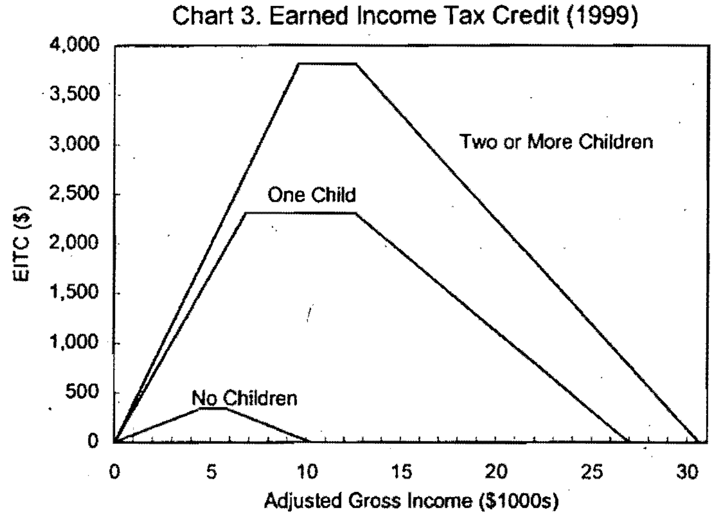


Chart 4. Size of EITC

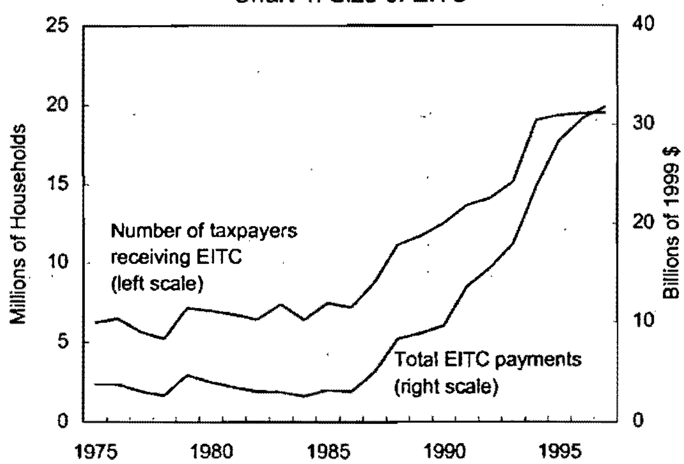


Chart 5. Maximum EITC and Difference in Labor Force Participation Between Single Women With and Without Children

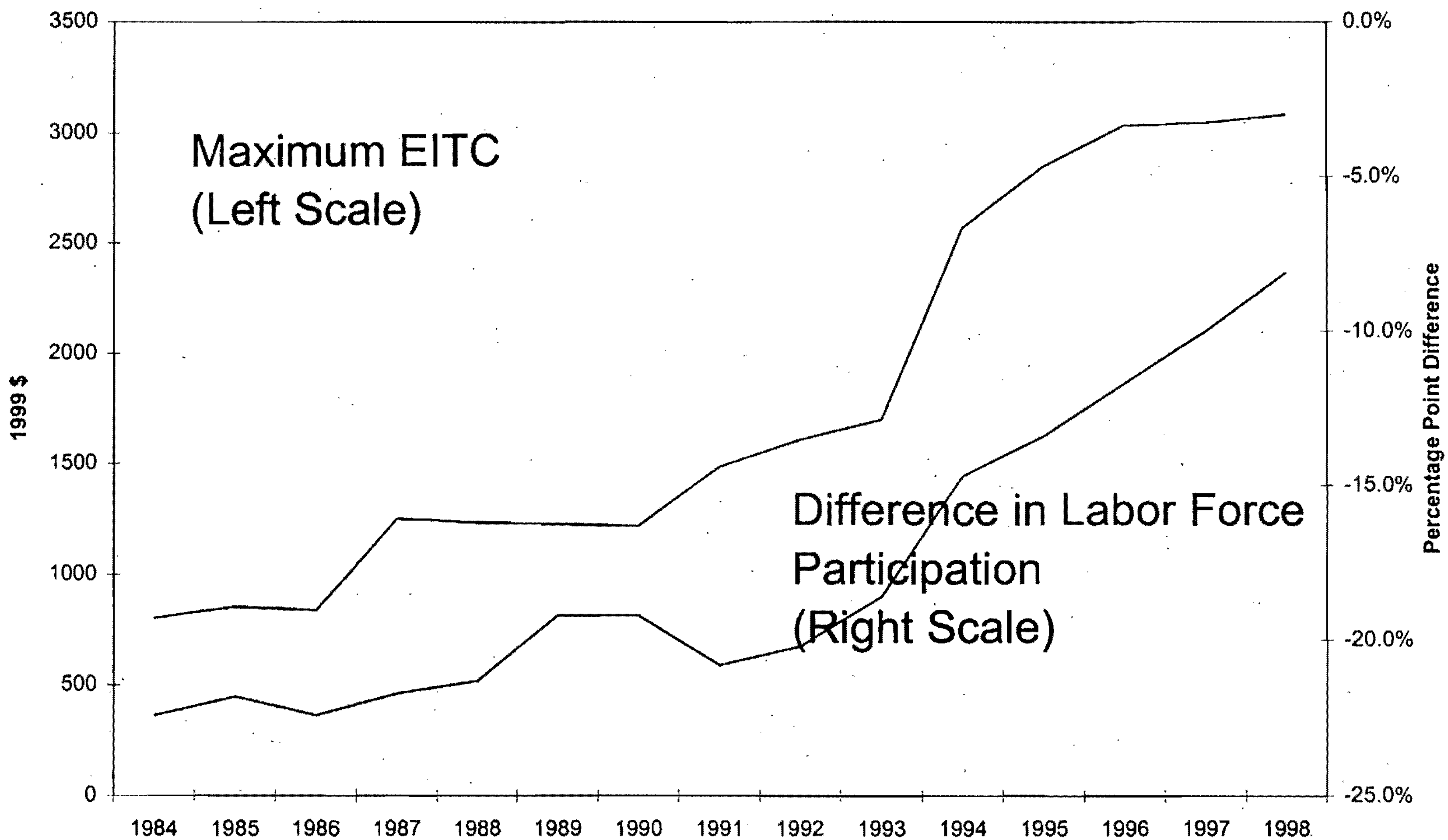


Chart 6. Families Receiving Welfare

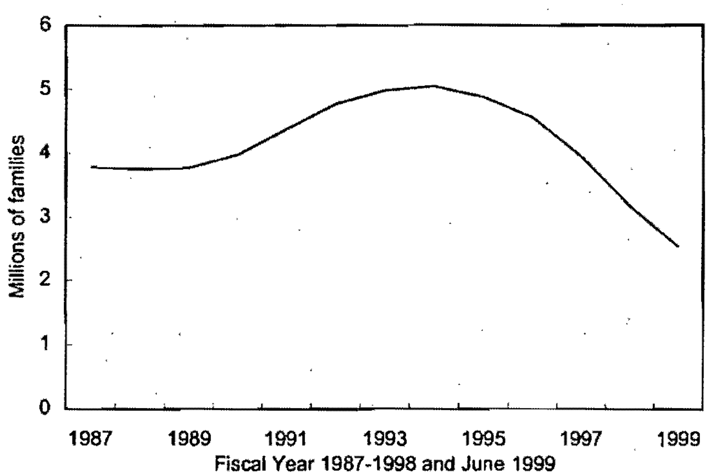


Chart 7. Employment Status in March after Year with Welfare Receipt

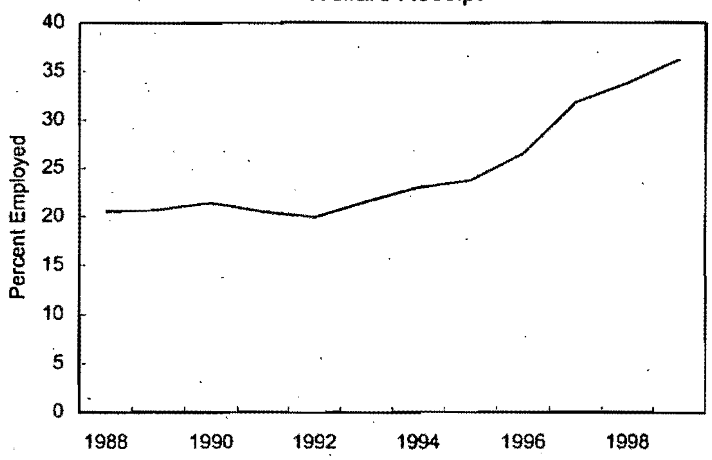
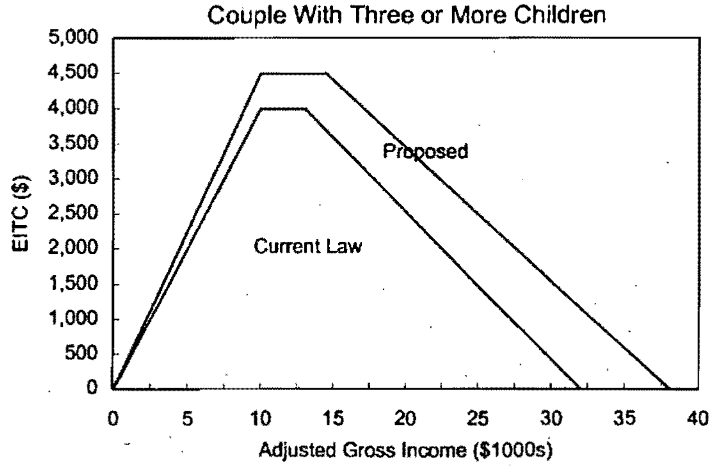


Chart 8. EITC in 2001 for Two-Earner Married Couple With Three or More Children



Both spouses earn at least $725. All dollar amounts are 2001 dollars.

1999-SE-011620

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 22, 1999

MEMORANDUM FOR SECRETARY SUMMERS
DEPUTY SECRETARY EIZENSTAT

FROM: **JON TALISMAN**
DEPUTY ASSISTANT SECRETARY (TAX POLICY)

SUBJECT: Proposal to Delay EITC Payments

Representative DeLay is floating a proposal that would make installment payments of the EITC "voluntary" during the 2000 filing season. The proposal requires taxpayers to inform the IRS that they do not want their EITC paid as part of their regular tax refund. Otherwise, the IRS would be required to pay out the EITC in monthly or quarterly installments. This is a variation on DeLay's earlier proposal to make installment payments of the EITC mandatory. The earlier proposal was criticized by Governor George W. Bush and others. JCT is reportedly scoring the modified proposal as raising $1 billion in FY 2000. Since the Labor-HHS appropriations bill contains a $1 billion shortfall, the conferees may turn to the DeLay proposal to make up the funding deficit. The Administration should oppose that because it would place unacceptable burdens on taxpayers and the IRS.

