EITC

PRESIDENT CLINTON PROPOSES TO EXPAND THE EARNED INCOME TAX CREDIT IN ORDER TO INCREASE THE REWARD FOR WORK AND FAMILY

January 12, 2000

Today President Clinton Will Announce His $21 Billion Plan to Expand the Earned Income Tax Credit – A Key Part of His " New Opportunity Agenda." The President's proposal would expand the Earned Income Tax Credit (EITC) to provide tax relief for 6.4 million hard-pressed working families. The expansion will cost about $21 billion over 10 years.

Building on the Successes of the 1993 EITC Expansion. In 1993, the President signed into law the largest EITC expansion ever to provide a tax cut for 15 million working families while rewarding work and family. Today, the success of the EITC in reducing poverty and encouraging work is clear:

4.3 Million People ***Directly*** **Lifted Out of Poverty by the EITC in 1998** – more than double the number lifted out of poverty in 1993.
2.3 Million Children ***Directly*** **Lifted Out of Poverty by the EITC in 1998.** This includes 600,000 African-American children and 600,000 Hispanic children.
Largest Drop in Poverty and Child Poverty in Over Three Decades. The poverty rate has fallen from 15.1 percent in 1993 to 12.7 percent in 1998 – the lowest since 1979. At the same time, the child poverty rate fell from 22.7 percent to 18.9 percent – the lowest child poverty rate since 1980.
More Single Mom's Are Working Than Ever Before. The percentage of single mothers who work and receive no welfare has risen from 60.9 percent in 1992 to 75.0 percent in 1998.

The President's Proposal Increases the Reward to Work and Family in Four Ways:

Expand the Maximum Credit for Working Families with Three or More Children By $500. This would provide a tax break for 2.1 million low- and moderate-income working families. This expansion is targeted at the highest concentration of child poverty: in 1998 the poverty rate for children in families with three or more related children was 28.5 percent – more than twice the 11.9 percent poverty rate for children in families with one or two related children.
Expand the Credit for Married, Two-Earner Couples. This would benefit over 1.3 million married filers. For married, two-earner couples, this provision by itself would provide an average tax break of $250.
Increase the Reward to **Work While Expanding the Credit for Families with Two or More Children.** This would provide an additional tax break, and an additional incentive to work, for families with two or more children by lowering the phaseout rate to give more rewards to families struggling to work their way into the middle class.
Encouraging Savings Through Simplification. Currently, when a working family contributes to a 401(k) they may see their EITC reduced. This proposal encourages savings and simplifies the calculation of earned income for the purposes of the EITC.

Here is How These Changes Would Increase the Reward to Work for American Families:

THE PRESIDENT'S PROPOSED INCREASE IN THE EARNED INCOME TAX CREDIT				
	Pre-1993 Law	**Current Law**	**Proposal**	**Increase**
Married*; 2 children; $20,000 earnings	$1,438	$2,524	$2,940	+$416
Individual; 3 children; $15,000 earnings	$2,331	$3,577	$4,116	+$538

Married*; 3 children; $23,000 earnings	$902	$1,892	$2,867	+$975

*Both spouses must earn at least $725 to qualify for the additional credit for a married couple.

DETAILS OF THE PRESIDENT'S PROPOSAL

The President's Proposal Would Expand the Earned Income Tax Credit to Provide Tax Relief for 6.4 Million Hard-pressed Working Families. The average increase for families with three or more children is $544 and some married couples with three or more children could see as much as an additional $1,155 tax credit. The expansion will cost about $21 billion over 10 years. The four major provisions of President's EITC expansion are:

Expand the Maximum Credit for Working Families with Three or More Children By $500. The President's proposal would add a "third tier" to the EITC to expand benefits for families with three or more children. Very low-income families will get 45 cents for every additional dollar they earn -- compared to 40 cents under current law. This higher credit rate will increase the maximum credit for a family with three children in 2001 from $3,992 to $4,491 -- a roughly $500 increase. This proposed new "tier" of the EITC is motivated by the fact that 60 percent of all poor children -- 7.7 million children -- are in families with three or more children. Adding a third tier to the EITC would provide a tax break for 2.1 million low- and moderate-income working families.

Expand the Credit for Married, Two-Earner Couples. The President's proposal would allow married couples to earn an additional $1,450 more before beginning to have their EITC phased out. For example, in 2001 a married, two-earner couple with children would be able to earn up to $14,480 and still receive the maximum EITC, as compared to the $13,030 threshold under current law. The result of this provision would be to provide an additional $250, on average, for married, two-earner couples. This provision would benefit over 1.3 million married filers.

Increase the Reward to Work While Expanding the Credit for Families with Two or More Children. The third provision of the President's proposal would provide an additional tax break, and an additional incentive to work, for families with two or more children. Under current law the EITC for these families is reduced by 21.06 percent for each dollar they earn above the maximum threshold. The President's proposal would lower this phase-out rate to 19.06 percent -- a tax break for 5.4 million of America's hard-pressed working families.

Encouraging Savings Through Simplification. Under current law, 401(k) contributions and other forms of nontaxable earned income are counted as income in computing the EITC. For many families this means that if they increase their contributions to a 401(k) then they will see their EITC reduced. The President proposes to encourage savings for poor people by eliminating nontaxable earned income from the calculation of the EITC. In addition to encouraging savings, this step will simplify the EITC, and continue to increase compliance.

THE PRESIDENT'S 1993 EITC EXPANSION HAS CONTRIBUTED TO THE LARGEST REDUCTION IN POVERTY IN OVER THREE DECADES

In 1993, the President Signed Into Law the Largest EITC Expansion Ever. The President's policy provided a tax cut for 15 million working families. For every dollar a very low-income working parent with one child earns, the EITC was increased from 23 cents to 34 cents (25 cents to 40 cents for two plus children). The maximum credit was increased by over $1,500. The income limit on eligibility was increased by about $3,700.

Nearly 19 Million Families Claim the EITC. In FY 1999, the cost of the program was $30.5 billion. In 2001, the average credit for all claimants will be $1,680 and for claimants with children it will be $1,990. [Source: U.S. Department of the Treasury]

In 1998, the EITC Was *Directly* Responsible for Lifting 4.3 Million People Out of Poverty – Twice the Number Lifted Out in 1993. Census Department statistics show that the EITC was *directly* responsible for lifting 4.3 million people out of poverty in 1998 – more than twice the number lifted out of poverty in 1993. The *indirect* contribution of the EITC to poverty reduction may be even greater given the evidence that the EITC provides a powerful incentive to work. [Source: Calculations using data from the U.S. Census Bureau.]

In 1998, the EITC Was *Directly* Responsible for Lifting 2.3 Million Children Out of Poverty. The 2.3 million children lifted out of poverty by the EITC include 600,000 African-American children and 600,000 Hispanic children. [Source: Calculations using data from the U.S. Census Bureau.]

Expanded EITC and Higher Minimum Wage Has Led to Large Real Income Growth For Hard-pressed Families. A working parent with two children earning the minimum wage in 1993 made $10,559 with the EITC (in 1998 inflation-adjusted dollars) – well below the poverty line. With the 1993 increase in the EITC and the 90 cent increase in the minimum wage in 1996 and 1997, a similarly situated family in 1998 was above the poverty line – making $13,268 – a 26 percent inflation-adjusted increase in their standard of living.

Poverty Rate Fell To 12.7 Percent in 1998 – Its Lowest Level Since 1979. The poverty rate has declined from 15.1 percent in 1993 to 12.7 percent in 1998 – that's the largest five-year drop in poverty in nearly 30 years (1965-1970). There are now 4.8 million fewer people in poverty than in 1993. (In 1998, the poverty threshold was $16,660 for a family of four.) [Source: U.S. Census Bureau]

The Largest Five-year Drop in Child Poverty in More than Three Decades. While the child poverty rate remains too high, between 1993 and 1998, the child poverty rate has declined from 22.7 percent to 18.9 percent – that is the lowest child poverty rate since 1980 and the largest five-year drop in nearly 30 years (1965-1970). [Source: U.S. Census Bureau]

The Poverty Rate for Children in Families with Three or More Children is More than Double the Poverty Rate for Children in One or Two-Children Families. Although the poverty rate for children in families with three or more related children has fallen from 32.3 percent in 1993 to 28.5 percent in 1998, this is still more than twice the 11.9 percent poverty rate for children in families with one or two related children. 7.7 million children in families with three or more children were growing up in poverty in 1998. [Source: Calculations by the Department of the Treasury using data from the U.S. Census Bureau.]

<u>THE EVIDENCE IS OVERWHELMING THAT THE EITC ENCOURAGES WORK</u>

More Single Mothers With Children Are Working Than Ever Before. After staying essentially constant in the 1980s and early 1990s, the percentage of singe mothers aged 16 to 45 who work and receive no welfare has risen from 60.9 percent in 1992 to 75.0 percent in 1998. The percentage of single mothers who worked rose from 73.7 percent in 1992 to 86.6 percent in 1998. [Source: Calculations by

Professor Jeffrey Liebman using data from the Bureau of Labor Statistics' March Current Population Surveys.]

According to One Study, More Than 60 Percent of the Increase In the Employment of Single Mothers Has Been Due to Expansions of the EITC. Bruce Meyer and Dan Rosenbaum find that 63 percent of the change in the employment of single mothers between 1984 and 1996 can be explained by the expansions of the EITC. [Source: "Welfare, the Earned Income Tax Credit, and the Labor Supply of Single Mothers." National Bureau of Economic Research Working Paper No. 7363. September 1999.]

Another Study Predicted That the 1993 EITC Expansion Would Induce 516,000 Families To Move From Welfare to Work. Stacy Dickert, Scott Houser, and John Karl Scholz found that the 1993 EITC expansion would induce 516,000 families to move from welfare to work. [Source: "The Earned Income Tax Credit and Transfer Programs: A Study of Labor Market and Program Participation." *Tax Policy and the Economy* No. 9, MIT Press: Cambridge, 1995.]

Another Study Shows that Increasing the Reward to Work, Increases Labor Force Participation. Nada Eissa and Jeffrey Liebman found that the EITC significantly increases labor force participation among single mothers, especially less educated women. [Source: "Labor Supply Response and the Earned Income Tax Credit." *Quarterly Journal of Economics* 111(2), 1996.]

EITC

CENTER ON BUDGET AND POLICY PRIORITIES

Revised June 14, 1995

THE ROTH-NICKLES EITC PROPOSAL

Senators Roth and Nickles recently introduced legislation to reduce the Earned Income Tax Credit (EITC), which they may offer on the Senate floor as an amendment to the welfare reform bill. Treasury Department estimates show that this legislation would cut the EITC by $66 billion over seven years — or about *triple* the size of the EITC reduction reflected in the Senate budget resolution. Senators Roth and Nickles have said that over 10 years, their proposal reduces the EITC by $120 billion.

The Roth-Nickles bill contains nearly all of the EITC reductions assumed in the Senate budget resolution and adds to them an array of additional cuts, some of which are very large. This analysis covers the proposals included in the Roth-Nickles package that are *not* also reflected in the Senate budget resolution.[1] These include: ending inflation indexing of the EITC; reducing the EITC for families that receive child support or Social Security; and eliminating the EITC for some families with savings.

These proposals represent deep EITC reductions. The Treasury Department estimates that by tax year 2000, some 19 million low-income working households would be adversely affected by the proposal and have their EITC reduced an average of more than $600 a piece that year. Eight million working families with two or more children would lose an average of $886 in 2000, according to the Treasury analysis, while seven million families with one child would lose an average of $563. More than four million poor workers without children would have their EITC terminated, losing an average of $173 each. (The size of these EITC benefit reductions is expressed in 1996 dollars.)

Some of these proposals also would add major new complexities to the EITC and be difficult to administer. As a result, they would be likely to cause an increase in error rates.

Ending Inflation Indexing of the EITC

- President Reagan proposed indexing the EITC in the mid-1980s; his proposal was enacted as part of the Tax Reform Act of 1986. The Roth-Nickles proposal, however, would end indexation. Meanwhile, indexation

[1] In addition to the EITC reductions discussed here, the Roth-Nickles bill also includes the following EITC changes assumed in the Senate budget resolution: repeal of the scheduled 1996 expansion of the EITC for families with two or more children, a reduction of up to $89 per family below current EITC levels for families with two or more children, and the elimination of the EITC for poor workers without children.