The IRS says that it cannot implement either a mandatory or voluntary installment payment plan in time for the 2000 filing season. Earlier this month, the IRS determined that they would not be able to implement a mandatory installment payment system until July 1, 2000, or possibly later. They have not made a similar assessment with respect to a voluntary system, but IRS staff believes that a voluntary system, with more extensive computer programming changes, could require even more time to implement than a mandatory system.

If the proposal could be implemented, it would lead to confusion, errors, and involuntary delays of refunds. Under the plan, taxpayers may be required to check a box on their tax return in order to receive the EITC as part of their regular tax refund. Some taxpayers are likely to be confused by the new instructions and inadvertently fail to check the box. As a result, they will receive a much smaller tax refund than anticipated.

While DeLay appears to be counting on taxpayer confusion to generate revenues, it is more likely that surprised taxpayers will call the IRS (and their Congressmen) to complain. If permitted by the legislation, the IRS would likely respond by paying out the remaining amount of the EITC immediately to callers, but this would require additional, burdensome procedures and could reduce the estimated savings from the proposal. Further, it may cause reductions in other IRS functions, as the agency cuts back other services in order to respond quickly to taxpayers' complaints about their inadvertent installment payments of the EITC.

1999-SE-010964

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 4, 1999

INFORMATION

MEMORANDUM FOR SECRETARY SUMMERS
DEPUTY SECRETARY EIZENSTAT

FROM: JON TALISMAN JT
DEPUTY ASSISTANT SECRETARY (TAX POLICY)

SUBJECT: Briefing Materials to Defend EITC

We have updated our briefing materials on the EITC to respond to recent congressional proposals to delay tax refunds for working families. The attached materials show how the EITC removes children from poverty and moves single mothers from welfare to work. We have sent these materials to the NEC and Hill staff.

Attachments

October 4, 1999

MEMORANDUM FOR JON TALISMAN AND LEN BURMAN

FROM: **JANET HOLTZBLATT AND JANET McCUBBIN**

SUBJECT: Congressman Obey's Request

According to Marti Thomas, Obey's staff would like some assistance on data for the minority views report on the Labor HHS bill (which is due Tuesday,) specifically a short (they said no longer than 1 page) description of EITC, its history and how it works. Attached are the following materials, which have reviewed and approved by Len Burman, in response to that request:

- A short version of our walk-through on the EITC. Longer versions of the walk-through have been provided to Congressional staff since 1995. We took out the material dealing with EITC compliance and also updated most numbers. We have not yet updated the analysis of the effects of the EITC on poverty, pending further information from Census.
- Background materials from the 1998 Ways and Means Green Book.

Distribution:

Kiefer
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Thomas

Earned Income Tax Credit:
Rewarding Working Families

Department of the Treasury
October, 1999

Overview

GENERAL DESCRIPTION AND GOALS OF EITC

Earned Income Tax Credit: General Description

- The earned income tax credit (EITC) is a refundable tax credit for working families with low incomes.

- For every dollar a low-income worker earns up to a limit, between 8 and 40 cents are provided as a tax credit. Above a given level, the size of the tax credit is gradually reduced.

- Because the credit is refundable, individuals can receive the full amount to which they are entitled even if the amount exceeds the individual income taxes they owe.

- On 1999 tax returns, the EITC will provide a tax credit averaging about $1,610 for nearly 20 million workers and their families. Working families with earnings of up to $30,580 per year may be eligible for the EITC.

Two Goals of the EITC

- **Encourage Families To Move From Welfare to Work** by making work pay.

- **Reward Work for Working Families** so parents who work full-time do not have to raise their children in poverty -- and families with modest means do not suffer from eroding incomes.

  -- By providing an offset against other Federal taxes, the EITC increases disposable income for workers and their families.

Moving Families From Welfare To Work

- Social Security taxes and various means-tested benefits create economic disincentives for welfare recipients to work. For each additional dollar a worker earns, benefits decline and payroll taxes increase.

  -- The EITC offsets these disincentives with a strong incentive to work. About 80 percent of EITC payments offsets the individual income, social security, and other Federal taxes borne by families receiving the credit.

- The EITC encourages families to work two ways.

  -- The EITC is only available to working families. If you don't work, you don't get the credit.

  -- At the lowest income levels, the EITC grows with each dollar of earnings. For people with very little income, more work means more benefits from the EITC.

Rewarding America's Working Families

- People who work hard and play by the rules should be rewarded for their efforts.

  -- Parents who work full-time for an entire year should not have to raise their children in poverty.

  -- Parents with moderate incomes should not see their standards of living decline.

- The condition of low- and moderate-income families has deteriorated since 1979.

  -- Payroll taxes increased five times between 1983 and 1990.

  -- In the early 1970s, most states provided AFDC benefits as a wage supplement to a mother with two children whose earnings equaled 75 percent of the poverty level. By the mid-nineties, only three states provided comparable benefits.

  -- The poverty rate for families with children grew by nearly half from 1979 to 1993. Even after recent declines in the poverty rate, 15.1 percent of families with children still lived in poverty in 1998.

  -- Between 1979 and 1992, the earnings of a male without a high school degree declined by more than 23 percent in real terms. Among male workers with a high school degree, real earnings declined by 17 percent over this period.

- The EITC <u>rewards work</u>. But there is still more to do to ensure that full-time workers do not raise their children in poverty.

Providing the EITC Through the Tax System

- The EITC is a non-bureaucratic way to reward work effort. There are no middlemen or service providers. There are no long lines at government offices. There is no need to take valuable time off from work in order to apply for the credit. The tax refund is provided by the IRS directly to the working families.

- **EITC claimants are taxpayers**. If the EITC did not exist, almost 95 percent of EITC filers would still file an individual income tax return (in addition to paying payroll and excise taxes), and the IRS would still have to process their returns and verify much of the same information regarding their filing status, number of children, and income.

- Participation in the EITC tends to be higher than many other assistance programs targeted to low-income families. In 1990, 80 to 86 percent of those eligible received the credit. This high participation rate is striking when compared to the food stamp participation rate of 59 percent in 1989.[1]

- Because most EITC claimants would be filing a tax return even if the credit did not exist, the direct budgetary costs of administering the EITC are significantly lower than if the credit were provided through another means. In FY 1995, the food stamp program cost $3.7 billion to administer, while AFDC administrative costs were an additional $3.5 billion -- nearly 14 percent of the combined costs of these two programs. By way of comparison, the entire IRS budget in FY 1995 was $7.6 billion, roughly the combined total administrative budgets of the AFDC and food stamp programs.

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[1] Food stamp participation was not studied in 1990. Since 1989, food stamp participation rates have climbed (to 71 percent of eligible individuals in 1994). Comparable data are not available for the EITC.

CURRENT LAW

The EITC Since Tax Reform

- In 1985, President Reagan included a significant expansion of the EITC as part of his tax reform proposal. Under the Tax Reform Act of 1986:

  -- the EITC credit was increased;
  -- the credit benefit thresholds were indexed for inflation; and
  -- eligibility was extended to families with incomes of $26,900 (1999 dollars).

- President Bush favored an expansion of the EITC. As a consequence of the Omnibus Budget Reconciliation Act of 1990:

  -- the EITC credit rate was increased to exceed the combined employer-employee rate for payroll taxes;
  -- a small adjustment for family size was added to the credit structure;
  -- some of the eligibility criteria were simplified to make verification easier for the IRS.

- President Clinton has proposed numerous steps to improve the effectiveness and administration of the EITC. Many of his proposals were enacted as part of OBRA 1993, the Uruguay Agreement Act of 1994, H.R. 831, the Personal Responsibility and Work Opportunity Reconciliation Act of 1996, and the Taxpayer Relief Act of 1997. The Administration has taken other administrative actions to improve and strengthen the integrity of the EITC.

The EITC After OBRA 1993

- In February 1993, the Clinton Administration made several proposals to expand and simplify the EITC. With certain modifications, Congress enacted these proposals as part of the Omnibus Budget Reconciliation Act of 1993 (OBRA 1993).

- For every dollar a very low-income working parent with one child earns, the EITC was increased from 23 cents to 34 cents.

- For every dollar a very low-income working parent with two or more children earns, the EITC was increased from 25 cents to 40 cents.

  -- The maximum credit was increased by over $1,500.
  -- Eligibility for the credit was extended to families with two or more children that have incomes of up to $30,580 (or about $3,700 above the prior law level).[2]

- A small EITC, designed to help offset the employee portion of payroll taxes, was extended for the first time to very low-wage workers without qualifying children.

- OBRA 1993 eliminated two complex supplemental credits for health insurance coverage and for taxpayers with children under the age of one.

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[2] Some critics of the program have argued that the EITC should not be available to families with incomes of $30,000. But if the income thresholds had not been changed in 1993, the increase in the maximum credit would have resulted in a phase-out rate of 30 percent. By modifying the income thresholds slightly, the EITC phase-out rate for a family with two or more children was increased from 17.86 percent to 21.06 percent. Moreover, the income cut-off is far less than the median income for a family of four. In 1999, the median income for a family of four is estimated to be over $57,000.

OBRA 1993 Achieved Goals of Program

- OBRA 1993 supported welfare over work by bolstering the incomes of families moving from welfare to work.

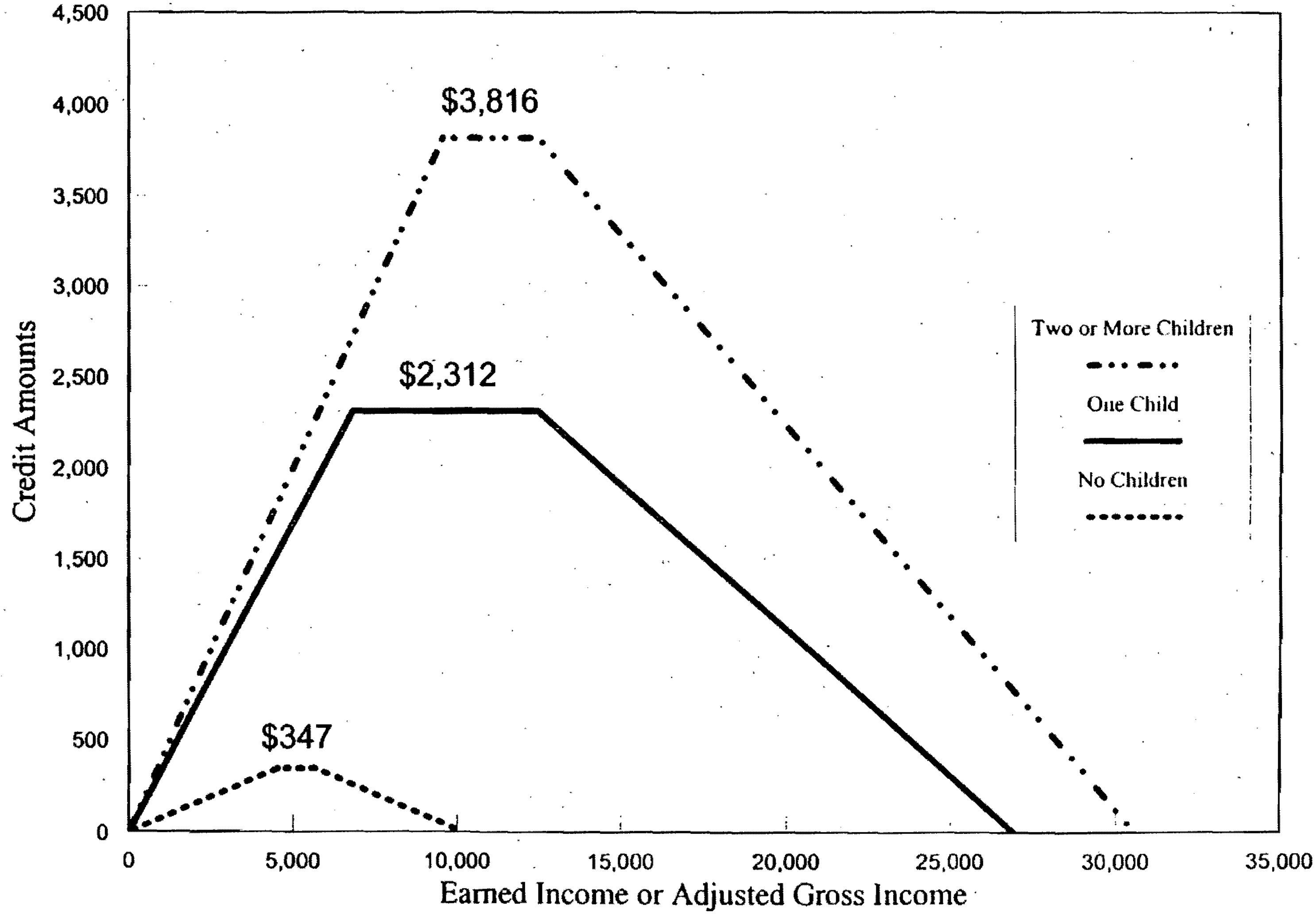
  -- From every added dollar a low-income family earns, payroll taxes (including the employer's share of payroll taxes) take 15.3 cents while Food Stamp benefits decline by 24 cents. For a low-wage family with two children, the EITC fully offsets these effects by providing a 40 cent credit for every dollar earned.

- OBRA 1993 rewarded work for working families by moving toward the goal that a full-time worker should not live in poverty if he or she works throughout the year.

Extending the EITC to Low-Income Workers Who Do Not Reside with Qualifying Children

- OBRA 1993 extended a small earned income tax credit (EITC) to very low-wage workers who do not reside with children.
  - -- To be eligible for this credit, a worker must have adjusted gross income of less than $10,200 in 1999.
  - -- The credit is equal to 7.65 percent of earned income up to a maximum credit of $347 in 1999. It was designed to help offset the work disincentive effects of the social security tax rate (7.65 percent for employees and employers, each).
  - -- This provision reduces taxes, on average, by $195 for 3.2 million workers in 1999.
- To be eligible for the EITC without children in residence, workers must be over age 24 and below age 65.
- The credit is primarily targeted to workers with income below the poverty level, which is $8,116 in 1999.
- In 1997, claimants of this credit earned, on average, $5,000.

The Earned Income Tax Credit, 1999



Earned Income Tax Credit Parameters

1999

	Credit Rate	Plateau Beginning Point	Plateau End Point	Maximum Credit	Phase-out Rate	Income Cut-off
Current Law						
Taxpayers who reside with one qualifying child	34.0%	$6,800	$12,460	$2,312	15.98%	$26,928
Taxpayers who reside with two or more childrei	40.0%	$9,540	$12,460	$3,816	21.06%	$30,580
Taxpayers who do not reside with children	7.65%	$4,530	$5,670	$347	7.65%	$10,200

Disqualified Investment Income Amount: $2,350

EITC INCREASES WORK AND REDUCES POVERTY

Helping to Move Families from Welfare-to-Work

- The number of individuals receiving welfare fell by 48 percent from January 1993 through March 1999 -- the largest decline in over 50 years.

- The EITC helps workers stay in the labor force and off of welfare by increasing their take-home pay. About 19.8 million workers are expected to claim the EITC for tax year 1999. They will receive an average credit of $1,610. About 16.5 million of these claims will be for workers living with children, who will receive an average credit of $1,890.

- Eissa and Liebman (1996) estimate that the EITC expansion and other provisions in the Tax Reform Act of 1986 increased labor force participation among single women with children by 2.8 percentage points -- from 73.0 percent to 75.8 percent. Among women with less than a high school education, they estimate that the 1986 Act increased labor force participation rate by 6.1 percentage points.

- Dickert, Hauser, and Scholz (1995) found that the EITC could result in an increase in labor supply of 19.9 million hours in 1996 relative to 1993 law and induce 516,000 families to move from welfare to the workforce.

- Meyer and Rosenbaum (1997) find that annual labor force participation of single mothers has increased by nearly nine percentage points between 1984 and 1996, and that much of this increase may be explained by the significant expansions of the EITC and other changes in tax policy over this period.

EITC Reduces Poverty

- The Census Bureau reports that the EITC lifted 4.3 million persons out of poverty in 1998.

- The EITC moves children and single mothers out of poverty.

  - Among the 4.3 million persons lifted out of poverty by the EITC, over half -- nearly 2.3 million -- were children under the age of 18.

  - Nearly 2.0 million persons, living in families headed by an unmarried female, were removed from poverty as a consequence of the EITC.

- Minority working families benefit from the EITC.

  - The EITC removed about 1.1 million African-Americans and nearly 1.2 million persons of Hispanic origin from poverty in 1998.

Growth of EITC Contributes to Drop in Child Poverty

- After falling sharply in the 1960s, poverty among children increased between 1969 and 1993.

- Since 1993, the child poverty rate has fallen. Using a measure of poverty that takes into account both taxes and transfers, the child poverty rate declined by 4.7 percentage points between 1993 and 1996.

  -- An analysis by the Council of Economic Advisers shows that about half of this decline is attributable to changes in tax policy, and in particular, the recent expansion of the EITC.

STATE-BY-STATE DATA

Earned Income Tax Credit Claims by State
for the 1997 Tax Year

State	Total Number of Taxpayers	Total Number of EITC Claims	Percentage of Taxpayers Claiming EITC	Total Claim Amount (thousands of $)	Average Claim Amount ($)	Total Number with Refundable EITC	Total Refundable Amount (thousands of $)
Alabama	1,864,029	460,087	24.7	777,301	1,689	381,961	650,959
Alaska	343,154	30,442	8.9	37,444	1,230	22,095	27,197
Arizona	1,966,894	347,168	17.7	540,008	1,555	276,786	440,538
Arkansas	1,081,085	257,224	23.8	421,488	1,639	208,278	344,487
California	13,837,236	2,411,531	17.4	3,678,384	1,525	1,912,630	2,955,666
Colorado	1,898,354	241,770	12.7	334,125	1,382	181,536	258,938
Connecticut	1,602,085	146,997	9.2	196,440	1,336	110,621	154,611
Delaware	356,399	50,967	14.3	76,212	1,495	40,268	61,918
Florida	6,898,458	1,309,902	19.0	1,997,956	1,525	1,033,989	1,597,677
Georgia	3,377,576	711,201	21.1	1,153,161	1,621	576,532	943,840
Hawaii	552,105	66,480	12.0	81,529	1,226	49,136	62,314
Idaho	520,936	84,111	16.1	124,412	1,479	64,167	96,789
Illinois	5,553,152	765,955	13.8	1,126,013	1,470	598,975	907,254
Indiana	2,724,201	374,273	13.7	546,748	1,461	288,742	435,000
Iowa	1,316,118	153,575	11.7	212,169	1,382	113,127	162,327
Kansas	1,176,500	149,335	12.7	216,463	1,450	112,309	169,008
Kentucky	1,665,227	308,909	18.6	453,628	1,468	241,479	363,609
Louisiana	1,824,508	491,482	26.9	852,446	1,734	414,532	726,127
Maine	574,272	82,894	14.4	112,697	1,360	60,640	83,957
Maryland	2,522,375	336,829	13.4	490,921	1,457	260,688	387,883
Massachussetts	2,958,740	285,476	9.6	367,706	1,288	208,050	279,718
Michigan	4,427,591	573,904	13.0	826,354	1,440	450,384	667,753
Minnesota	2,240,064	221,730	9.9	295,830	1,334	162,040	222,035
Mississippi	1,138,928	359,304	31.5	636,843	1,772	303,239	539,125
Missouri	2,451,886	393,452	16.0	590,464	1,501	306,594	473,474
Montana	404,283	66,766	16.5	94,821	1,420	51,193	73,512
Nebraska	785,435	96,567	12.3	138,134	1,430	71,767	106,178
Nevada	837,719	124,595	14.9	176,939	1,420	95,739	140,232
New Hampshire	586,297	58,487	10.0	77,268	1,321	41,171	56,522
New Jersey	3,861,555	455,475	11.8	653,969	1,436	350,775	514,985
New Mexico	756,492	182,151	24.1	276,693	1,519	149,110	228,083

Earned Income Tax Credit Claims by State
for the 1997 Tax Year

State	Total Number of Taxpayers	Total Number of EITC Claims	Percentage of Taxpayers Claiming EITC	Total Claim Amount (thousands of $)	Average Claim Amount ($)	Total Number with Refundable EITC	Total Refundable Amount (thousands of $)
New York	8,113,041	1,302,604	16.1	1,885,239	1,447	996,603	1,458,013
North Carolina	3,460,153	665,037	19.2	1,029,859	1,549	526,281	830,626
North Dakota	300,134	38,142	12.7	52,612	1,379	28,341	40,220
Ohio	5,430,932	702,487	12.9	1,008,230	1,435	542,448	802,252
Oklahoma	1,413,851	287,876	20.4	443,442	1,540	228,521	357,429
Oregon	1,501,235	204,819	13.6	289,491	1,413	156,191	227,596
Pennsylvania	5,585,284	707,978	12.7	980,167	1,384	539,527	771,473
Rhode Island	463,759	60,085	13.0	80,759	1,344	45,986	64,171
South Carolina	1,718,667	383,828	22.3	615,850	1,604	310,875	508,016
South Dakota	340,181	49,296	14.5	70,969	1,440	37,110	54,857
Tennessee	2,455,823	493,820	20.1	759,032	1,537	387,979	607,837
Texas	8,456,037	1,907,725	22.6	3,212,454	1,684	1,551,967	2,616,510
Utah	875,651	112,064	12.8	165,649	1,478	85,712	129,525
Vermont	282,240	37,501	13.3	49,308	1,315	27,038	36,386
Virginia	3,030,210	448,041	14.8	670,120	1,496	351,735	540,989
Washington	2,608,639	307,805	11.8	418,207	1,359	233,532	327,391
West Virginia	729,612	139,600	19.1	201,410	1,443	110,427	164,753
Wisconsin	2,476,864	260,311	10.5	369,134	1,418	195,314	286,241
Wyoming	226,595	33,761	14.9	47,737	1,414	25,986	37,845
District of Columbia	267,591	53,616	20.0	79,636	1,485	43,831	66,462
Other	1,216,700	22,223	1.8	20,348	916	17,636	17,283
Total U. S.	123,056,853	19,817,658	16.1	30,014,218	1,515	15,581,593	24,077,590

Department of the Treasury
Office of Tax Analysis

October 4, 1999

Source: Internal Revenue Service, "Statistics of Income Bulletin," Spring, 1999, pgs. 153-205.