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of the tax brackets and the personal exemption for those at higher income levels would remain.

Higher-income families thus would continue to enjoy protection against the effects that inflation would have on their tax burdens, while working poor families would no longer have this protection. (Moreover, the House tax bill would extend indexing to capital gains, the gift and estate tax, and depreciation allowances, three tax code provisions that primarily benefit the wealthy and large corporations.)

- If EITC indexing is eliminated, millions of working families will face tax increases. Families with incomes between about $11,000 and $27,000 whose wages simply keep pace with inflation will find that their EITC *decreases* each year while their payroll taxes rise. The increases in tax burdens they will face as a consequence will grow larger with each passing year.

  For example, if a family's income keeps pace with inflation and EITC indexing has ended, a family with two or more children and income of $12,000 in 1996 will, five years later, receive an EITC $460 smaller than the credit it received in 1996. The family's EITC will be more than $1,000 lower than it would have been if the EITC had continued to be adjusted for inflation. And while its EITC is falling, the family's payroll tax will have climbed $167.

  The purchasing power of this family's EITC will decline 27 percent in the five-year period. Moreover, for some working families, the decline would be even steeper. Families that earn $20,000 and whose wages simply keep pace with inflation will find that the purchasing power of their EITC declines *more than 50 percent* over five years if indexation ends.

- The Treasury Department estimates that by the year 2000, nearly 18 million low-income working households would be adversely affected by this proposal. This one proposal would reduce the EITC by *$32 billion over seven years*.

- Senator Roth argues this provision will reduce fraud and is needed to prevent EITC income limits from growing too much. Ending indexing, however, would not curb fraud. Fraud is best curtailed by the types of steps the IRS instituted this year to tighten the processing of tax returns claiming the EITC — such as checking all Social Security numbers on these returns to ensure no child is claimed twice — not by cutting the EITC for hard-pressed working families whose incomes barely keep pace with inflation.

Furthermore, the EITC income limits for families with one child were not raised at all by the 1993 EITC expansions. The income limits for these families continue to be those that President Bush supported and signed into law in 1990, adjusted only for inflation.

The income limits for families with two or more children were raised modestly — about 14 percent — in the 1993 reconciliation act. This was done for a sound reason — that Act increased the EITC benefit for families with two or more children to move close to a longstanding goal that had been espoused by conservatives and liberals alike and by organizations such as the Heritage Foundation — namely, that if a parent works full-time throughout the year the parent should not have to raise his or her children in poverty. The increase in the EITC benefit for families with two or more children necessitated modestly raising the EITC income limit for these families. Otherwise, EITC benefits would have to phase down too rapidly as earnings increased, raising marginal tax rates too high.

Once the changes enacted in 1993 for families with two or more children are phased in fully, the EITC income limits for *all* types of eligible families will simply rise with inflation, just as the income tax brackets do for families at all income levels including families at high income levels.

Cutting the EITC for Families that Receive Child Support or Social Security

The Roth-Nickles proposal would cut between $6 billion and $8 billion over five years by counting Social Security, child support, and several smaller items as part of adjusted gross income for EITC purposes and thereby reducing or eliminating EITC benefits for families that receive Social Security or child support.

Counting child support payments would be problematic, as it would be difficult and burdensome to administer and would add inequities to the tax code. It also would sharply reduce the EITC for many families headed by a divorced working mother.

- The IRS has no information on the child support payments that a custodial parent receives and lacks a reliable means of securing this information. The GAO recently took note of the administrative difficulties such a proposal would cause. This proposal thus would be difficult for the IRS to enforce. An almost-certain result would be higher error rates.

- In addition, counting child support in this manner would essentially lead to income being taxed twice. *Non-custodial* parents already pay income tax on the income from which child support payments are made. Under this proposal, receipt of child support payments also would increase the tax burdens of *custodial* parents by reducing their EITC payments, effectively taxing the same income a second time.

- This change also would be likely to lessen child support collections. Some of the non-custodial parent's child support payments would effectively be taxed away, thereby lessening the non-custodial's parent's incentive to make such payments.

Counting Social Security benefits as part of adjusted gross income also raises a number of issues. The Social Security beneficiaries affected would primarily fall into three groups: families in which one parent works while the other is disabled and receives Social Security disability benefits; elderly individuals who have modest earnings and are raising a grandchild; and families containing a child who receives Social Security survivors benefits because one of the child's parents has died.

- While the Social Security benefits these families receive represent income, counting these benefits in adjusted gross income when calculating EITC benefits could subject Social Security beneficiaries who are raising children to larger taxes on their Social Security benefits than some other Social Security beneficiaries at higher income levels.

- In addition, the bill would count *all* of Social Security benefits in adjusted gross income. Yet a portion of Social Security benefits represent funds that beneficiaries themselves have paid in to the Social Security system.

Eliminating Some Families with Savings

Legislation enacted earlier this year eliminated EITC eligibility for families with interest, dividend, rent, and certain other income of more than $2,350. The Roth-Nickles proposal would sharply lower this limit to $1,000, slicing several billion dollars more from the EITC. The $1,000 level would not be indexed; it thus would tighten over time, disqualifying more families with each passing year.

This would eliminate the EITC for many low-income working families with modest savings who are saving for such reasons as to send a child to college, make a downpayment on a house, start a business, or meet a medical emergency — a growing concern as the proportion of low-income working families that lacks health insurance continues to rise.

This proposal also would compel many low-income families to consume enough of their assets to stay below the limit. We should neither be punishing low-income working families if they save nor inducing them to consume rather than to save.

- This proposal also poses equity problems. Working families saving to purchase a modest home could be disqualified; families that already own a home — and thus do not need to amass as much in savings — would remain eligible.

- Senator Roth is likely to draw an analogy to the stringent assets limit in AFDC. Such a comparison is inappropriate. AFDC is primarily for families that do not work. By contrast, the EITC is for families that do work. It is designed to provide them tax relief and to encourage them to work and save so that they can pull themselves and their children into the economic mainstream.

Delaying EITC Benefits

The Roth-Nickles legislation also would delay payment of a family's EITC benefit until the Internal Revenue Service is able to match information on the tax return with information on W-2s. While the intent of this proposal is laudable, the proposal is not practicable at this time; it would cause extremely long delays between the filing of a tax return and receipt of an EITC payment.

In an analysis issued June 7, the Joint Tax Committee noted that this proposal "could result in delays of many months between the filing of tax returns and the issuance of refunds...." At present, the matching of tax returns and W-2s for tax returns filed in a given year does not occur until the next calendar year. Even if this process could be greatly accelerated, the delays could not be shortened in the foreseeable future to less than six months.

Delays of this length in issuing EITC payments are likely to weaken the perceived link between work and EITC receipt. Rather than mandating that IRS undertake a procedure for which it lacks the technology and staff to perform in a reasonable timeframe, Congress should concentrate on moving forward with IRS plans for Tax Systems Modernization so that the IRS obtains the technology to institute additional procedures in the future to improve compliance with both the EITC and other aspects of the tax code.

Conclusion

These proposals represent deep cuts in the EITC and would impose large tax increases on millions of low-income working families who rely on the credit to offset their payroll and income taxes and to boost their limited wages so they can raise their children more adequately. The proposals also would make low-paid work less remunerative and thereby lessen the rewards of working over receiving welfare.

Finally, the proposal would tax a significant number of near-poor working families into poverty and tax millions more who already are poor deeper into poverty.

TREASURY ESTIMATES OF EFFECTS OF EITC REDUCTIONS IN THE SENATE BUDGET RESOLUTION AND THE ROTH-NICKLES BILL

	Senate Budget Resolution in 1996	Roth-Nickles Bill In 1996	Roth-Nickles Bill In 2000*
Total EITC Recipients			
Number of Affected Taxpayers	14 million	19 million	19 million
Average Reduction	$239	$311	$602
Taxpayers with Two or More Children			
Number of Affected Taxpayers	8 million	8 million	8 million
Average Reduction	$305	$516	$886
Taxpayers with One Child			
Number of Affected Taxpayers	2 million	7 million	7 million
Average Reduction	$137	$166	$563
Taxpayers without Children			
Number of Affected Taxpayers	4 million	4 million	4 million
Average Reduction	$173	$173	$173

Source: Department of the Treasury, Office of Tax Analysis

* Figures in this column are expressed in 1996 dollars. The much larger reductions in the year 2000 than in 1996 are due to the removal of indexation.

EITC

PPi

PROGRESSIVE POLICY INSTITUTE

POLICY BRIEFING

June 19, 1995

GOP Cuts in the EITC

Raising Taxes on the Working Poor

M. Jeff Hamond and Lyn A. Hogan

The earned-income tax credit (EITC) is one of the most successful social policies of the last two decades. President Clinton's five-year, $21 billion expansion of the EITC in 1993, based on proposals from the Progressive Policy Institute (PPI), represents his greatest social policy accomplishment and provides the foundation for any serious welfare reform.[1] The expanded credit will help 1.4 million families—including close to 3 million children—escape poverty by 1996.[2]

Yet the EITC is a target for cuts as the Republican-controlled Senate attempts to balance the budget by the year 2002. Despite the GOP's strong past support for the EITC, some Republicans now charge that the program is too costly, ineffective, and rife with fraud. The evidence shows that these charges are exaggerated or plainly incorrect, and it is time to set the record straight. *If conservatives are serious about promoting work by low-income families and ensuring that full-time workers escape poverty—prerequisites for successful welfare reform—they will help preserve this program.*

Purpose of the EITC. The EITC's fundamental purpose is to "make work pay," by supplementing the earnings of those working for poverty-level wages. As opposed to less well-targeted approaches such as the minimum wage, the EITC benefits only those below a certain income level—and the vast majority of working families with children that are poor or near-poor. When the 1993 reforms are fully implemented next year, the EITC will bring the income of a family of four with a full-time, year-round worker at least up to the poverty line, taking into account the value of the family's food stamps and the burden of its payroll taxes.

The program accomplishes this goal by matching each dollar earned with a refundable tax credit of between 7.65 cents and 40 cents, depending on family size, until an income ceiling is reached. For a family with two or more children, the refundable credit reaches a maximum level of $3,370 when a worker earns $8,425, remains at that level through earnings of $11,000, and then gradually declines to zero when earnings reach

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[1] The current design of the credit is based on an approach developed by PPI vice president Robert J. Shapiro, who advanced the idea that no family with a full-time, year-round worker should have to live in poverty. For example, see "An American Working Wage: Ending Poverty in Working Families," PPI, Policy Report No. 3, February 1990.

[2] John Karl Scholz, "The Earned Income Tax Credit: Participation, Compliance, and Anti-Poverty Effectiveness," *National Tax Journal*, March 1994, pp. 59-81.

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$27,000.[3] The size of the credit varies according to family size since the poverty level varies with family size.

The EITC embodies both progressive and conservative values by: (1) rewarding those who work, rather than those who live on public assistance; (2) targeting the greatest benefits to those with the greatest need; (3) offsetting the tax burden on families struggling to make ends meet; (4) providing incentives for people to enter the workforce who otherwise might not do so; and (5) achieving these ends with virtually no government bureaucracy. Moreover, the EITC supports the private market, rather than interfering with it. In fact, it is the *only* program specifically designed to help poor people who choose to work.

PPI's first policy report, published in June 1989,[4] analyzed the EITC and the minimum wage as alternative strategies for helping working poor families. Raising the minimum wage, it was found, would help mainly second and third workers in middle-income families, ignore poor workers who are self-employed, and be financed through higher prices on everyone, including poor people. By contrast, a redesigned EITC could be targeted exclusively to lower-income people, cover *all* the working poor, and be financed through the progressive income tax. Having established the superior value of the EITC, it is now troubling to see such a sensible program come under such thoughtless attack.

Opponents have leveled the following criticisms of the program, all misleading or inaccurate:

- Criticism #1: The program's sharply rising costs have created another "out-of-control entitlement" that needs to be reigned in.

- Criticism #2: The credit is poorly targeted: It assists only a small minority of Americans below the poverty line, while simultaneously helping many who are not poor.

- Criticism #3: The program is subject to unacceptably high rates of fraud.

- Criticism #4: On balance, it *discourages* work because so many recipients qualify in the phase-out range of the credit.

- Criticism #5: The program discourages marriage, because low-income couples who marry face sharp cuts in their total benefits.

We will demonstrate why none of these criticisms is well-founded.

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[3]Credit rates and dollar figures are for 1996 and beyond, when the 1993 expansion will be fully phased in.

[4]Robert J. Shapiro, "Work and Poverty: A Progressive View of the Minimum Wage and the Earned Income Tax Credit," PPI, Policy Report No. 1, June 1989.

Rising costs. The total costs of the EITC have grown significantly—from $6.9 billion in 1990 to a projected $24.6 billion in 1996. Sens. Don Nickles (R-OK) and Judd Gregg (R-NH) have criticized this aspect of the EITC, arguing that cuts in the program are justified because Congress must "restrain its unsustainable rates of growth." This contrasts sharply with past GOP positions, when EITC expansions were preferred to regular increases in the minimum wage.

What critics conveniently ignore is that the recent expansions were *specifically endorsed* by Congress. While growth in the major entitlements (Medicare, Medicaid, and Social Security) is driven by rising health care costs and shifting demographics, the cost of the EITC has grown quickly because Congress has voted to expand its scope and benefits twice in the last five years. Moreover, the purpose it served was clear and compelling: ensuring that families with full-time workers would not live in poverty. In fact, once the 1993 changes are fully phased in next year, the annual program costs will start to *decline* as a percentage of the gross domestic product (GDP), again in contrast to the major entitlement programs serving the elderly.

Target Population. Republicans have criticized the EITC for reaching only a small minority of poor Americans: Of all families below the poverty line, only about 35 percent are eligible for the EITC.

This statistic simply reflects the fact that the EITC is designed to target *not* all poor families, but only low-income *working* families. By this measure, the program is remarkably successful: Of all families eligible to receive the EITC in 1990, between 80 percent and 86 percent did receive it. The EITC participation rate, therefore, is higher than that for Aid to Families with Dependent Children (AFDC), which reaches 62 percent to 72 percent of eligible families, or food stamps, which reaches 54 percent to 66 percent.[3] Furthermore, analysts predict that the participation rate could easily exceed 90 percent when the 1993 reforms are fully implemented.

Waste, Fraud, and Abuse. As benefits and participation have expanded, the number of fraudulent claims has also increased. Some GOP senators, most notably William Roth (R-DE) and Nickles, aim to cut the EITC because they claim the program has a fraud rate of 35 percent to 45 percent, thereby costing taxpayers billions of dollars in fraudulent refunds and penalizing honest working families whose earnings do not pull them up to the poverty line.

Critics have made an important mistake by repeatedly citing this statistic. It is based on a January 1994 study by the Internal Revenue Service (IRS) of returns filed electronically during the first few weeks of the tax filing season, and it is inaccurate and misleading for the following reasons:

- The 35 percent to 45 percent statistic from that study is an *error* rate, not a *fraud* rate. If a worker claimed the credit but was $1 off—either high or

[3]Scholz, *op. cit.*, and John Karl Scholz, "Testimony Before the Senate Committee on Governmental Affairs," April 5, 1995.

low—in the calculations, this was included in the "error" statistic. Many of these unintentional errors are corrected by the IRS and result in no overpayment of credit. The IRS estimates that *nearly half* of the supposed fraudulent claims were actually unintentional errors of this type.[6]

- While the remaining half of the erroneous returns were instances of the EITC being claimed in error, this number also overstates the current fraud rate for several reasons:

  —The number refers to the percentage of *erroneous claims*, not the percentage of *overpayments*. A 20 percent fraud rate, for example, does not mean that $4 billion of a $20 billion program are fraudulent refunds; it means that one-fifth of all families claiming the credit significantly overestimated their refunds.

  —Some taxpayers who claimed the credit in error, when they do not qualify, may also have done so unintentionally due to the complexity of the tax laws.

  —Returns filed electronically early in the filing season are widely believed to have higher EITC fraud rates than returns filed overall.[7]

  —The study was based on returns for tax-year 1993. Since then, the IRS has implemented new procedures to cut down on EITC fraud, such as double-checking the Social Security numbers of all dependents to make sure that each exists and that the same child is not claimed on multiple returns.

Thus the true fraud rate was *never* 35 percent to 45 percent; rather, perhaps 20 percent of claims contained error or fraud—and again, this does not mean that 20 percent of all *refunds* were erroneous or fraudulent. (In fact, an accurate dollar amount of losses due to fraud has not been calculated since the 1990 expansion.) A 20-percent error and fraud rate is still unacceptably high, but the new prevention procedures undertaken by the IRS for the 1994 tax year should reduce the rate significantly. While these procedures have delayed tax refunds for many Americans this year, the efforts of the IRS have saved millions of dollars; most importantly, delays and fraud will be reduced in future years as IRS verification strategies are improved.

In sum, there *are* problems with error and fraud that should be addressed, and the IRS is working on this problem. The challenge is to reduce fraud without resorting to a solution that will eliminate incentives for the poor to work.

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[6]Margaret Milner Richardson, Commissioner of Internal Revenue, "Testimony Before the Senate Committee on Governmental Affairs," April 4, 1995.

[7]Center on Budget and Policy Priorities, "The Earned Income Tax Credit and Calls to Reduce It," May 2, 1995.

Work Disincentive. Some critics assert that the EITC is actually a net work *disincentive*, because once poverty-level income is achieved, the EITC support begins to phase out. For example, the credit declines by 21 cents for each dollar of additional earnings between $11,600 and $28,500 for a family of four (in 1996), in effect applying an additional 21 percent tax rate to these earnings. Some Republicans charge that this provision discourages work, thus reducing the labor efforts of low-income workers.

Effective marginal tax rates *are* high in the phase-out range. For example, at the lower end of the range, where families are eligible for food stamps but not yet subject to federal or state income taxes, the marginal tax rate can be as high as 65 percent for families with two children. (This is the sum of marginal tax rates resulting from sales and excise taxes, payroll taxes, the phase-out of the food-stamp program, and the phase-out of the EITC). At the high end of the range, where families pay income taxes but are not eligible for food stamps, the marginal rate approaches 60 percent for two-child households.[8]

We also agree that the maximum allowable income has been set higher than necessary. For example, recent data show that more than 60 percent of families receiving the credit fall in the phase-out range,[9] which shows that the credit is not perfectly targeted and could be improved.

Nevertheless, recent research shows that the incentive to enter the labor force provided by the newly expanded EITC outweighs any disincentives in the phase-out range. Some people probably *do* choose not to work extra hours as a result of the high marginal rates. On balance, however, the expanded program will provide a net positive work impact equal to 20 million hours per year by 1996 if labor market entrants work 400 hours annually.[10] In the final analysis, the total net benefit may be larger since the average EITC recipient worked 1,300 hours in 1993.[11] The problematic disincentives in the phase-out range—a feature of *any* tax provision that phases out as income rises—can be addressed without resorting to the shortsighted solution of cutting the program.

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[8]Edgar K. Browning, "Effects of the Earned Income Tax Credit on Income and Welfare," *National Tax Journal*, March 1995, pp. 23-43. Browning concedes that it is theoretically possible for a family to receive food stamps and be subject to income taxes, but he considers the two mutually exclusive to simplify the analysis.

[9]Janet Holtzblatt, Janet McCubbin, and Robert Gillette, "Promoting Work Through the EITC," *National Tax Journal*, September 1994, pp. 591-608.

[10]Scholz, 1995, *op. cit.*, and "The Earned Income Tax Credit and Transfer Programs: A Study of Labor Market and Program Participation," prepared for the National Bureau of Economic Research.

[11]James Bovard, "Clinton's Biggest Welfare Fraud," *The Wall Street Journal*, May 10, 1994, p. A18. Bovard suggests that the EITC should be targeted to full-time, year-round workers (i.e., 2000 hours per year or more). Other analysts, however, including PPI's Shapiro, challenge this view, noting that most working poor people cannot control their ability to work year-round. Many poor workers are employed in seasonal occupations such as agriculture, and the employment of all low-skilled workers is sensitive to changes in business conditions over which they have no control. Limiting the EITC to full-time, year-round workers, Shapiro notes, would in effect exacerbate the poverty of working families whose breadwinners lose their jobs or are forced to cut back their hours through no fault of their own.

Marriage Disincentive. Critics of the EITC say the credit discourages marriage, because when two single, low-income workers choose to marry, the dollar value of their EITC can fall dramatically. Consider a single man with two children and a single woman with two children, each earning $11,000 a year. Separately, each would be eligible for a 1996 EITC of $3,370. If they marry and both continue to work, their EITC drops to one payment of $1,054—a drop of $5,700, or more than 25 percent of their combined earned income.

A closer look, however, deflects this criticism. The EITC actually serves as a marriage *incentive* for low- or no-income taxpayers with children, especially when only one member of the prospective couple has a child, or unmarried couples who plan to have children. For example, a single man with earnings of $11,000 marrying a non-working mother with two children would receive a 1996 tax credit of $3,370, money he would not have received had he remained single. The high cost of health care and child care—hard to afford in the private sector but readily available in the welfare system—encourage low-earning women with young children to choose welfare over work. Therefore, it seems more likely that on the lower rungs of the economic ladder, the EITC would *encourage*, not discourage, marriage.

The EITC: Improve It, Don't Gut It

As a foundation for welfare reform, a nonbureaucratic work incentive, and one of the few social programs that actually works, the EITC is a cornerstone of a progressive social policy for the 21st century. We can get people to move from welfare to work only if work pays, and the EITC ensures that it will.

The program is not perfect, however, and needs some minor adjustments. *Unlike the new GOP critics, we believe in improving a valuable program rather than cutting it because it doesn't work perfectly*. Some social programs are worthwhile investments; they need repair, not the budget axe.

Some suggested reforms:

- Require firms to notify their low-wage workers in writing that the credit can be applied to each paycheck, rather than collected at year's end. Less than 1 percent of EITC recipients use this option. Applying the credit to each paycheck would provide better assistance to working families and would likely reduce fraud, because firms have an incentive to correctly report hours worked and income earned.

- Adjust the phase-in and phase-out ranges to maximize the number of families in the former and minimize the number in the latter. There is a trade-off here, as there is in any program with a phase-out range: Shortening the phase-out range requires that income in this range be taxed at even *higher* rates. Nonetheless, it may be preferable to have a smaller number of workers pay a high tax rate than have many more workers pay a slightly lower tax rate. We recommend that Congress: (1) lengthen the phase-in range; (2) shorten the phase-out range (thus increasing the marginal tax rate); and (3) reduce the maximum allowable income to qualify, in order to better target the credit. These changes will place more families in the work incentive range of the EITC without increasing its total cost.

- Implement further policies designed to reduce fraud. We should deny the EITC to undocumented workers. Currently, they are eligible for the EITC if they meet the credit's eligibility rules—a policy at cross purposes with immigration policy. Revisions to the EITC criteria would ensure that undocumented workers would no longer qualify for the credit.

With compelling evidence that the EITC is a success—it will help 25 percent of eligible workers with below-poverty incomes escape poverty by 1996[12]—cuts in the program are the equivalent of raising taxes on low-income working families to help balance the budget. These cuts will have the effect of pushing more families into poverty, thus making real welfare reform much more difficult. In their quest to slash or block grant every social program, Republican senators have acted hastily by endorsing cuts in the EITC; they are removing the foundation for welfare reform and condemning many of America's low-income workers to poverty.

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[12] Scholz, 1994, *op. cit.*

WR - EITC

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REMARKS: Revised version of earlier paper

INFORMATION SYSTEMS AND INFRASTRUCTURE

A NEW VISION

Under the welfare reform bill, new computer and information technology will deliver a much higher level of service for clients, States, and the Federal Government. As part of a reformed welfare system oriented toward work, we propose to use these new technologies to provide, for example, new automated screening and intake processes, eligibility decision-making tools, and benefit delivery techniques. In addition, other new technologies such as expert systems, relational databases, voice recognition units, and high performance computer networks, will help empower families and individuals seeking assistance. Moreover, these technologies will reduce fraud and abuse so that Federal and State benefits are only available to those who are truly in need.