Note: The credit amount claimed may be different from the amount actually paid.

105TH CONGRESS
2d Session

COMMITTEE PRINT

WMCP: 105-7

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

1998 GREEN BOOK

BACKGROUND MATERIAL AND DATA ON PROGRAMS WITHIN THE JURISDICTION OF THE COMMITTEE ON WAYS AND MEANS

MAY 19, 1998

Prepared for the use of Members of the Committee on Ways and Means by members of its staff. This document has not been officially approved by the Committee and may not reflect the views of its Members

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TABLE 13-11.—DISTRIBUTION OF ITEMIZED DEDUCTIONS FOR MEDICAL EXPENSES, 1995

Income class (thousands) [1]	Average deduction	Returns (thousands)	Total amount (billions) [2]
0–$10	$5,819	471	$2.7
$10–$20	5,736	1,140	6.5
$20–$30	3,799	1,035	3.9
$30–$40	4,015	888	3.6
$40–$50	4,086	679	2.8
$50–$75	4,992	790	3.9
$75–$100	7,146	220	1.6
$100–$200	12,038	114	1.4
$200 and over	38,442	13	0.5
Total	5,039	5,351	27.0

[1] The income concept is defined in the introduction to this chapter.
[2] Amounts in excess of the floor on itemized medical deductions (7.5 percent of adjusted gross income).

Source: Internal Revenue Service.

EARNED INCOME CREDIT

Legislative History

The earned income credit (EIC Code sec. 32), enacted in 1975, generally equals a specified percentage of wages up to a maximum dollar amount. The maximum amount applies over a certain income range and then diminishes to zero over a specified phaseout range. The income ranges and percentages have been revised several times since original enactment, expanding the credit (see table 13–12).

In 1987, the credit was indexed for inflation. In 1990 and again in 1993, Congress enacted substantial expansions of the credit. Auxiliary credits were added for very young children and for health insurance premiums paid on behalf of a qualifying child in 1990. These were repealed in 1993. Also in 1993, eligibility for the credit was expanded to include childless workers. The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 incorporated new rules relating to taxpayer identification numbers and the modified AGI phaseout of the credit in addition to amending the credit's unearned income test (described below). The Taxpayer Relief Act of 1997 also included provisions to improve compliance. The provisions: (1) deny the EIC for 10 years to taxpayers who fraudulently claimed the EIC, 2 years for EIC claims which are a result of reckless or intentional disregard of rules or regulations); (2) require EIC recertification for a taxpayer who is denied the EIC; (3) imposes due diligence requirements on paid preparers of returns involving the EIC; (4) requires information sharing between the Treasury Department and State and local governments regarding child support orders; and (5) allows expanded use of Social Security Administration records to enforce the tax laws, including the EIC. The Balanced Budget Act of 1997 also increased the IRS authorization to improve enforcement of the EIC.

TABLE 13-12.—EARNED INCOME CREDIT PARAMETERS, 1975–97

[Dollar amounts unadjusted for inflation]

Calendar year	Credit rate (percent)	Mininum income for maximum credit	Maximum credit	Phaseout rate (percent)	Phaseout range: Beginning income	Phaseout range: Ending income
1975–78	10.00	$4,000	$400	10.00	$4,000	$8,000
1979–84	10.00	5,000	500	12.50	6,000	10,000
1985–86	14.00	5,000	550	12.22	6,500	11,000
1987	14.00	6,080	851	10.00	6,920	15,432
1988	14.00	6,240	874	10.00	9,840	18,576
1989	14.00	6,500	910	10.00	10,240	19,340
1990	14.00	6,810	953	10.00	10,730	20,264
1991:						
One child	16.70	7,140	1,192	11.93	11,250	21,250
Two children	17.30	7,140	1,235	12.36	11,250	21,250
1992:						
One child	17.60	7,520	1,324	12.57	11,840	22,370
Two children	18.40	7,520	1,384	13.14	11,840	22,370
1993:						
One child	18.50	7,750	1,434	13.21	12,200	23,050
Two children	19.50	7,750	1,511	13.93	12,200	23,050
1994:						
No children	7.65	4,000	306	7.65	5,000	9,000
One child	26.30	7,750	2,038	15.98	11,000	23,755
Two children	30.00	8,425	2,528	17.68	11,000	25,296
1995:						
No children	7.65	4,100	314	7.65	5,130	9,230
One child	34.00	6,160	2,094	15.98	11,290	24,396
Two children	36.00	8,640	3,110	20.22	11,290	26,673
1996:						
No children	7.65	4,220	323	7.65	5,280	9,500
One child	34.00	6,330	2,152	15.98	11,610	25,078
Two children	40.00	8,890	3,556	21.06	11,610	28,495
1997:						
No children	7.65	4,340	332	7.65	5,430	9,770
One child	34.00	6,500	2,210	15.98	11,930	25,750
Two children	40.00	9,140	3,656	21.06	11,930	29,290

Source: Joint Committee on Taxation

Explanation of Provision

The EIC is available to low-income working taxpayers. Three separate schedules apply.

Taxpayers with one qualifying child may claim a credit in 1997 of 34 percent of their earnings up to $6,500, resulting in a maximum credit of $2,210. The maximum credit is available for those with earnings between $6,500 and $11,930. At $11,930 of earnings the credit begins to phase down at a rate of 15.98 percent of earnings above $11,930. The credit is phased down to 0 at $25,750 of earnings.

Taxpayers with more than one qualifying child may claim a credit in 1997 of 40 percent of earnings up to $9,140, resulting in a maximum credit of $3,656. The maximum credit is available for those with earnings between $9,140 and $11,930. At $11,930 of earnings the credit begins to phase down at a rate of 21.06 percent of earnings above $11,930. The credit is phased down to $0 at $29,290 of earnings.

Taxpayers with no qualifying children may claim a credit if they are over age 24 and below age 65. The credit is 7.65 percent of earnings up to $4,340, resulting in a maximum credit of $332. The maximum is available for those with incomes between $4,340 and $5,430. At $5,430 of earnings, the credit begins to phase down at a rate of 7.65 percent of earnings above that amount, resulting in a $0 credit at $9,770.

All income thresholds are indexed for inflation annually. In order to be a qualifying child, an individual must satisfy a relationship test, a residency test, and an age test. The relationship test requires that the individual be a child, stepchild, a descendant of a child, or a foster or adopted child of the taxpayer. The residency test requires that the individual have the same place of abode as the taxpayer for more than half the taxable year. The household must be located in the United States. The age test requires that the individual be under 19 (24 for a full-time student) or be permanently and totally disabled.

An individual is not eligible for the earned income credit if the aggregate amount of disqualified income of the taxpayer for the taxable year exceeds $2,200. This threshold is indexed. Disqualified income is the sum of:

1. Interest (taxable and tax exempt),
2. Dividends,
3. Net rent and royalty income (if greater than zero),
4. Capital gains net income, and
5. Net passive income (if greater than zero) that is not self-employment income.

For taxpayers with earned income (or modified AGI, if greater) in excess of the beginning of the phaseout range, the maximum earned income credit amount is reduced by the phaseout rate multiplied by the amount of earned income (or modified AGI, if greater) in excess of the beginning of the phaseout range. For taxpayers with earned income (or modified AGI, if greater) in excess of the end of the phaseout range, no credit is allowed.

The definition of modified AGI used for phasing out the earned income credit disregards certain losses. The losses disregarded are:

1. Net capital losses (if greater than zero),
2. Net losses from trusts and estates,
3. Net losses from nonbusiness rents and royalties, and
4. Seventy-five percent of the net losses from businesses, computed separately with respect to sole proprietorships (other than in farming), sole proprietorships in farming, and other businesses.

The definition of modified AGI also includes tax-exempt interest and nontaxable distributions from pensions, annuities, and individual retirement accounts (but only if not called over into similar vehicles during the applicable rollover period).

Individuals are ineligible for the credit if they do not include their taxpayer identification number and their qualifying child's number (and, if married, their spouse's taxpayer identification number) on their tax return. Solely for these purposes and for purposes of the present-law identification test for a qualifying child, a taxpayer identification number is defined as a Social Security number issued to an individual by the Social Security Administration other than a number issued under section 205(c)(2)(B)(i)(II) (or that portion of sec. 205(c)(2)(B)(i)(III) relating to it) of the Social Security Act regarding the issuance of a number to an individual applying for or receiving federally funded benefits.

If an individual fails to provide a correct taxpayer identification number, such omission will be treated as a mathematical or clerical error by the Internal Revenue Service. Similarly, if an individual who claims the credit with respect to net earnings from self-employment fails to pay the proper amount of self-employment tax on such net earnings, the failure will be treated as a mathematical or clerical error for purposes of the amount of credit allowed.

The EIC is relatively unique because it is a refundable tax credit; i.e., if the amount of the credit exceeds the taxpayer's Federal income tax liability, the excess is payable to the taxpayer as a direct transfer payment. In this sense, the EIC is like other Federal programs that provide poor and low-income families with public benefits. However, the EIC differs from other Federal programs in that its benefits require earnings.

Under an advance payment system, available since 1979, eligible taxpayers may elect to receive the credit in their paychecks, rather than waiting to claim a refund on their tax return filed by April 15 of the following year. In 1993, Congress required that the IRS begin to notify eligible taxpayers of the advance payment option.