The goals of these enhancements are to:

- Enable operation of a time-limited welfare system by providing case tracking and management;
- Improve the child support enforcement system by providing centralized case tracking, expanded locating services, expanded data matching, and expedited procedures;
- Prevent and reduce fraud and abuse by sharing data among States and agencies of the Federal Government; and
- Improve agency efficiency and service to clients by, for example, eliminating the need for clients to use different entry points before they receive services and reducing paper procedures.

PART A - SYSTEM DEVELOPMENT AND WELFARE REFORM

Background

In the late 1970s, the Federal Government began improving the administration of welfare programs using computerized information systems. According to a recent GAO report, in the previous 10 years the Federal government had spent nearly $900 million in the development and operation of Aid to Families with Dependent Children (AFDC) and Food Stamp Program (FSP) automated systems alone. This has meant more cost-effective systems that integrate service delivery at the local level by using combined application forms for multiple programs (including AFDC, FSP, and Medicaid) and a combined interview to determine eligibility for the various programs.

Another development has been the use of electronic transfer of funds or Electronic Benefit Transfer (EBT) technology to deliver benefits. This technology -- mentioned in the National Performance Review -- allows recipients to use a debit card, similar to a bank card, at retail food stores and automated teller machines (ATMs) to access their benefit accounts.

Over time, States and the Federal government have developed increasingly complex computer management information systems for financial management and benefit delivery, program operations, and quality control. Some programs, such as Child Support Enforcement, are in the midst of large-scale (and long-term) computer system change, while others, such as AFDC (with its FAMIS[1] systems), are nearing completion of a development cycle.

Both FAMIS and Child Support Enforcement Systems (CSES) mean that many States have integrated, automated, income maintenance systems that help caseworkers in determining eligibility, maintaining and tracking case status, and reporting management information to the State and Federal governments. Other essential welfare programs, namely JOBS and child care, have limited and fragmented automated systems, however.

Despite their accomplishments, many State systems have serious limitations: limited flexibility, lack of interactive access, limited ability to exchange data electronically, limited use of matching for detecting fraud and abuse, etc. Even the most sophisticated systems fall short of the goals stated earlier.

THE NEW SYSTEM

To achieve our vision and address these problems, we propose enhancing State and local information systems to improve management and delivery of services and linking them with a national data "clearinghouse" to coordinate data exchange. This two part strategy will make it possible to operate a time-limited welfare system, improve the child support enforcement system, and reduce fraud and abuse. The key point is that both are needed: the enhanced state systems linked to a national clearinghouse for data exchange; neither will accomplish much without the other. These new systems are described below.

Enhanced State Systems. At the State and local level, the new systems infrastructure would include automated subsystems for:

- Intake, eligibility determination, assessment, and referral;
- Case management, tracking, and service delivery; and
- Benefit payment and reporting.

1. Family Assistance Management Information System

The infrastructure would consist of new systems components integrated with existing or modified State and county-level systems. The wide variations in existing automated systems make it unreasonable to try to standardize these systems. Instead, we need linkages that allow for the accurate exchange of data between systems.

By linking the various programs and systems, States could provide integrated services and/or benefits to families and individuals "at-risk" of needing financial assistance and other services, those receiving assistance, and those transitioning from public assistance to self-sufficiency. As part of this automation effort, enhanced funding will be offered as an incentive for States to develop and carry out statewide, automated systems for JOBS/WORK management and monitoring, and to enable seamless services for child care.

Such an automated system infrastructure would enable States to provide greater support to families who might otherwise dissolve and to parents who may, because of unmet needs, be forced to terminate employment or training opportunities. In other words, this structure will allow the integration and interfacing of multiple systems for benefit and service delivery, for example, AFDC, food stamps, work programs, child care, Child Support Enforcement (CSE), and others.

In addition, as Electronic Benefit Transfer (EBT) and Electronic Funds Transfer (EFT) become more widespread, they would be used for other programs, such as reporting of JOBS participation and child care reporting and payments. As an example, a JOBS participant could be required to self-report either with a touch-tone phone that connects to a Voice Recognition Unit (VRU) or with plastic card technology.

To facilitate development of these systems, the Federal Government, in partnership with the States, or groups of States in partnership with the Federal Government, will develop model systems that perform these functions or subsets of these functions. Used in other situations, these partnerships have proved effective in quickly developing model systems that meet the needs of the States and Federal Government and then are widely adopted.

National Clearinghouse. The key to linking State-level data is the National Clearinghouse which will be a collection of abbreviated case and other data that provides the minimum information for carrying out essential program activities. These essential activities include operating a time-limited welfare system, enhancing the child support enforcement system, and preventing and reducing fraud and abuse.

The Clearinghouse will not be a Federal data system that does individual case activities, rather it will link data and "point" to the State systems where detailed data resides. States will retain general processing responsibility for all major activities, but will exchange information with the Clearinghouse.

By about three years after enactment, the Clearinghouse will maintain at least the following data registries:

- The National New Hire Registry will maintain employment data on individuals, primarily based on new hire information supplied by employers and quarterly employment information supplied by State agencies administering unemployment compensation laws. Information in this Registry will be matched regularly with other Registries and databases to assist the child support enforcement, AFDC, unemployment compensation, and other programs determine employment status and income.

- The National Locate Registry will enhance and subsume the current Federal Parent Locator Service (FPLS) to allow States to locate persons who owe child support or who are owed child support.

- The National Child Support Registry will maintain identification information (e.g. names, addresses, and Social Security Numbers) on all child support cases contained in State child support case databases to improve child support services.

- The National Welfare Receipt Registry will contain such data as Social Security Numbers, beginning and ending dates of welfare receipt, participation in various work programs, and the name of the State providing benefits so States can operate a time-limited welfare system.

The National Welfare Receipt Registry is described in detail to give an idea of how these Registries will function. In general, the other Registries will operate similarly.

National Welfare Receipt Registry

The National Welfare Receipt Registry is designed to enable States to operate efficiently a time-limited welfare system. Each AFDC agency information will send electronically to this Registry information on individuals receiving benefits. Upon request, the Clearinghouse will send electronically information to the State agency. The information to be exchanged is as follows:

- Information sent to the Clearinghouse by States includes identification information, such as the names and Social Security Numbers of members of the family; the dates an individual went on and off assistance; participation information for AFDC, JOBS, and WORK programs; information on extensions of time-limits and sanctions for noncompliance for these and other programs; as well as other information determined necessary by the Secretary.

- Information sent to the States by the Clearinghouse includes whether the applicant has been reported to have received assistance and, if so, when and in which State(s); whether the Social Security Numbers supplied are valid; whether the applicant is recorded in the New Hire Registry as recently employed; and other information as determined by the Secretary.

Information Discrepancies. Under the welfare reform proposals, if an information discrepancy exists between the information the client presents to the State agency and the information in the Clearinghouse, the Clearinghouse must assist in the resolution. Specifically, the Clearinghouse must verify that the data recorded there matches the information in the State where the individual had previously collected assistance. If necessary, the Clearinghouse must correct its information and report the updated information to the requesting State. Then the States involved must take appropriate action to resolve any discrepancy, following normal due process requirements, and must submit corrected information to the Clearinghouse when the discrepancy is resolved.

ENHANCED STATE SYSTEMS

At the same time that the National Clearinghouse is established, a number of State systems will be enhanced. These include transitional assistance support information systems to administer time-limited welfare, child care information systems to improve management and delivery of child care services, JOBS/WORK information systems to manage and deliver work program services, central case data registries for child support cases, systems to expedite procedures for activities related to child support, and locator services for child support enforcement purposes. These enhanced systems are described below.

Transitional Assistance Support Information System

The State agency, to assist in the administration of time-limited welfare, will establish and operate a statewide, automated, Transitional Assistance Support Information System. This system will serve to significantly improve the effectiveness and efficiency of State systems information infrastructures for the management, monitoring, and reporting on clients as they work toward independence and self-sufficiency. The State may receive enhanced funding for these changes under specific approaches approved by DHHS and described below.

Minimum System. The minimum capabilities of this State system include:

- Exchanging information as described above in a standard, electronic format with the National Clearinghouse;

- Querying electronically the National Welfare Receipt Registry in the National Clearinghouse before granting assistance;

- Using the information received from the Clearinghouse in the determination of eligibility and period for which assistance may be granted;
- Reporting corrected or updated information to the Registry; and
- Meeting current statutory requirements for security and privacy.

Augmented System. In a collaborative effort with other States in which an augmented system is developed, a State may adopt the augmented system and receive enhanced match for development costs. Under this augmented system, clients will receive considerably enhanced service responsiveness through prescreening to match available services to individuals and determine the required qualifying and verification information needed for each service. The additional automated functions must include at least: determining eligibility; improving government assistance; performing case maintenance and management functions; calculating, managing, and reconciling payments to eligible recipients; providing for processes and procedures to detect and prevent fraud and abuse; and producing reports.

Child Care Case Management Information System

Again in collaborative efforts, States will be given enhanced match to develop a comprehensive Child Care Case Management Information System. This system will provide statewide, automated, procedures and processes to achieve seamless child care delivery, including all child care programs of the State. This system will help the State in administration of child care program(s) and to manage the nonservice related CCDBG funds. The functions will meet both the minimum requirements described above plus additional functions that will include, at least, the ability to: identify families and children in need of child care, establish eligibility for child care, and identify funding source(s); plan and monitor services, compute payments, and update and maintain the family and child care eligibility status for child care; maintain and monitor necessary provider information; process payments and meet other fiscal needs for the management of child care program(s); produce reports required by Federal and State directives; monitor and report performance against performance standards; and electronically exchange information with other automated case management systems and with the statewide automated transitional assistance support system.

JOBS/WORK Case Management Information System

States will be given enhanced match to develop a JOBS/WORK Case Management Information System, again if the development is done as a collaborative effort. This system will provide statewide, automated, procedures and processes to control, account for, and monitor all factors of the JOBS and WORK programs and support both management and administrative activities of the programs. These functions will meet both the minimum requirements described above plus additional functions including the capability to: assess a participant's service needs; develop an employability plan; arrange, coordinate, and manage the services or resources needed for the plan; track and monitor ongoing program participation and attendance; exchange information electronically with other programs; and provide performance and assessment information to the Secretary.

Centralized Child Support Case Registry

To improve paternity establishment and child support services, each State will set up and maintain a single, Centralized Child Support Case Registry for all child support cases in which services are being provided. The State will maintain an up-to-date subset of these data in the National Clearinghouse in the National Child Support Registry.

The State Central Registry will maintain and regularly update a complete payment record of all amounts collected and distributed; amounts owed or overdue (including interest or late payment penalties and fees); and the termination date of the support obligation. In addition, it will maintain information on judicial and administrative actions and orders related to paternity and support, information from data matches, and other information. Finally, it will extract and exchange data with Federal, in-State, interstate databases and locator services, as well as data systems of other States.

Centralized System of Collection and Disbursement of Child Support Payments

States will also set up and maintain a centralized, automated unit for collection and disbursement of child support. In addition to these functions, the State system will generate wage withholding notices and orders to employers, monitor nonpayment, and use administrative enforcement mechanisms.

Expedited and Enhanced Procedures for Child Support Enforcement

In addition, the welfare reform bill will enhance current information systems to use new, expedited procedures in the child support and paternity area. These newly streamlined, centralized, and automated procedures will link more databases together in ways that facilitate their use and include:

- Changes to the way that child support arrearages are offset against Federal income tax refunds so that such offsets take priority over most debts owed Federal and State agencies;
- Adoption of the Uniform Interstate Family Support Act with some additional modifications;

- Access to:

  - Financial or other information needed to establish or enforce a child support order as well as a requirement that States must report child support arrears to consumer credit bureaus if they are overdue;

  - Records of State and local government agencies including vital statistics, tax and revenue, personal property, occupational and professional licenses, ownership or control of businesses, employment security, public assistance, motor vehicles, and corrections; and

  - Customer records of public utilities and cable companies and information held by financial institutions on individuals who owe or are owed support.

Under welfare reform, States have additional or strengthened options for child support enforcement that the enhanced information systems will facilitate and these include the:

- Ability to intercept or attach any payment to the child support obligor by a State or local government agency, assets of the obligor held by financial institutions, or retirement funds (including streamlined access to military retirees' compensation);

- Ability to impose liens, and if appropriate, to force sale of property and distribution of proceeds;

- Ability to withhold, suspend, or restrict driver's, professional, occupational, and recreational licenses of individuals owing past-due support;

- Ability to deny, revoke, or restrict a passport to an individual who owes more than $5,000 in child support arrears; and

- Ability to revoke transfers of income or property made to avoid payment of child support.

Use of the above expanded, expedited, streamlined, and centralized procedures will substantially enhance collection and distribution of child support.

Enhanced Federal Parent Locator Services

Coupled with the expanded record gathering at the State level described above, the authority of the Federal Parent Locator Service (FPLS) to gather and use data will be broadened substantially to include additional information needed to locate non-custodial parents. These will include gathering information on wages and other employment benefits, and on other assets (or debts), for child support purposes, obtaining information from consumer credit reporting agencies, and reducing restrictions on disclosure of information from IRS and Social Security Administration records.

PART B - FRAUD AND ABUSE

These proposed changes to the welfare system will lead to substantial improvements in detecting and controlling fraud and abuse compared to the current system. Reducing and preventing fraud and abuse will ensure that more resources go to those who deserve assistance and the money saved can be used for other things in welfare reform.

In many States, existing systems cannot handle the growing number of applications for aid and the transient nature of these clients. Compared to existing information systems, new local, State, and Federal systems will dramatically increase the ability to detect fraud and abuse. As knowledge of these efforts grows, prevention and deterrence of fraud and abuse will increase as well.

A major part of this effort is that welfare reform will relax restrictions on data sharing among AFDC, child support enforcement, Medicaid, unemployment compensation, food stamp, and territorial cash assistance programs. Information will also be shared with Treasury for administration of the Earned Income Tax Credit (EITC), and the Social Security Administration for various programs. Other types of data sharing at the State level will also increase, for example, States will be able to use motor vehicle, law enforcement, union hiring halls, and many other data systems to obtain information for child support purposes. Finally, many of these enhancements will be integrated into the current Income and Eligibility Verification Systems (IEVS).

To strengthen these efforts, the welfare reform bill requires that Social Security Numbers of all parties must be recorded on marriage licenses and divorce decrees, and of the parents on birth records and child support and paternity orders. In addition, the Social Security Administration will verify Social Security numbers of all family members applying for welfare.

The following examples illustrate what States could do with the newly-available information. The National Clearinghouse will provide States with information on employment so States can detect unreported income of noncustodial parents, leading to increased child support payments. It will also allow States to detect unreported income of individuals getting welfare, unemployment compensation, or workman's compensation.

Improved parent locator capabilities will mean States can find absent parents more quickly and easily. Coupled with improved information on employment, broadened authority to intercept and attach income and assets, and the other improved enforcement tools outlined above, we expect substantially increased child support collections and reduced welfare spending.

States can use the location and receipt of AFDC and the names and Social Security Numbers of members of AFDC families to detect and prevent other forms of fraud and abuse. Such information, either alone or by matching it with other data sources, will allow States to prevent, for example, clients from receiving benefits in multiple locations, from claiming non-existent children, and from claiming children by more than one family.

The recent expansion of the Earned Income Tax Credit (EITC) has increased the need for data exchange to reduce fraud and abuse and for research. Under the new information infrastructure, HHS and the States will be creating databases that could be matched to IRS records, especially those concerning the EITC. These would include databases on welfare receipt, new hires, custodial and noncustodial parents, SSA information, etc. Joint efforts using these databases to explore options for improved compliance and targeting of the EITC are necessary. These efforts should include resolution of questions regarding discrepancies between Census information and IRS tax records. For instance, HHS would like to understand why there may be many single males claiming the EITC and why EITC participation rates exceed 120 percent as reported in some academic papers. These and similar questions could be resolved through data sharing efforts.

In summary, expanded efforts to do data matching between databases will pay off handsomely in preventing and reducing fraud and abuse. Based on evaluations of current efforts in this area, reported problems with the current systems could be substantially reduced with changes and expansions planned under the new information systems. For instance, the new structure will increase the timeliness of information, and therefore, accuracy of the matches, making it more cost effective for case workers to pursue them. New sources of data matches will make it possible to pursue kinds of fraud and abuse that have never been addressed before. To do these matches, new agreements will have to be negotiated between levels of government. For example, to obtain unemployment insurance records from States, DOL is developing a legislative proposal to make such information routinely available at the national level.

Partly because of increasing the detection of fraud and abuse and partly because of changing the culture of the welfare system, much fraud and abuse will be prevented or deterred before it occurs. For instance, people who currently have unreported jobs, but are fraudulently getting cash assistance, will be "smoked-out" because the JOBS plus WORK requirements will prevent them from working at their unreported employment. In the face of increased likelihood of detection of fraud and abuse, others may decide not to come onto the rolls at all or, once on, to actively pursue self-sufficiency.

PART C - ISSUES OF CONTINUING CONCERN

Two major issues are of concern in elaborating the above infrastructure: issues of privacy and issues surrounding data sharing between and among levels of government.

Privacy Issues. Under the new system more people will have access to more information about each client, so privacy and data security issues need to be re-examined. Fortunately, we have long successful experience addressing these issues, both technologically and organizationally. It will be extremely important to assure the public that their privacy is being protected.

Data Sharing Issues. The second issue concerns the laws, regulations, and policies governing the exchange of information between and among levels of government and whether they support welfare reform efforts, especially regarding reduction of fraud and abuse. Some States and some agencies of the Federal Government, such as Census, SSA, and the IRS, have elaborate rules limiting data sharing, such as requiring all data exchanges to be spelled out in statute and limiting access to all identifiers. These will need to be worked through to use fully the potential for data sharing that the new infrastructure allows.

PART D - PROPOSALS TO COORDINATE BETTER TAX AND TRANSFER POLICY

Finally, beyond the current welfare reform bill, additional proposals for improving the coordination of tax and transfer policy could make use of the new data systems proposed under welfare reform. These new policy proposals could toughen up the programs so resources go to the most needy. The options discussed below are meant to be illustrative of what could be done with the new information that will be available when the new systems are in place.

1. *For a male head of household to claim the EITC, paternity, adoption, legal guardianship, or foster care as determined by a legal proceeding must be established.*

This policy change would focus the EITC on those with more legitimate claims on EITC dollars. One way to implement this proposal would be to have the agency responsible for the basis for the EITC claim also be responsible for preparing the certification that the EITC claim is valid. For example, the adoption or foster care agency or court that decides guardianship would give the certification to the head of household. A copy of the certification would be included with the tax return.

In the case of paternity establishment, this proposal would be a policy change from current law which does not require that paternity be established. When paternity was established, the child support enforcement agency could supply the certification papers to the head of household claiming the EITC.

2. *For a joint or head of household return, all child support must be paid before processing the EITC. The EITC would be reduced (or eliminated completely) by the amount of the unpaid child support and the amount owed would be sent to the custodial parent.*

Since the State child support records keep track of how much is owed for each child, those records could supply to the IRS the amount of unpaid child support by SSN.

As proposed in the welfare reform bill, such debts are to be collected from refunds, but current IRS procedures for rapid disbursement of refunds do not incorporate such checking of child support records beforehand. The IRS would have to change its procedures to delay refunds enough to check that child support had been paid in the tax year. Doing so would reduce the amount of unpaid child support.

3. *An adult claiming a child for EITC and other tax purposes, must be the same adult claiming the child for AFDC and food stamp purposes.*

This proposal would ensure that the EITC helped welfare recipients become self-sufficient. Since the National Clearinghouse will contain all the SSNs for AFDC cases and could be expanded to contain the SSNs for food stamp recipients as well, these data could be matched annually with the tax data to carry out this proposal.

4. *Each child claimed for EITC must have a valid Social Security Number. Under this proposal, the IRS must cross-check EITC claims with SSA records.*

This proposal would strengthen existing law. Next year the IRS will begin entering the SSNs of these children and these could be validated by SSA.

5. *The IRS must check that the child is not claimed more than once.*

This check can be done internally at IRS, however, it would be more effective if done in conjunction with validating the SSNs as proposed in 4.

6. *The IRS and HHS must ensure that reporting of wages is consistent between tax and transfer systems.*

Currently, the IRS does some checking of the reporting of wages by employees with the records provided by employers to SSA. The checking could be extended to comparing the amount of wages to tax and transfer agencies. Specifically, States could produce annual reported wage totals by SSN to be matched with tax and SSA records. The National Clearinghouse would be the ideal place to do this matching because much of the data would already be there since the Clearinghouse will contain data for all States.

7. *Ensure that welfare overpayments and child support payments can be subtracted from EITC payments.*

Currently, welfare overpayments are collected from on-going benefits, but if the client is no longer receiving welfare the collection is harder. Collecting the overpayment by reducing the EITC would be a single collection rather than a lengthy incremental process as is the case with AFDC currently.

As proposed in the welfare reform bill, child support arrears are debts to be collected before debts owed to other Federal or State agencies, including before welfare overpayments. State data systems would contain the required data for processing these actions, but the ease with which this can be done depends on the degree of automation of the State systems. Again, the IRS would have to modify its procedures before disbursing the refunds to account for these debts.

Congressional Proposal to Delay EITC Refunds

EITC

- Today's Wall Street Journal reports that House Republicans are considering a plan to delay EITC payments next year.
  - Under the plan, the IRS would be required to pay EITC refunds quarterly or monthly over a twelve-month period. According to Congressional aides, taxpayers would also not be allowed to claim advance payments of the EITC through their employers for tax year 2000.
  - As a result, about a quarter of EITC refunds – roughly $7 billion – for tax year 1999 would be pushed into FY 2001.
- The proposal would impose a **tax increase on 20 million working families** who expect to receive the full amount of the credit when they file their tax return next winter and spring. No other group of taxpayers is being asked to delay receipt of their tax refund.
- **The IRS cannot implement the proposal.** At this late date, the IRS cannot change its computer programs for the next filing season in order to pay out EITC refunds separately or any tax refund in installments.
- Nearly 20 million low and moderate-income taxpayers will claim the EITC on 1999 tax returns. They will claim an average EITC of $1,610. If they have children, they will receive, on average, an EITC of $1,890. Most EITC claimants have income below $30,000. Nearly all EITC payments are made during the filing season.
  - Most claimants chose to receive the EITC at the end of the year in a lump-sum payment, rather than advance payments during the course of the year. They have made decisions about personal saving and consumption on the expectation of a large refund this spring.
  - Some may have planned to purchase a car or move to a better apartment when they receive their EITC refunds. Others have borrowed money in the expectation of receiving an EITC refund at the end of the year. Receiving the EITC in monthly payments will disrupt these plans, and in some cases, impose further costs on taxpayers who do not have other resources to fall back upon.
- By choosing to receive the EITC at the end of the year, low-income taxpayers have already made a significant interest-free loan to the government. Delaying the refund further is, in effect, demanding that low-income taxpayers extend the loan to the government.
  - Many low-income taxpayers, caught by surprise by the delay of their refund, may have to borrow money from private sources. There is already a sizable refund-anticipation loan market, which often charges high interest rates to low-income taxpayers who seek to receive their EITC refund in advance. Delaying refunds will push more low-income taxpayers into the refund anticipation loan market.

A Tax Increase on Working Families

The proposal to spread out payments of refunds of the EITC to working families over 12 months is tantamount to a tax increase.

- Families that would have saved their refunds will lose the interest that they would otherwise have earned.
- Families that would have used the money to pay off debt will be able to retire less debt because they will incur more interest expense.
- Families that would have used the money to purchase a consumer durable such as a car will have to take out larger loans to do it.

Examples:

1. A couple with two children earning $10,000 is planning to use their $3,816 EITC to purchase a used car to get to work. Because the payments will be delayed over 12 months, they will have to get a loan at 10 percent interest. As a result, they will only be able to afford a car costing $3,617. Spreading out the EITC is tantamount to a tax of almost $200 to this family.