Interaction with Means-Tested Programs

The treatment of the EIC for purposes of AFDC and food stamp benefit computations has varied since inception of the credit. When enacted in 1975, the credit was not considered income in determining AFDC and food stamp benefits, and the credit could not be received on an advance basis. From January 1979 through September 1981, the credit was treated as earned income when actually received.

From October 1981 to September 1984, the amount of the credit was treated as earned income and was imputed to the family even though it may not have been received as an advance payment. Pursuant to the Deficit Reduction Act of 1984, the credit was treated as earned income only when received, either as an advance payment or as a refund after the conclusion of the year.

Under the Family Support Act of 1988, States generally were required to disregard any advance payment or refund of the EIC when calculating AFDC eligibility or benefits. However, the credit was counted against the gross income eligibility standard (185 percent of the State need standard) for both applicants and recipients.

OBRA 1990 specified that, effective January 1, 1994, the EIC was not to be taken into account as income (for the month in which the payment is received or any following month) or as a resource (for the month in which the payment is received or the following month) for determining the eligibility or amount of benefit for AFDC, Medicaid, SSI, food stamps, or low-income housing programs.

EFFECT OF PROVISION

More than 18.5 million taxpayers are expected to take advantage of the EIC in 1997 (see table 13–13). Their claims are expected to total $26.8 billion, 81 percent of which will be refunded as direct payments to these families. As table 13–13 also shows, approximately 69 percent of the tax relief or direct spending from the EIC accrues to taxpayers who file as singles or heads of households.

Table 13–14 shows the total amount of earned income credit received for each of the calendar years since the inception of the program, the number of recipient families, the amount of the credit received as refunded payments, and the average amount of credit received per family.

EXCLUSION OF PUBLIC ASSISTANCE AND SSI BENEFITS

LEGISLATIVE HISTORY

While there is no specific statutory authorization, a number of revenue rulings under Code section 61 have held that specific types of public assistance payments are excludable from gross income. Revenue rulings generally exclude government transfer payments from income because they are considered to be general welfare payments. In addition, taxing benefits provided in kind, rather than in cash, would require valuation of these benefits, which could create administrative difficulties.

EXPLANATION OF PROVISION

The Federal Government provides tax-free public assistance benefits to individuals either by cash payments or by provision of certain goods and services at reduced cost or free of charge. Cash payments come mainly from the Aid to Families with Dependent Children (AFDC) and Supplemental Security Income (SSI) Programs. Inkind payments include food stamps, Medicaid, and housing assistance. None of these payments is subject to income tax.

DEPENDENT CARE TAX CREDIT

LEGISLATIVE HISTORY

Under section 21 of the Internal Revenue Code, taxpayers are allowed an income tax credit for certain employment-related expenses for dependent care. The Internal Revenue Code of 1954 provided a deduction to gainfully employed women, widowers, and legally separated or divorced men for certain employment-related dependent care expenses. The deduction was limited to $600 per year and phased out for families with incomes between $4,500 and $5,100.

The Revenue Act of 1964 made husbands with incapacitated wives eligible for the dependent care deduction and raised the threshold for the income phaseout from $4,500 to $6,000.

TABLE 13–13.—DISTRIBUTION OF TAX PROVISIONS: EARNED INCOME CREDIT, 1997

Income class	Joint returns		Head of household and single returns		All returns	
	Number	Amount	Number	Amount	Number	Amount
$0–$10,000	681	$924	4,495	$4,816	5,175	$5,740
$10,000–$20,000	1,615	3,592	4,824	9,270	6,439	12,862
$20,000–$30,000	2,038	2,873	3,067	3,900	5,106	6,773
$30,000–$40,000	920	711	730	602	1,650	1,313
$40,000–$50,000	112	93	18	18	130	111
$50,000–$75,000	29	35	5	12	33	47
$75,000 and over	0	0	0	0	0	0
Total	5,394	8,229	13,139	18,618	18,534	26,847
Percent distribution by type of return	29.1	30.7	70.9	69.3	100.0	100.0

Note.—Number of returns in thousands, amount of credit in millions.

Source: Joint Committee on Taxation.

TREASURY CLEARANCE SHEET

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FROM: Jon Talisman, Deputy Assistant Secretary (Tax Policy)
THROUGH: ________
SUBJECT: Briefing Materials to Defend EITC

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1997-SE-005998

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220
June 3, 1997

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY SUMMERS

FROM: **DON LUBICK** DCL | KS
ACTING ASSISTANT SECRETARY (TAX POLICY)

SUBJECT: Defending the EITC

Michael Froman asked me to provide you with some briefing materials regarding our arguments in defense of the earned income tax credit (EITC). Although the FY 1998 budget resolution only assumes savings from the Administration's EITC compliance initiatives, it is likely that the credit may still come under attack in at least three different contexts:

- The budget resolution report language specifies that further reforms of the EITC may be necessary to improve compliance. At Senator Nickles' urging, the Senate version of the resolution includes "Sense of the Senate" language calling on the Administration to propose additional compliance measures. It is possible that Congress intends to consider more comprehensive EITC reforms in the fall, after the passage of the reconciliation bills.

- Chairman Archer has assured Democratic members that the EITC will not be reduced in reconciliation (other than the $124 million in assumed compliance savings) to finance tax cuts. However, it is unclear whether he would try to use EITC savings to offset additional spending. There has been some speculation that the Human Resources subcommittee might try to offset some of the costs of the welfare reform add backs, by repealing the EITC for low-wage workers who do not reside with children.

- In its draft report, the National Commission on Restructuring the IRS proposes that the Administration and Congress work together to reduce the EITC overpayment rate to under ten percent, while maintaining its high participation rate. An earlier draft contained a proposal, by Representative Portman, to block grant the refundable portion of the credit. Archer reportedly asked Portman to remove this option from the Commission's report, but, this proposal may resurface in some other context.

In anticipation of these possible EITC fights, I have attached one-pagers on (1) the benefits of the EITC and administering it through the tax system; (2) a summary of the EITC compliance study for tax year 1994; (3) the Treasury press release describing the eight EITC compliance initiatives, announced in April; and (4) the arguments in favor of the EITC for workers who do not reside with children.

Benefits of the EITC

- The EITC helps workers stay in the labor force and off of welfare by increasing their take-home pay. About 18.6 million workers are expected to claim the EITC for tax year 1996. They will receive an average credit of $1,422. About 14.7 million of these claims will be for workers living with children, who will receive an average credit of $1,746. About 3.8 million workers who do not live with qualifying children will receive a smaller average credit, of $173.

- About 85 percent of EITC payments offset the Federal tax burden of these low and moderate income families.

- The EITC is the only program designed to offset high marginal tax rates inherent in the social security and welfare systems; as such, it is a cornerstone for welfare reform. The EITC encourages individuals to move from welfare to work. Dr. Karl Scholz (Deputy Assistant Secretary for Tax Policy and University of Wisconsin) estimated that changes to the EITC enacted in OBRA 1993 would induce 516,000 families to move from welfare to the workforce, saving $2 billion per year (net of the increase in EITC payments to these families).

- According to the most recent data from the Bureau of the Census, the EITC lifted 3.7 million persons out of poverty in 1995.

- The EITC also reduces economic pressures on workers and families, who are struggling to make ends meet. In 1996, working families with children could receive the EITC if their income was below $28,495 ($25,078 for workers residing with just one child). In contrast, median income for a family of four in 1996 was about $51,000 (and median income for a family of three was about $43,000).

- The EITC helps low and moderate income workers without forcing them to take time off of work to apply for benefits, and without subjecting them to the stigma of visiting a welfare office.

- The EITC helps low and moderate income workers without a special bureaucracy. If there were no EITC, nearly 95 percent of EITC claimants would still file a tax return (either because they would be required to file, or because they would want to obtain a refund of withheld taxes). We do not know how much it costs to administer just the EITC portion of the income tax system. However, we do know that it costs far less to administer the EITC, than to administer the AFDC or Food Stamp programs. Together, administrative costs for AFDC ($3.5 billion) and Food Stamps ($3.7 billion) are equal to almost the entire IRS administrative budget for FY95.

Office of Tax Analysis
April 21, 1997

IRS Study of EITC Compliance in Tax Year 1994

- In April, the IRS released a study of EITC compliance during tax year 1994.

- Previously, the IRS conducted a pilot study which was limited to 1993 tax returns filed electronically during a two week period. The new study is more representative of EITC claimants and should not be compared to the 1993 study.

- The 1994 study found that $4.4 billion, or 25.8 percent of total EITC claimed, exceeded the amount to which taxpayers were eligible. IRS enforcement practices, which were in effect at that time, reduced the estimated net error rate to 23.5 percent. With the tighter procedural tools put in place by last year's welfare reform act, the net error rate would have been reduced to 20.7 percent.

  - The three most common errors were caused by taxpayers (1) claiming children with whom they did not live for at least six months; (2) who filed as single or head of household when they were, in fact, married (and thus did not include spousal income in adjusted gross income); or (3) claiming a child, with whom they lived, but who should have been claimed by another member of their household. The third type of error is common among unmarried couples and extended families.

- While EITC noncompliance remains at unacceptably high levels, the study's results do show significant improvement since the late eighties, the last time that the IRS examined a comparable group of taxpayers. In the 1988 Taxpayer Compliance Measurement Program (TCMP), the IRS determined that 35.4 percent of the amount of the EITC claimed exceeded the amounts for which taxpayers were eligible -- between 10 and 15 percentage points higher than current levels.

- Both legislative and administrative initiatives have likely contributed to the improvement in compliance. Since 1993, the Administration has taken 17 steps to ensure that only those who are eligible and deserving receive the EITC. The study's results do not reflect the enactment or implementation of all of these steps.

- In 1996, the IRS released a study showing that other areas of the tax code are a much greater source of noncompliance than the EITC. The tax gap study found that the gross individual income tax gap, before enforcement actions, was between $93.2 and $95.2 billion. Over 40 percent ($39.1 to $39.9 billion) of the gross tax gap for 1992 was attributable to the underreporting of business income (including self-employment income, partnership income and rents and royalties).

- While EITC compliance has improved, error rates are still too high. The Administration is proposing 8 new legislative and administrative proposals to further reduce EITC errors.

Office of Tax Analysis
June 2, 1997

DEPARTMENT OF THE TREASURY

TREASURY NEWS

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FOR IMMEDIATE RELEASE
April 23, 1997

Contact: Michelle Smith
(202) 622-2960

Treasury Department announces initiatives to crack down on EITC errors

Treasury on Wednesday announced eight new initiatives to reduce Earned Income Tax Credit errors, in response to an Internal Revenue Service study of compliance. The study found that $4.4 billion, or 25.8 percent of total EITC claimed, exceeded the amount to which taxpayers were eligible on tax returns filed between January 1995 and April 1995.