2. A single parent with one child and income of $20,000 expects to use their $1,103 refund to pay off her credit card debt. If she receives the EITC in installments, she will have to pay interest at 18 percent. As a result of the interest costs, she will end the year with $208 of unpaid debt. That $208 is effectively an additional tax.

- The IRS cannot cut a separate refund check for EITC claimants.
  - Right now, the IRS is completing its testing of computer programs for the next filing season. These programs are not set up to pay out the portion of refunds attributable to the EITC separately or to make installment payments of any refund amount. At this late date, there is not sufficient time to develop and adequately test new programs.
  - These programming changes would come on top of IRS efforts to meet the Y2K challenge.

Office of Tax Policy
September 14, 1999

Earned Income Tax Credit: Rewarding Work for Working Families

Department of the Treasury
October 18, 1995

Overview

- General Description and Goals of EITC
- Bipartisan History of EITC
- Current Law
- Error Rates
- 17 Administration Measures and Proposals To Improve the EITC and Reduce Error Rates
- Congressional Proposals to Cut the EITC
- Press Articles
- State-by-State Data

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 7 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 taxes they owe.

- In 1996, the EITC will provide a tax credit averaging nearly $1,400 for over 20 million workers and their families. Working families with earnings of up to $28,500 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 move 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 78 percent of EITC payments are refunds to taxpayers of individual income and social security taxes.

- 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 EITC.

  -- 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.

- The EITC is a non-bureaucratic way to encourage work over welfare. There are no middlemen and service providers. There are no long lines at government offices. The tax refund is provided by the IRS directly to the working families.

Rewarding America's Working Families

- People who work hard and play by the rules shouldn't lose the game.

  -- 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, while in 1996 the real value of the minimum wage will decline to its lowest real value in 40 years.

  -- 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. Currently, only three states provide comparable benefits.

  -- The poverty rate for working families with children grew by nearly half from 1979 to 1993.

  -- The bottom 40% of American families by income--those earning less than $30,000 in 1993-- made 10% less in real terms in 1993 than in 1979.

- The EITC <u>rewards work</u>. But there is still more to do. The EITC and Food Stamps are nearly enough--but not enough--to raise a family of four with a full-time minimum wage worker above the poverty line.

A HISTORY OF BIPARTISAN SUPPORT FOR THE EITC

Leading Republicans Have Supported the EITC

- The EITC has enjoyed bipartisan support since Russell Long helped create it in 1975. Republicans and Democrats alike have viewed the EITC as a non-bureaucratic way to make work pay better than welfare.

- President Reagan called the EITC, "The best anti-poverty, the best pro-family, the best job creation measure to come out of the Congress."

- Senator Packwood said in 1991 that the EITC is "a key means of helping low-income workers with dependent children get off and stay off welfare."

- Senator Domenici said in 1990, "The EITC is a great way to help low income families with the costs of raising their children. It sends assistance to those in need; to those who work hard and yet struggle to make a living and provide for their children."

- Others who have expressed especially strong support for the EITC include Senators Dole, Hatch, and Grassley; Representatives Armey and Petri; and former Representative Kemp.

A Decade of Bipartisan Development

- 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 slightly over $25,000 (1996 dollars).

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

  -- the EITC credit rate exceeds 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, and H.R. 831. The Administration has taken other administrative actions to improve and strengthen the integrity of the EITC.

CURRENT LAW

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 credit 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 credit was increased from 25 cents to 40 cents.

  -- The maximum credit was increased by nearly $1,500.
  -- Eligibility for the credit was extended to families with two or more children that have incomes of up to $28,524 (or about $3,000 above the prior law level).[1]

- 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.

[1] Some critics of the program have argued that the EITC should not be available to families with incomes of $28,500. 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, raising the marginal tax rate too high. 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 1996, the median income for a family of four will be nearly $50,000.

OBRA 1993 Achieved Goals of Program

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

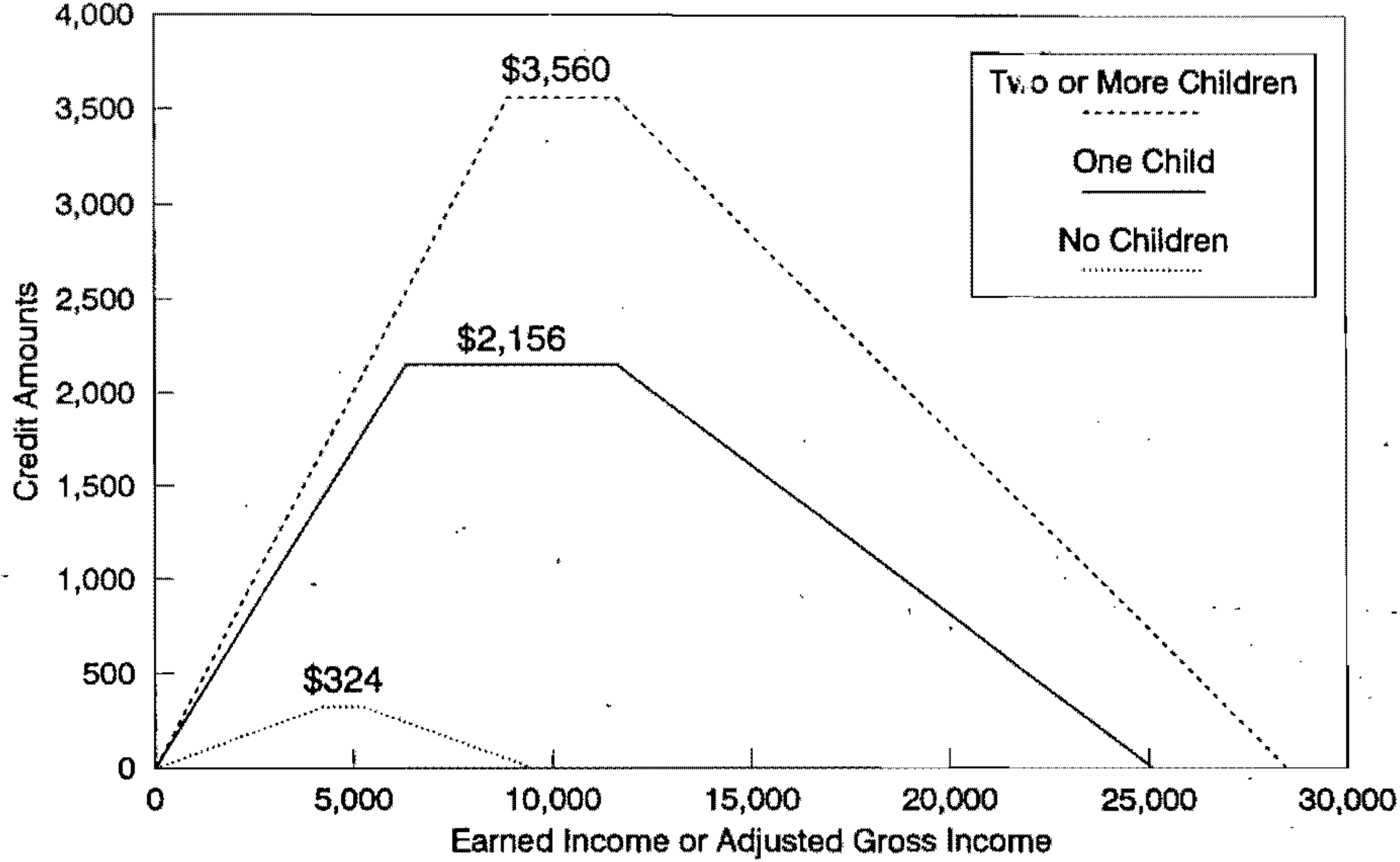
  -- From every added dollar a low-income family earns, payroll taxes take 15.3 cents while Food Stamp benefits decline by 24 cents. For a low-wage family with two children, the EITC fully offsets these effects by providing a 40 cent credit for every dollar earned.

- 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.

  -- Since the minimum wage has not kept pace with inflation, the job is not completed yet. That is one of the reasons that the President has proposed that the minimum wage be increased over two years by 90 cents.

- In addition, OBRA 1993 simplified the EITC by repealing the two complex supplemental credits for health insurance coverage and for taxpayers with children under the age of one.

The Earned Income Tax Credit, 1996



Earned Income Tax Credit: Number of Recipients and Average Credit

	Income Eligibility	Total Number of Recipients	Average Amount
Recipients with children			
Calendar Year 1994	up to $25,296	14.2 million	$1,371
Calendar Year 1995	up to $26,673*	14.8 million [illegible]	$1,589
Calendar Year 1996	up to $28,495*	14.8 million	$1,747
Calendar Year 1997	up to $29,261	15.1 million	$1,786
Calendar Year 1998	up to $30,124	15.4 million	$1,836
Calendar Year 1999	up to $30,997	15.6 million	$1,887
Calendar Year 2000	up to $31,859	15.9 million	$1,934
Calendar Year 2001	up to $32,751	16.2 million	$1,983
Calendar Year 2002	up to $33,682	16.5 million	$2,032
Recipients who do not reside with children			
Calendar Year 1994	up to $9,000	4.1 million	$170
Calendar Year 1995	up to $9,230	4.4 million [illegible]	$168
Calendar Year 1996	up to $9,500	4.3 million	$174
Calendar Year 1997	up to $9,750	4.3 million	$180
Calendar Year 1998	up to $10,040	4.4 million	$185
Calendar Year 1999	up to $10,330	4.4 million	$191
Calendar Year 2000	up to $10,620	4.4 million	$197
Calendar Year 2001	up to $10,920	4.4 million	$203
Calendar Year 2002	up to $11,230	4.4 million	$210

This # will differ from IRS figures. IRS figures show # of claimants; this is the estimate of recipients. I would prefer, if possible that you avoid 1994 # of taxpay (IRS will show about 15 million claimants in 1994.) No problem (for moment) with other years.

* with 2+ more children
for taxpayers with 1 child, the cut-off is $25,078 in 1996 ($24,396 in 1995).

Department of the Treasury
Office of Tax Analysis

Mar. 8, 1996

Note: Estimates reflect FY 1997 budget economic and technical assumptions.

EITC Growth Rate

- Some have claimed that EITC growth is "explosive" or "out of control."

- The EITC is growing as it was designed to grow because of expansions signed into law by Presidents Clinton, Bush, and Reagan. As soon as those expansions are fully phased in, the rapid growth in the EITC will cease.

  -- After 1997, EITC costs will grow in tandem with inflation and population growth.

CBO Lowers Estimates of EITC Costs

- In its mid-session review of the budget (released on August 25, 1995), CBO lowered its estimate of EITC outlays by $17.7 billion between FY 1996 and 2002.

- According to CBO, these revisions are necessary because "EITC spending has been lower than expected this year, possibly as a result of a recent crackdown by the Internal Revenue Service on fraudulent claims."

  -- The revisions also reflect the passage of H.R. 831, which contained a modified version of the Administration's proposal to impose a cap on the amount of interest and dividend income received by EITC claimants. This proposal improved the targeting of the EITC to the most needy families.

ERROR RATES

Incorrect Statements about Error Rates

- Some in Congress are using the issue of error rates to justify deep cuts in the EITC--which are big tax hikes for working families. For example, some have claimed that a preliminary IRS study shows that 35 percent to 45 percent of EITC payments are made erroneously.

- These statements are incorrect. Preliminary data from a small IRS study found that about 26 cents of every dollar claimed exceeded the proper amount -- **but even this number does not represent the EITC today**. Any use of the preliminary study to make broad claims about error rates depends on outdated information and misinterpreted data.

1. Outdated Information. The study is based on outdated information (1993 returns filed in January 1994) and takes into account virtually none of the **12** aggressive Administration steps to cut the error rate (outlined below) that are now in place or the 5 additional Administration proposals which are pending Congressional action. (Taking into account only 3 of those 17 steps reduces the error rate estimate to 19 percent.)

2. Misinterpreted Data. The study measures amounts claimed, not amounts paid out after IRS enforcement. In addition:

   -- The study is limited to electronic filers who filed in the first two weeks of the tax filing season. These filers are not representative of the EITC population as a whole.

   -- Even if the study were up-to-date, the estimates refer to the percentage of returns with claims filed in error, not the percentage of benefits paid in error--the standard meaning of "error rate." Thus, this high figure is not correct or meaningful as a measure of error rates today.

More Misconceptions about Error Rates

- Some say that no other part of the tax code has as many errors as the EITC.

    -- In 1992, IRS estimated that for all non-farm self-employed individuals, the gross tax gap--the gap between the amount of tax owed and the amount voluntarily paid--was $37.2 billion.

    -- That is <u>more than the entire EITC in 1996.</u>

- Some say that all of the errors in the EITC are due to fraud.

    -- In fact, a large share of the errors are unintentional--resulting from the ordinary mistakes that taxpayers make on all kinds of tax returns.

17 ADMINISTRATION MEASURES AND PROPOSALS TO IMPROVE THE EITC AND REDUCE ERROR RATES

Simplicity and Verifiability

- The Clinton Administration recognizes that error rates are a problem and has acted aggressively to reduce them.

- Specifically, the Clinton Administration is committed to structuring the EITC so that deserving and eligible individuals--and only those individuals--are able to claim and receive the EITC.

- Two key means to this end are the simplicity and verifiability of EITC claims.

  -- If eligibility rules are simple, taxpayers can more accurately claim the EITC and avoid costly errors.

  -- If eligibility rules are verifiable, the IRS can better ensure that the EITC is paid only to those who are eligible.

- The Administration has taken 12 measures to ensure the simplicity and verifiability of the EITC and to reduce erroneous or undeserved claims. The Administration has also proposed, and is waiting for Congressional action, on 5 additional steps to improve the EITC.

OBRA 1993

1. The EITC was simplified by repealing the complex supplemental credit for health insurance coverage.

   -- Some taxpayers made mistakes in their claims because they did not understand the complicated eligibility criteria.

2. The EITC was further simplified by repealing the supplemental credit for children under the age of one.

   -- This should also improve EITC compliance, as taxpayers could not understand the eligibility criteria for the young child credit, and the rules were difficult to administer.

Uruguay Round Agreement Act of 1994

3. The EITC was denied to nonresident aliens.

   -- Under prior law, nonresident aliens could receive the EITC based on their earnings in the United States, even though they are not required to report their worldwide income to the IRS.

4. Prisoners will not be eligible for the EITC based on their earnings while incarcerated.

   -- The EITC was never paid to prisoners, and this ensures that it will not be paid to them, now or in the future.

5. Taxpayers will be required to provide a taxpayer identification number for each EITC qualifying child, regardless of age.

   -- This will allow the IRS to verify eligibility for each child claimed by the taxpayer.

6. The Department of Defense is required to report to both the IRS and military personnel non-taxable earned income paid during the year that is included in computing the EITC.

   -- This will ensure that military personnel receive the benefit for which they are eligible.

H.R. 831

7. The recent bill extending the health insurance deduction for self-employed individuals included a variation of a Clinton Administration proposal to deny the EITC to taxpayers with $2,500 of taxable interest and dividends. Many of these taxpayers have significant assets and do not need the EITC.

    -- Under H.R. 831, the EITC will be denied to taxpayers with investment income in excess of $2,350. The investment income cap is not indexed, as the Administration has proposed.

Verifying and Delaying Questionable Refunds

8. The IRS has instituted a series of tough new administrative measures to reduce error and fraud in the EITC. The IRS now scrutinizes the social security numbers of all EITC qualifying children.

    -- Children's social security numbers are checked to make sure the numbers are valid, and no child is claimed more than once.

    -- Last year, the IRS only validated the social security numbers of children claimed on EITC returns filed electronically. This year, the IRS is tightening its validation tests and checking all returns--whether they are filed electronically or on paper.

    -- Refunds on returns with missing, invalid, or duplicate social security numbers will be delayed, while the IRS investigates further.

9. EITC refunds may also be delayed if the IRS has questions regarding the validity of the claim.

    -- Certain taxpayers will be required to provide additional documentation to verify that their EITC claim is valid before the credit is awarded.

During the 1995 filing season, the IRS delayed refund checks to 7.4 million filers as a consequence of these two actions. Matching social security numbers has also had a major effect in deterring people from filing illegitimate claims. Through July, 1995, the number of EITC claimants with children has fallen by 143,000 relative to last year.

Intensifying Scrutiny of Electronic Return Originators

10. Beginning with the 1995 filing season, the IRS is no longer providing direct deposit indicators (DDIs) to preparers of electronic returns (EROs). The DDIs gave preparers a quick signal from the IRS that a taxpayer was going to receive a refund check. Preparers used this information to advanced taxpayers loans on their refund checks within a couple days of filing a return. With the DDI, the taxpayer would receive a loan, and the IRS would pay the refund directly to the ERO. If the return was later determined to be fraudulent, the IRS -- not the preparer -- was left with the bill if the taxpayer disappeared with the refund anticipation loan.

-- Eliminating the DDI provides EROs with greater incentives to check the eligibility of EITC claimants. Preparers will not find it in their interest to advance refund anticipation loans to filers who may not be receiving a refund from the IRS.

-- In its enforcement activities, the IRS has also found that some EROs have been responsible for refund fraud. The IRS has taken several steps to stop this practice:

  -- Fingerprint and credit checks are conducted on certain new ERO applicants.

  -- IRS is conducting additional compliance checks to ensure that EROs are meeting new, stricter requirements for participation in the program. During the 1995 filing season, the IRS conduced <u>6,500</u> compliance checks.

  -- The IRS is working with the Justice Department to prosecute preparers and EROs who take advantage of the EITC to defraud the Federal government.

Preventive Actions

11. The 1994 Schedule EIC was shortened and simplified to make it easier for low-income taxpayers to understand if they are eligible for the credit.

12. Taxpayers were also warned on the cover of the 1994 tax return that they would be required to provide valid social security numbers for all dependents and EITC qualifying children.

    -- In December 1994, over 180,000 taxpayers who filed in 1994 with incorrect or invalid social security numbers received letters from the IRS alerting them to be more careful on their 1995 tax returns.

    -- IRS participated in extensive media campaigns before and during the filing season to emphasize the need for accurate SSNs.

Five Additional Proposals To Reduce Errors Still Pending

- The Administration submitted 5 additional proposals as part of the President's FY 1996 budget which are still pending final legislative action.

1. The EITC would be denied to undocumented workers.

2. The IRS would be authorized to use simpler and more efficient procedures when taxpayers fail to supply a valid social security number. Taxpayers entitled to the credit would have 60 days to provide a correct social security or, if they failed to do so, could refile with the correct information to obtain the EITC.

   In combination, these provisions would strengthen the IRS's ability to prevent erroneous refunds from being paid out. The proposals would improve the targeting of the EITC by providing the credit only to individuals who are authorized to work in the United States.

3. In June, the Administration proposed that the IRS be given the authority to use simpler procedures to assess EITC claimants for any outstanding self-employment tax liability. This proposal will reduce incentives to overreport income to obtain a larger EITC.

4. The FY 1996 budget for the IRS contains funding for the continuation of its tax systems modernization (TSM) program. TSM is vital to the long-run efficiency of the IRS's collection functions. TSM will enhance the IRS's ability to detect erroneous EITC claims.

5. Last year, the Administration also proposed State demonstration projects to provide alternative ways of delivering advanced payments of the EITC.

We hope that Congress will act on these five proposals soon.

PRESS ARTICLES

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Cross-Purposes

WELFARE REFORM, taken seriously, always had two sides. The side most discussed concerned the need to change the system to give welfare recipients skills to take into the marketplace, and ultimately to require some work in exchange for public assistance. But the other side of welfare reform was at least as important. It involved helping those among the poor who *already* worked, on the theory that if the working poor did not receive sufficient incomes and basic benefits, such as health insurance, there would be little incentive for them to stay in the work force—and also little incentive for those on welfare to leave the rolls. Rewarding the working poor was also a moral commitment, since it makes no sense for politicians to give endless sermons about the value of work only to ignore the struggles of those who work hard, every day, for very little.

Congress is getting all sides of the welfare reform equation wrong. The welfare bills passed in the House and Senate cut money the states will need if they are to provide for the most basic material needs of the poor and also put them to work. At the same time, Congress is moving to cut benefits that flow to the working poor.

At the heart of efforts to help the working poor is the clumsily named Earned Income Tax Credit. It lifts the incomes of poor people who work by offsetting the federal income taxes of those who earn enough to pay them and by providing some money directly to the poor who don't even earn that much. Even the second is really mostly a tax cut, since poor wage earners are burdened by Social Security payroll taxes. It makes no sense for the federal government to tax people into poverty, one reason why the EITC was warmly embraced by Ronald Reagan and once enjoyed support across almost every line of party and ideology. Now, the new congressional majority wants to cut the EITC—by an excessive $23 billion over seven years in the House and a truly outrageous $43 billion in the Senate. It's incomprehensible that a Congress claiming it wants to increase the incentives to work and to save proposes to do exactly the opposite where the working poor are concerned.

Similarly, as Judith Havemann and Barbara Vobejda pointed out recently in The Post, cuts in Medicaid could reduce the number of children in working poor families who enjoy health coverage. And cuts in child care spending could have a completely strange effect: to move money away from the working poor and toward welfare recipients. This might enable some welfare recipients to work while forcing some who work back onto welfare. That can't make any sense. Surely it would be better for Congress to have a more consistent policy on child care that would help welfare recipients take jobs without penalizing poor people who already have them.

Critics of "the welfare state" said for years that government policy was doing too little to honor and reward work. Programs for the working poor were created partly in response to that criticism, and rightly so. Cutting such programs would make the welfare state no better and the lives of many people who work hard much worse.

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Cutting Tax Credit Means Much to Those With Little

By SARA RIMER

In Washington, the Senate Republicans say their plan to curb a tax credit for the working poor will save $42 billion by the year 2002.

Carolann Robbins, of Providence, R.I., says she cannot comprehend $42 billion. To Ms. Robbins, an administrative assistant who is raising two children alone, $1,800 is a lot of money. That is how much she got last year through the earned-income tax credit that the Republicans want to cut.

Signed into law by President Gerald R. Ford 20 years ago with bipartisan support, the credit was created to ease the burden of rising Social Security taxes for the working poor, and to provide an incentive to work. In Ms. Robbins's case, the program did as it was intended.

"When I first heard about it, I said, 'This is for poor people, I don't want to mooch in on that,'" said Ms. Robbins, who last year earned $16,000 — about $4,000 more than the poverty level for a family of three. "I don't think the Federal Government owes this to me. You're supposed to try and make it on your own."

But she says she used $800 of the credit to impose her own household budget cuts. With the money for a security deposit, utility down payments and a U-Haul, she moved her family from a $725-a-month apartment into one with a monthly rent of $495.

With the remaining $1,000 of the credit, she bought a used car — a 1986 Mercury Topaz with 80,000 miles on it — so that she could widen her search for a better job by driving to interviews beyond the area served by public transportation.

Ms. Robbins recently started a new job, as a $13.70-an-hour administrative assistant for an advertising agency. Her annual salary will be about $28,500 — too much for her to qualify for the earned-income tax credit next year.

"The earned-income tax credit really gives you a boost," she said. "If you use it properly, you can go up a few steps."

For the Republicans in Washington, their 1996 budget is all aggregate numbers — $245 billion in tax cuts, $270 billion in reduced Medicare financing, $182 billion in Medicaid cuts, $100 billion saved through changes in welfare and other low-income benefit programs.

The numbers say little, though, about the people whose lives would change if all the proposals are enacted. Carolann Robbins and her children were among the nearly 15 million families and 4.5 million childless workers who received earned-income tax credits last year that averaged $1,300. People earning as much as $25,296 in 1994 could get some credit and families with two children and an income of less than $11,200 got the maximum credit of $2,528. The program cost more than $20 billion last year.

The program, which has long enjoyed bipartisan support, was expanded in 1993 under President Clinton, in 1990 under President George Bush and in 1986 under President Ronald Reagan. President Reagan called the program "the best antipoverty, the best pro-family, the best job creation measure to come out of Congress."