IRS enforcement practices in effect during the 1995 filing season reduced the estimated net error rate to 23.5 percent. With the tighter procedural tools put in place by last year's welfare reform act, the net error rate would have been reduced further, to 20.7 percent.

"The eight initiatives put forward today are important steps in lowering EITC error rates," Treasury Secretary Robert Rubin said. "The EITC is critical in lifting families out of poverty, but it should only be going to those families who are eligible."

While EITC noncompliance remains at unacceptably high levels, the study's results do show significant improvement since the late 1980s, the last time that the IRS examined a comparable group of taxpayers. In the 1988 Taxpayer Compliance Measurement Program (TCMP), the IRS determined that 35.4 percent of the amount of the EITC claimed exceeded the amounts for which taxpayers were eligible. The improvement in EITC compliance since 1988 reflects certain legislative changes and a concerted effort by the Treasury Department and the IRS to crack down on EITC errors. Since 1993, the Administration has taken 17 steps to ensure that only those who are qualified and deserving of the EITC receive it.

A summary of Treasury's eight initiatives put forward today is attached. We urge Congress to support these efforts to improve EITC compliance.

-- 30 --

RR-1636

Legislative Proposals

- **Reckless or intentional disregard and fraud will be punished with denial of EITC eligibility in the future.** In addition to enforcing the current civil and criminal penalties, the IRS would automatically deny for ten years the EITC claims of those who are found to have claimed the credit fraudulently. If an EITC error is due to reckless or intentional disregard, the taxpayer would be ineligible for the credit for the next two years.

- **New recertification procedures for taxpayers whose EITC claims have been denied in the past.** If the IRS denies an EITC claim after an examination, the taxpayer would not be automatically eligible for the EITC in the future. Taxpayers must be recertified as eligible by the IRS in order to claim the credit again.

- **Improve debt collection.** The IRS would be able to place liens and execute levies on a portion of unemployment compensation, welfare benefits, and other types of assistance in order to collect outstanding tax liabilities and penalties.

- **New penalties on preparers.** Like many other taxpayers, a large number of EITC claimants -- about half -- turn to tax preparers to help them complete their tax returns. Under this legislation, the responsibilities of paid preparers would be clarified. Preparers who do not fulfill certain due diligence requirements would be subject to penalties ranging from $50 to the full amount of EITC overclaim.

- **Reduce unintentional taxpayer errors.** The definition of a qualifying child can be confusing to both taxpayers and the IRS. The Treasury legislation will provide simpler and clearer guidance on children qualifying for the EITC.

- **Test new systems of verifying EITC claims.** The Treasury Department would seek legislation permitting it to select four states to experiment with alternative ways of providing the EITC throughout the year. States would be required to verify eligibility for the EITC before paying out the credit. Effects on advance payment participation and compliance would be studied by Treasury.

Administrative Actions

- **Aggressive action to prevent erroneous EITC claims.** Using the results of the EITC compliance study and other pilot projects, the IRS will develop new profiles of potentially erroneous EITC claimants to select for pre-refund audits. During the 1998 filing season, the IRS is earmarking substantial resources for this intensified EITC compliance effort

- **Expand taxpayer access to volunteer services.** In 1996, 1.9 million low-income taxpayers receive assistance from over 47,000 volunteers in IRS-sponsored Volunteer

Income Tax Assistance (VITA) sites. The Treasury Department is contacting businesses and tax professional organizations to make sure that they are aware of the need for volunteers and computers at these sites. Improving access to free taxpayer assistance and electronic filing will help reduce the risk of unintentional errors.

Repealing the EITC for Low-Income Workers Who Do Not Reside with Qualifying Children

- Under the Omnibus Budget Reconciliation Act of 1993, a small earned income tax credit (EITC) was extended to very low-wage workers who do not reside with children.
    - -- To be eligible for this credit, a worker must have adjusted gross income of less than $10,000 in 1998.
    - -- The credit is equal to 7.65 percent of earned income up to a maximum credit of $341 in 1998. It was designed to help offset the work disincentive effects of the social security tax rate (7.65 percent for employees and employers, each).
- Repealing this provision would raise about $2.9 billion between FY 1998 and 2002. As a consequence of its repeal, taxes would increase, on average, by $180 for 3.9 million workers in 1998.
- Repealing the credit will affect workers who have already been adversely affected by the welfare reform act which was passed last year. Under the welfare reform act, individuals who do not reside with children, and who are between the ages of 18 and 50, face stringent work requirements in order to qualify for food stamp benefits.
    - -- To be eligible for the credit without children in residence, workers must be between the ages of 25 and 65. In 1994, about three-quarters of recipients were between the ages of 18 and 50 -- the group most adversely affected by the food stamp reductions.
    - -- Eliminating their EITC would be particularly harmful to those workers who lose their jobs, and then their food stamp benefits, during the year.
- In 1994, nearly half of the claimants for this credit had adjusted gross income of less than $5,000. On average, their wage income was $4,800. Despite their low income, only about 8 percent reported receipt of unemployment benefits -- possibly because many may have worked in jobs which were not covered under FUTA.

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1997-SE-002130

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

February 27, 1997

ACTION

MEMORANDUM FOR DEPUTY SECRETARY SUMMERS

FROM: KARL SCHOLZ KS
DEPUTY ASSISTANT SECRETARY (TAX ANALYSIS)

SUBJECT: EITC Noncompliance

Last week, Ken Apfel (OMB), Calvin Mitchell, and I met with Gene Sperling to discuss the Administration's response to a forthcoming IRS study on noncompliance among taxpayers who claimed the earned income tax credit (EITC) on their 1994 tax returns. Even though the IRS has not finalized the report yet, Apfel suggested that we advise Sperling as soon as possible to the report's general findings. At the meeting, we told Sperling that the report will show that about 20 to 25 percent, or $4.4 billion, of the EITC was overclaimed during the first four months of the 1995 filing season.

We now need to work closely with the IRS to develop new compliance initiatives and to coordinate the release of the report. It would be very helpful if you would call Deputy Commissioner Dolan and ask for his staff's cooperation with Tax Policy on these tasks. Suggested talking points for this conversation are attached.

Attachment

cc: Lubick
Mitchell
Krupsky
Barr

Talking Points for Conversation with Deputy Commissioner Regarding EITC Noncompliance

- I understand that the IRS is currently reviewing a study of EITC noncompliance during tax year 1994, and that this study will show that EITC error rates remain over 20 percent.

- We must be prepared to announce a serious plan of action to combat EITC noncompliance at the same time that this report is released.

- I recognize that EITC compliance has significantly improved since 1988, when the overclaim rate was over 35 percent In large part, this improvement is due to steps taken under Commissioner Richardson's and your leadership.

- But despite these improvements, the EITC error rate is still too high. While the EITC noncompliance is not the largest problem faced by the IRS, the EITC will be compared with AFDC and food stamps. Error rates for those programs are between 6 and 8 percent.

- I understand that the error rate is high because the IRS cannot verify certain EITC eligibility criteria, such as residency and relationship tests, before the refunds checks are mailed.

- Tax Policy has developed a preliminary set of options to address these problems and will send you a copy. You should get together with them as soon as possible to discuss these options and other possible solutions. Work on these options should be given a high priority, so that we can release both the study and the new EITC compliance initiative simultaneously.

Office of Tax Analysis
February 27, 1997

SD

95-150943

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 10, 1995

INFORMATION

MEMORANDUM FOR **SECRETARY RUBIN**

FROM: Glen Rosselli GR
Deputy Assistant Secretary (Economic Policy)

SUBJECT: Impact of Senate EITC Cuts on Rural Areas

Attached please find a copy of a table estimating the impact on nonmetro (so-called rural) areas of the EITC cuts approved by the Senate Finance Committee. The idea for this document came out of our daily budget (Erskine Bowles) meetings.

This EITC piece is to be included as one part of a White House-assembled rural impact document estimating the impact of Republican budget cuts on rural areas.

Attachment

EXECUTIVE SECRETARIAT

Tax Increase on Working Families in Nonmetro Areas in 2002
An Analysis of the Senate Finance Committee EITC Proposal

(1996 $)

State	Taxpayers	Tax Increase (Thousands)	Amount per Taxpayer
Alabama	154,277	$59,244	$384
Alaska	12,426	$3,534	$284
Arizona	49,852	$17,894	$359
Arkansas	131,975	$47,765	$362
California	106,599	$38,779	$364
Colorado	40,092	$13,647	$340
Connecticut	7,607	$2,363	$311
Delaware	9,088	$3,173	$349
District of Columbia	0	$0	$0
Florida	82,582	$29,952	$363
Georgia	229,549	$84,529	$368
Hawaii	12,281	$3,817	$311
Idaho	50,323	$17,371	$345
Illinois	143,740	$49,656	$345
Indiana	90,139	$30,782	$341
Iowa	73,929	$24,252	$328
Kansas	65,978	$21,834	$331
Kentucky	145,728	$49,844	$342
Louisiana	117,055	$43,199	$369
Maine	39,074	$12,661	$324
Maryland	27,458	$9,481	$345
Massachusetts	3,866	$1,239	$321
Michigan	91,714	$29,578	$323
Minnesota	64,589	$20,926	$324
Mississippi	250,385	$96,601	$386
Missouri	124,906	$42,714	$342
Montana	39,270	$13,063	$333
Nebraska	44,440	$14,914	$336
Nevada	12,588	$4,276	$340
New Hampshire	20,253	$6,651	$328
New Jersey	0	$0	$0
New Mexico	69,270	$24,196	$349
New York	96,602	$32,946	$341
North Carolina	219,038	$79,710	$364
North Dakota	18,229	$6,044	$332
Ohio	105,405	$34,851	$331
Oklahoma	100,873	$34,852	$346
Oregon	55,700	$18,992	$341
Pennsylvania	97,007	$31,712	$327
Rhode Island	3,542	$1,188	$335
South Carolina	111,533	$41,523	$372
South Dakota	29,824	$10,123	$339
Tennessee	148,929	$52,777	$354
Texas	299,579	$109,313	$365
Utah	21,823	$7,494	$343
Vermont	19,841	$6,312	$318
Virginia	114,078	$40,482	$355
Washington	49,945	$16,443	$329
West Virginia	69,513	$23,446	$337
Wisconsin	70,984	$23,465	$331
Wyoming	18,340	$6,109	$333
U.S. Total	*3,962,000*	*$1,396,000*	*$352*

*This analysis comprises approximately 73 percent of the total Senate Finance Committee EITC cuts between 1996 and 2002.

Department of the Treasury, October 6, 1995
Numbers may not add due to rounding.

95-150305

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 25, 1995

INFORMATION

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY SUMMERS

FROM: Glen Rosselli
Deputy Assistant Secretary for Economic Policy

SUBJECT: Senate Proposal to Cut the EITC

Attached find a copy of talking points on the Senate proposal to cut the Earned income Tax Credit.

This material was made available to Gene Sperling for purposes of breifing the President in advance of his lunch meeting with reporters today.

Attachment

EXECUTIVE SECRETARIAT

Senate Republican Proposal to Cut the Earned Income Tax Credit (EITC)

- On Friday we learned the specifics of Republican plans to increase taxes on millions of lower-income working families, tax increases which will go in part to finance tax cuts for the most affluent among us.

- Republican members of the Senate Finance Committee are proposing to slash the Earned Income Tax Credit and increase taxes by $41.5 billion over the next 7 years.

- 17 million low-income working Americans will be subject to an immediate tax increase averaging $281, which will grow to $457 per year by the year 2005.

- Low-income, working families would be especially hard hit.

  -- The final phase of the 1993 EITC increase currently scheduled to become effective in 1996 would be eliminated for families with 2 or more qualifying children. At the same time, the Republican plan would increase the so-called phaseout rates that reduce the EITC as the taxpayer's income rises thereby effectively raising their marginal tax rates.

  -- In 1996 alone, the Republican's proposal would result in a tax increase, on average, of $372 for each of the 7.4 million working families -- including their 18.5 million children -- that are raising 2 or more children.

  -- The 5.3 million families with only 1 child would suffer an average tax increase of $240 in 1996.

- Included in this package is a proposal to tax social security payments received by approximately 1 million widowed, retired and disabled taxpayers who care for about 2 million of their own children, grandchildren, or other children. These social security recipients will be subject to an average tax increase of $859.

- The modest EITC that was first made available last year to very low-income workers who do not reside with qualifying children would be eliminated.

  -- This component alone will subject 4.3 million taxpayers to an average tax increase of $173.

- All EITC recipients with annual income currently in excess of $11,630 will be subject to creeping tax increases every year as the so-called phaseout rates are increased. Thus, recipients will see their EITC reduced simply because of inflationary increases in their income.

- Working parents who receive child support payments will, for the first time ever, suffer a tax increase simply because they are fortunate enough to actually collect those payments. Payments which by the way are intended solely for the benefit of their children.

  -- This proposal would impose a terribly unfair form of double taxation, as amounts paid as child support (unlike alimony, for example) are generally taxable to the parent paying the child support, and not to the parent receiving it. Under the Republican plan, however, a parent receiving child support who also claims the EITC will be taxed on the receipt of child support.

  -- Among EITC recipients who collect child support, annual payments average about $3,200. Under this aspect of the proposal alone, about 700,000 custodial parents will be subject to an average tax increase of $549 in 1996. These custodial parents should be encouraged to seek and collect child support, rather than being penalized for obtaining it.

Example

- The effects of the Republican proposal can be illustrated by the example of an unmarried worker whose income is near the poverty level and who has 2 children.

  -- Under current law, in 1996 that individual would receive an EITC of $2,532, or $8 more than the employee and employer share of social security taxes paid with respect to her earnings. The Republican proposal would reduce her 1996 EITC, and thereby increase her taxes, by $299.

  -- Because of the annual increases in the phaseout rates, by the year 2000 this worker's taxes will be $489 higher under the Republican proposal than under current law. In 2005, the difference will total $807.

- This Administration will vigorously oppose this Republican proposal to increase taxes on low-income working Americans, including the components that tax social security benefits received by widowed, retired and disabled taxpayers and that subject child support payments to double taxation.

95-149579

DEPARTMENT OF THE TREASURY
WASHINGTON

September 7, 1995

MEMORANDUM FOR: SECRETARY RUBIN
DEPUTY SECRETARY SUMMERS

FROM: Dan Sichel, DS Deputy Assistant Secretary for Economic Policy

SUBJECT: Economic Efficiency of the EITC

From our conversation on Tuesday about the economic efficiency of the EITC, I took your basic question to be: The EITC is a subsidy and subsidies create inefficiencies. Doesn't this mean that the EITC is inefficient? To think through the issues we discussed yesterday, I met with Eric Toder and Janet Holtzblatt from Tax Policy and Glen Rosselli and John Hambor from Economic Policy.

On the basic point, you are essentially right that the EITC is a subsidy and thereby potentially produces inefficient distortions in labor market decisions. On the whole, however, these distortions appear to be small and, for many workers, may offset distortions from other income transfer programs and could, therefore, improve efficiency.

Moreover, the EITC is not primarily intended to promote economic efficiency; rather, it is chiefly a program to provide additional support to low-income working families. Viewed from this perspective, the EITC offers potential advantages compared to other transfer programs that provide support for low-income Americans. The following points flesh this out.

The EITC appears to have modest effects on labor market decisions, and could not, therefore, create large inefficiencies.

- The EITC can affect the decision to work and the number of hours worked. For example, the EITC could induce some workers to work who would otherwise not do so, perhaps pulling some workers off the welfare rolls. As we discussed yesterday, the number of workers pulled into the workforce from the welfare rolls appears to be a modest fraction of those receiving the EITC. Although there are few estimates of these behavioral responses, one study suggests that the expansion of the EITC in OBRA93 would pull about 500,000 families from the AFDC and Food Stamps programs.[1] Even if one increased this figure significantly to capture the effect of the entire EITC on pulling people from welfare to work, the figure would still be a modest share of the roughly 20 million families receiving the EITC.

---

[1]Dickert, Houser, and Scholz.

- The EITC could also induce workers in the phase-in range to increase their hours and workers in the phase-out range to decrease their hours. The same study mentioned earlier also estimates that the impact of the EITC on hours worked is relatively small.

- To the extent that the EITC has relatively modest effects on the labor market, the EITC looks more like a straight transfer program to provide support for low-income working families. Thus, any economic inefficiencies induced by the EITC likely are small.

The EITC offsets other distortions and may be improving efficiency for certain workers.

- The existing tax and income-transfer system already distorts labor market decisions. In particular, certain low-income workers face very high marginal tax rates as their incomes rise, from other taxes--such as payroll taxes--and a reduction in other benefit programs, such as food stamps. To the extent that the EITC offsets these other distortions, it may help these low-income workers to make efficient labor market decisions.

The EITC has other potential benefits that may offset distortions in labor market decisions.

- The EITC may generate positive economic externalities in terms of promoting the value of work by moving workers from welfare to work. It may also increase educational attainment of children in families receiving the EITC. Unfortunately, there is not evidence that can be directly related to the EITC on this point, and, the few studies that look directly at targeted programs--such as Head Start--have not produced definitive results on this point.

- The EITC is a non-bureaucratic transfer program and therefore may be less expensive to administer than other programs transferring resources to low-income Americans. Some of these savings, however, have been offset by higher costs associated with non-compliance. During the past year, Treasury has taken a number of steps to reduce non-compliance.

TREASURY CLEARANCE SHEET

NO. ______
Date 9/7/95

MEMORANDUM FOR: ☒ SECRETARY ☐ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☐ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER ______

FROM: Dan Sichel
THROUGH:
SUBJECT: Economic Efficiency of the EITC

REVIEW OFFICES (Check when office clears)

☐ Under Secretary for Finance
☐ Domestic Finance
☐ Economic Policy
☐ Fiscal
☐ FMS
☐ Public Debt

☐ Under Secretary for International Affairs
☐ International Affairs

☐ Enforcement
☐ ATF
☐ Customs
☐ FLETC
☐ Secret Service
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☐ Management
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☐ Public Affairs/Liaison
☐ Tax Policy
☐ Treasurer
☐ E & P
☐ Mint
☐ Savings Bonds

☐ Other ______

NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
Dan Sichel	DS	9/7/95	Economic Policy	622-0563
REVIEWERS				

SPECIAL INSTRUCTIONS

☐ Review Officer ______ Date ______

☐ Executive Secretary ______ Date ______

TREASURY CLEARANCE SHEET

NO. ______
Date 9/7/95

MEMORANDUM FOR: ☒ SECRETARY ☐ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☐ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER ______

FROM: Dan Sichel
THROUGH: ______
SUBJECT: Economic Efficiency of the EITC

REVIEW OFFICES (Check when office clears)

☐ Under Secretary for Finance
☐ Domestic Finance
☐ Economic Policy
☐ Fiscal
☐ FMS
☐ Public Debt

☐ Under Secretary for International Affairs
☐ International Affairs

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☐ Scheduling
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☐ Tax Policy
☐ Treasurer
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☐ Savings Bonds

☐ Other ______

NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
Dan Sichel	DS	9/7/95	Economic Policy	622-0563
REVIEWERS				

SPECIAL INSTRUCTIONS

☐ Review Officer ______ Date ______

☐ Executive Secretary ______ Date ______

95-145092

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

May 2, 1995

INFORMATION

MEMORANDUM FOR SECRETARY RUBIN

FROM: Alicia Munnell
Assistant Secretary for Economic Policy

SUBJECT: Earned Income Tax Credit

The major basis for the current attack on the Earned Income Tax Credit (EITC) is the perceived fraud problem. To neutralize this attack, we need a better analysis of IRS data, and an "aggressive" anti-fraud proposal.

More Extensive Analysis of IRS Data

Currently critics are focusing on reports of error rates in the 35 percent to 45 percent range. Using the numbers of returns in error grossly overstate the magnitude of the problem. The most useful single statistic would be the ratio of total over- and under-payments as a percent of total EITC payments.

Our expectation is that this number would be relatively small. If not, then some detailed information from the initial study would be useful, such as:

- Number of returns with over-payments and number with under-payments, and
- Distribution of over-payments by either dollar amount or as a percent of EITC payment.

Some other aspects of the initial study also raise concerns. First, it focused only on electronically-filed returns. Second, some have said that the survey may have occurred during an unusual period when the IRS had temporarily suspended its usual checking of social security numbers. Is this true?

EXECUTIVE SECRETARIAT

Ideal Statement

Ideally, we would like to be able to say something along the following lines:

The reported error rates have received a great deal of attention and are providing a misleading picture of the level of fraud in the EITC program.

The most useful way of looking at error is to look at the combined over and under payments as a percent of total EITC payments. This calculation shows that errors are only xx percent of the total. Of this amount, most can be attributed to relatively innocent errors by taxpayers, and only a small share is the result of what would generally be considered fraud.

Even the xx percent figure though should be interpreted with care. Our study focused only on early tax returns filed electronically, which tend to generally have a higher error rate than paper returns.

Timing

To be effective in the budget negotiations, we need to release a statement by the morning of May 8th, so it is available before the Budget Committee markup scheduled for later that day.

Second IRS Study

The IRS is also conducting a second study to determine what the error rate is in the new procedures put in place this year. To the degree that it shows that these new procedures have substantially reduced the error rate it will be very helpful. Preliminary results should be available this summer, likely in time for the budget reconciliation process. It would be much more helpful to focus on dollar amounts.

New Anti-Fraud Measures

Finally, it should be noted that some Democratic Senators are willing to defend the EITC against attacks and large cuts, but are less inclined to do so absent additional steps to find and eliminate error and fraud. For this reason it is essential that IRS come up with -- and the Administration ultimately propose -- additional measures to reduce error and fraud beyond those contained in this year's budget.

TREASURY CLEARANCE SHEET

NO. ______
Date May 3, 1995

IEMORANDUM FOR: ☒ SECRETARY ☐ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☐ ACTION ☐ BRIEFING ☒ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER ______

FROM: Alicia Munnell
THROUGH: ______
SUBJECT: Earned Income Tax Credit

REVIEW OFFICES (Check when office clears)

- ☐ Under Secretary for Finance
  - ☐ Domestic Finance
  - ☐ Economic Policy
  - ☐ Fiscal
    - ☐ FMS
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- ☐ Other ______

NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
Rosselli, G.	G.R.	5/2/95	DAS for Economic Policy	2-0090
REVIEWERS				

SPECIAL INSTRUCTIONS

☐ Review Officer ______ Date ______ ☐ Executive Secretary ______ Date ______

DEPARTMENT OF THE TREASURY
WASHINGTON

January 3, 1995

MEMORANDUM FOR MARK GEARAN

THROUGH: (Acting) Secretary Newman

FROM: Ben Nye
Jonathan Kaplan

SUBJECT: Promotion of the Earned Income Tax Credit

I. Introduction

In response to our conversation last week, we have developed several ideas related to the Earned Income Tax Credit (EITC) and how it fits into the Administration's long term communications strategy. At its heart, the EITC is a tax cut that provides incentives for individuals to get off of welfare and back to work. We have outlined below a background sketch of the EITC expansion, some of the key Administration themes that the EITC helps to advance, and a number of opportunities for outreach. If you find the idea regarding the President's State of the Union speech worth pursuing, we could begin coordinating it immediately.

II. Administration Expansion of the EITC

The expansion of the EITC, contained in the Omnibus Budget Reconciliation Act of 1993 (OBRA 93), sought to increase the number of those eligible for the EITC as well as the size of the credit.

- **Who receives the EITC?** The expansion cut taxes for the 14 million working families already receiving the EITC (23.1 percent of all non-elderly American families). It also added 4.7 million childless workers to the program. By 1997, when the EITC expansion is fully phased-in, the number of EITC recipients will have increased from 14 million to 20 million.

- **How big is the expanded credit?** In 1997, the maximum credit amount will increase from $2,000 to almost $3,400. This increase helps to bolster the stagnating real incomes of those at lower income levels.

- **How do eligible workers receive the credit?** People eligible for the EITC may receive the credit in either of two ways, in a lump sum or on a current basis (in their paycheck) through advance payment. In the past, fewer than 1 percent of claimants received the credit on a current basis.

• **Why do so few use advance payment?** A GAO study found that the low level of advance EITC participation was due to the fact that recipients are generally unaware of the option.

• **Which method of payment is preferable?** For low-income workers, the advance EITC payment can ease the burden of meeting day-to-day expenses. Providing the credit on a bi-weekly or monthly basis may also be of particular importance for those making the transition from welfare to work. One programmatic goal has been to encourage more EITC recipients to take advantage of the advance EITC.

• **Are there problems associated with the EITC?** A principal concern with the EITC program is the potential for fraudulent and erroneous claims. As a result, a second programmatic goal is reducing EITC fraud. According to some accounts, annual loss due to programmatic fraud ranges from $1 to $5 billion. To a significant extent, this problem is attributable to the IRS not having adequate information to verify eligibility for the credit when the credit is claimed.

• **How can the Administration address these concerns?** As for fraud, the IRS believes that shifting more EITC payments to the advance EITC, where an employer/employee relationship exists and an employer is involved in determining the amount of the credit, will help reduce fraudulent claims. Toward this end, the President last year informed millions of working Americans about the EITC expansion and the advance EITC in a three-part outreach strategy that included a cabinet press briefing, a CEO outreach campaign, and additional media. The Administration's EITC campaign was fairly successful. Based on employer returns for the first two quarters of 1994, the estimated number of filers of the advance EITC rose by 270 percent last year, from 31,311 participants in 1993 to 84,688 in 1994--a modest but significant increase. Now is the time to launch this outreach campaign once again.

III. Themes

The EITC expansion provides a unique communications opportunity for the Administration. The Administration could promote the EITC success as a part of its four-year legislative agenda, consistent with the current middle class tax cut and welfare reform proposals.

A. *Linking EITC Expansion to Welfare Reform*

With the welfare reform summit scheduled for mid-February, it is an opportune time to emphasize the fact that with the passage of EITC expansion in 1993, the Administration succeeded in pushing through a critical component of any welfare reform package. An expanded EITC also ensures that workers--who remain in the workforce by virtue of their boosted incomes--receive the on-the-job training that they would not otherwise receive on welfare. EITC expansion is consistent both with the

Administration's goal of moving welfare recipients back into the workforce and with the theme of "making work pay." It also demonstrates that welfare reform was an early priority for the Administration.

B. *Linking EITC Expansion to the Middle Class Bill of Rights*

The EITC expansion clearly shows that the Administration has been advocating tax cuts since President Clinton took office. Administration officials should not discuss the middle class tax cut issue without raising the fact that we have already cut taxes for 20 million American workers through the EITC expansion. Furthermore, because the EITC is now available for those with incomes up to $27,000, this is a tax cut that benefits not only the working poor, but also the lower middle class.

IV. Outreach Strategy

While Treasury and the IRS will continue to push their outreach efforts, there are a number of opportunities for other agencies and departments in the Administration to take the lead. We have taken the liberty of providing a few ideas for you.

A. *President Clinton*

1. State of the Union

With attention focused on tax cut proposals and welfare reform, the President should highlight in his State of the Union speech the Administration successes in cutting taxes and getting people off of welfare through EITC expansion in OBRA 93. *The President could recognize a worker, seated in the gallery, who recently left welfare by using the Clinton EITC tax cut to supplement his/her otherwise low income.* By pointing to tax cuts and welfare reform that the Administration has already enacted, the President can stress that these have indeed been themes of his Administration since day one.

2. EITC-Specific Events

The President could further highlight his EITC successes by conducting a Saturday radio address on the issue or by videotaping a public service announcement informing eligible workers of the advance payment option. He could also visit a voluntary income tax assistance (VITA) site or a low-income neighborhood to focus attention on the benefits of the advance EITC. In addition, some have advocated changing the name of the Earned Income Tax Credit to a less bureaucratic-sounding title, such as the Working Americans Credit. If the Administration determined that a name change is desirable, then a major event could be scheduled to christen the program.

B. *Cabinet Affairs and Business Liaison Outreach*

In an effort to promote a consistent message, Cabinet officials could mention EITC in their speeches as a critical early component of the Administration's tax cut and welfare reform proposals. These officials could also visit EITC-specific sites, such as a VITA center or a business, and encourage eligible taxpayers to take advantage of this Clinton tax cut.

EITC is a particularly good issue for the Administration to stress with labor unions, particularly those linked to industries adversely affected by NAFTA and GATT. Secretary Reich and others could conduct events with major unions geared towards increasing awareness of EITC eligibility. It is also worth noting that the EITC expansion amounts to a substantial increase in the minimum wage, raising it from the current level of $4.25 per hour to approximately $6.00 per hour.

The Administration had a great deal of success last year reaching out to big business on this issue. CEOs of major corporations such as Auggie Busch (Anheuser-Busch), Josh Weston (ADP), David Glass (Wal-Mart), and Don Fisher (The GAP) helped to spread the word about the advance EITC option throughout private industry. It was fairly successful, contributing significantly to the 270 percent increase in advance EITC enrollees. The Administration could expand the CEOs' participation this year by establishing a President's Steering Committee to promote EITC. Secretary Brown, Leon Panetta, Laura Tyson, and Robert Rubin could also play critical roles in this outreach. Further, on the small business side, Phil Lader and the SBA could reach out to small business, bringing into the fold members of the NFIB and the SBLC.

C. *Intergovernmental Affairs and Political Affairs Outreach*

It may also prove effective to encourage state and local government officials to promote the advance EITC program in their communities and with their own lower income workers. These offices could also work with the DNC in an effort to publicize the advance EITC. Treasury has compiled state-by-state and district-by-district figures on how many taxpayers are eligible for the expanded EITC which also might be helpful.

If you find any of these ideas useful, we would like to discuss them with you at your convenience. We will call you to follow up.

cc: Sylvia Matthews
Josh Steiner

DEPARTMENT OF THE TREASURY
WASHINGTON

94-139313

October 25, 1994

MEMORANDUM FOR SECRETARY BENTSEN

From: Joshua L. Steiner JS

Subject: GAO Report on the EITC

As we discussed this afternoon, the GAO has prepared a report on the EITC. The report, which outlines a number of fraud and overpayment problems, was given to Senator Roth today.

The White House is very concerned that the Republicans will use the report to attack one of the cornerstones of the President's budget. This afternoon Frank held a meeting with Ron Noble, Peggy Richardson, Linda Robertson, Eric Toder, Gene Sperling and Bruce Reed to discuss the report and our possible response.

Eric and Peggy are preparing a memo for you which outlines these issues and asks for your guidance on how we should proceed. In summary there are four issues which we would like to discuss with you in the morning:

1. Should we make a preemptive strike by announcing the steps we have already taken to combat fraud and the steps we plan to take before the start of the next filing season? We would need to make this announcement tomorrow.

2. If we do make this announcement, should it include an Administration decision to deny illegal aliens access to the EITC (the GAO report estimates that 160,000 illegal immigrants received the credit)?

3. If we do make this announcement, should it include an Administration decision to implement changes that would make it more difficult for tax preparers to make anticipation loans for the EITC? This is an issue Peggy has examined in some detail and has discussed with Frank.

4. If we do make this announcement, what role would you want to have? Peggy and Ron (who chaired the Tax Refund Fraud Task Force) might hold a briefing or you could. Your involvement would obviously draw more attention to the actions the Administration is taking.

Gene and Bruce spoke with Leon Panetta after our meeting and they report that he might give you a call. He supports denying illegal aliens the credit and wants to raise the profile of our actions so he may ask you to participate in any announcement.

cc: Frank Newman