But Republicans in Congress have said the program is rife with fraud — although the Internal Revenue Service has said it has significantly cracked down on fraud. Opponents have also said the program discourages people from working to raise their incomes and that its rules do not take all sources of income into account.

Some recipients use their money to buy televisions, said Senator Don Nickles, an Oklahoma Republican.

"This is the most abused program in government," said Senator Nickles, who is one of the major opponents of the credit, adding, "This program has expanded beyond anybody's imagination."

According to the Treasury Department, under the proposed cuts, 17 million households would lose an average of $281 in 1996; by 2005, the loss would average $457. The average reductions would be largest for families with two or more children. They would lose an average of $372 next year and larger amounts in subsequent years, according to the department.

The Administration has said that about 35 percent of all families with children receive benefits from the credit. By 2005, more than one of every five of them would become ineligible under the Republican plan.

The credit that Carolann Robbins has counted on has drawn far less attention than more popular programs like Medicare. There are no armies of lobbyists or service providers behind the tax credit. There are no agencies filled with recipients waiting to collect their checks.

The Internal Revenue Service administers the earned-income tax credit. Workers apply for it when they file their tax returns. If they qualify, they get a tax reduction or a check if the credit exceeds the tax they owe.

In telephone interviews, tax credit recipients around the country — located through the nonprofit Center

Cont 11

Tax Credit

on Budget and Policy Priorities in Washington, which strongly supports the credit — said they used the money for everything from medical bills to eyeglasses to day care to school supplies for their children.

For them, the money received from the tax credit can mean the difference between making it on their own — or not.

A 36-year-old woman in Somerville, Mass., who spoke on the condition that she not be identified, got a $44 tax credit last year. "I bought a week's worth of groceries," said the woman, who has kidney disease and is on dialysis. She receives $653-a-month in Social Security disability payments, and works part time as a $5-an-hour baby sitter.

Under the proposed cuts, the woman would not receive any credit next year: All childless workers would be eliminated from the program.

In Revere, Mass., Edna Vincente, a $19,000-a-year program assistant for a day-care agency, says she put last year's $2,000 tax credit into parochial school tuition for her two daughters, ages 6 and 10. She was able to get a break on the tuition by agreeing to help out with bingo games and other school fund-raisers, she said.

Eric Martin, 25, says he earned $11,000 last year as a plumber's helper in Erie, Pa. His wife, Lynn, who just returned to work after giving birth to their third child last month, works 24 hours a week as a $4.45-an-hour price coordinator at the Giant Eagle supermarket.

The family got a $2,650 credit last year, Mr. Martin said. He said they used it to cover medical bills, which had gone unpaid since neither he nor his wife receive medical benefits.

In Baton Rouge, La., Carolyn Roberts, 25, earned $13,600 last year as a secretary. She said she and her two daughters, ages 10 and 2, had been homeless since she and her husband separated last year, and had been shuttling from one friend's house to another. She said she had used her $2,500 credit to move her family into a $250-a-month apartment.

"We were waiting on that check," Ms. Roberts said in a telephone interview. "I went out that day and got an apartment. I was just so happy. I cried."

Like the other recipients who were interviewed, Ms. Roberts said she did not know much about the Federal budget. She said she worried about her own budget, for which she would get $359 less in 1996 under the Republican Senate proposal, according to Center on Budget and Policy Priorities.

"You borrow from Peter to pay Paul, and sometimes you forget about both of them," she said.

She pays $120-a-month for health insurance. Her furniture was donated through a Catholic agency, she said. She does not have credit cards, or cable television, she said. Her mother makes the family's clothes — and buys shoes for her granddaughters, Ms. Roberts said.

Two months ago, Ms. Roberts took a second job, as a waitress on the late shift at the Texas Club, making about $300 last month. "I want a house," she said. "We save our dimes in a pickle jar."

Diane Lewis, who is raising her 9-year-old son alone, earned $20,000 last year as a hunger outreach worker in Hartford. "I got a lot of money back last year," she said of her credit in a telephone interview. "I got about $1,000."

She said most of the money went to pay her gas bill, after she made do without gas for eight months, preparing meals in a $100 microwave oven, which she also used to boil water to bathe her son.

"I paid in person the day I got the check," said Ms. Lewis, 30, a former welfare recipient. "They turned on the gas a couple days later. It was great."

Ms. Lewis said she used $70 of the credit to send her son to a two-week summer camp in Andover, Conn.

Next year, even without the proposed cuts, she will not qualify for the tax credit. Ms. Lewis said she recently received a $6,000 raise, intended to cover the cost of medical benefits.

"I don't qualify for anything now," she said. "Not a medical card, not food stamps, nothing."

"I tell my co-workers 'I'm middle class now,'" she said proudly. "When they're looking for someone to participate in a forum for low-income people I tell them I can't do it anymore."

A21

Robert J. Samuelson

Pouncing on the Working Poor

The Republicans have a split personality. At times, they are principled and bold, striving to make government live within its means even at the risk of being unpopular. They challenge farm spending and Medicare. But at other times, they are simply mean and petty, rewarding friends and punishing anyone else. A case in point is the plan to reduce the Earned Income Tax Credit (EITC), a measure that provides tax relief for the working poor and, until now, had enjoyed wide bipartisan support.

For good reason. Put simply, the EITC makes sense. It mainly allows low-income workers to keep more of what they earn from work. Through income tax refunds, it returns Social Security payroll taxes (now 15.3 percent of wages) and offsets excise and sales taxes. It rewards work and discourages welfare. In 1996 the EITC would cost the government about $25 billion. Two-thirds of the benefits would go to those with incomes under $20,000, and most of the rest would go to those with incomes under $25,000.

To raise taxes on these workers is genuinely hard-hearted. The Republicans are right to reexamine welfare and Medicaid; these programs haven't reduced long-term poverty and dependency. But the EITC ought to be wildly popular with conservatives. It cuts taxes. It promotes self-sufficiency and self-respect. It doesn't dictate to beneficiaries how to spend their money—whether on food, rent or toys. Politically, it substitutes for misguided increases in the minimum wage.

In fairness, the Republicans wouldn't kill the EITC outright. They would merely make it more stingy. Created in 1975, the EITC was expanded significantly in 1986, 1990 and 1993. The Republicans can cite "policy" reasons for reversing some of this liberalization, but the real reasons are political. First, poor workers aren't Republicans, and the proposed changes are technical and obscure. Who cares? Not Republicans, it seems.

Second, Republicans are desperate to find revenues to balance the budget and provide $245 billion in tax cuts over seven years (1996-2002). The House Ways and Means Committee would cut the EITC $23 billion over seven years; the plan now being considered by the Senate Finance Committee involves cuts exceeding $40 billion. In effect, Republicans are raising taxes for poorer workers so that taxes for higher-income workers can be lowered. Perhaps this is good politics; it is lousy social policy.

True, the EITC isn't perfect; no government program is. One complaint is that it has spawned widespread fraud. But the worst abuses have been curbed, argues Robert Greenstein, head of the Center on Budget and Policy Priorities, an advocacy group. The most costly scam involved the submission of tax forms with phony Social Security numbers. The IRS is now verifying Social Security numbers before issuing refunds. One sign that the anti-fraud measures are working is that the Congressional Budget Office recently reduced its estimate of the EITC's cost.

Another problem is one that affects many programs for the poor. It involves a question: How fast, as peoples' incomes rise, should benefits be reduced? If the EITC is abruptly ended at a given income level, then recipients are discouraged from earning more money. Most extra earnings are offset by a loss of the tax credit. Consider: In 1996 the maximum tax credit would be $3,564 for a parent with two children under 18; this credit applies to those with incomes between $8,910 and $11,630. If each dollar earned above $11,630 triggers a dollar's loss of the credit, recipients would face a huge disincentive to work more.

The solution has been to reduce the EITC gradually. No more than 21 cents of each extra dollar of earnings is lost from a lower EITC. But

cont

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Working

the phase-out means that, in small amounts, the EITC benefits workers with incomes up to $28,553 in 1996. Absurd, say Republicans. That's well above any definition of poverty. So, the Republicans would phase out the EITC faster. With other changes, the Senate Finance Committee plan would increase taxes an average of $372 in 1996 for 7.4 million two-child families, estimates the Clinton administration. By 2005, a fifth of families eligible under present law would lose the EITC.

The Republicans act as if supply-side economics (lower tax rates spur work and investment) is okay for the wealthy but not for the near poor. The Republicans are simply wrong when they say that most of these workers are being subsidized by the EITC. At the very lowest levels, this is true: The refund exceeds income, payroll and excise taxes. But the effect disappears at $12,000 to $15,000 of income (depending on the number of children in the family) and, beyond that, the EITC merely reduces the tax burden.

Work is still the best anti-poverty program. Of workers with full-time, year-round jobs, less than 3 percent have incomes below the poverty line. In some ways, the EITC is too narrow even now. It barely applies to workers without children, and the Republicans would eliminate this part of the credit altogether. It's as if they don't believe single workers can be poor or that, by promoting better work habits among young men, the EITC might foster more stable future marriages.

Naturally, the Republicans deny they're being cruel. In practice, they say, their proposed family income credit of $500 per child would offset any loss from a stingier EITC. There are two responses to this. First, it's not yet clear whether the credit will actually be enacted; and second, if it is, Republicans shouldn't—relatively speaking—discriminate against low-income families by withdrawing an existing tax benefit.

Of course, people at some point have to pay for government through taxes; and of course, the EITC should constantly be reviewed for flaws and abuses. But trimming it now is the wrong tax increase on the wrong people at the wrong time. Beyond being bad policy, it also strips the Republicans of valuable moral authority—the public perception that they're being "fair" in overhauling government. Once that's gone, Republicans will find it harder to make needed, but unpopular, changes. They are at war with themselves and, all too often, their worst impulses prevail.

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11/21/95

David S. Broder

So Much for Fairness

The Republican Revolution in Congress is dropping its cloak of fairness faster than the trees on Capitol Hill are shedding their leaves. Last week almost all pretense of equality in sharing the burden of budget cutbacks disappeared.

While one House committee called for the abolition of the Medicaid program of health care for the aged, the indigent and the disabled, another took a whack out of what President Reagan and many others had called the most effective and incentive-building device for bolstering the income of the working poor.

It would be pleasant to pretend that these are oddities, but the accumulating evidence points clearly to the conclusion that Republicans, who love to accuse their opponents of practicing "class warfare," are really sticking it to the economically struggling families of America. I'll come back to that bigger pattern another day, but let's focus for now on one example that captures the whole sad picture.

Twenty years ago, President Ford signed into law the first bill creating the Earned Income Tax Credit (EITC), which basically gives low-income workers modest help by refunding some or all of the taxes they pay, or, if their wages are very low, writing them a small government check.

the EITC benefit. It's also a device for helping workers stay above the poverty line. Today, some 20 million workers are getting tax credits averaging about $25 a week. The credit ranges from 7 cents to 40 cents per dollar earned, phasing down as you approach the top limit and ending for most families when earnings reach between $500 and $600 a week. It costs about $28 billion this year, and all but $1.5 billion of that goes to families making less than $2,500 a month.

President Reagan in 1986 called the EITC "the best antipoverty, the best pro-family, the best job creation measure to come out of Congress." Arguing against a boost in the minimum wage earlier this year, House Majority Leader Dick Armey (R-Tex.) said that "a direct subsidy like the Earned Income Tax Credit is a more compassionate means of assisting low-income families."

But last week, with minimum debate and on a party-line vote, the House Ways and Means Committee's Republican majority decided to reduce or eliminate the EITC benefits for two-thirds of the working poor who now get help from the program, in order to save $23 billion over the next seven years. Populist conservatives such as Armey and House Budget Committee Chairman John Kasich (R-Ohio) who claim the

mittee Republicans upped the ante to at least $40 billion.

Republicans talk a lot about "providing incentives." The rationale for their plan to cut capital gains taxes is that the top-bracket taxpayers, who will receive most of the direct benefits of that cut, need more incentives to save and invest. Letting them keep more from their stock market and real estate deals will do that.

But when it comes to the working poor, the Republicans apparently decided that incentives aren't really that important. Their plan phases out EITC benefits faster than current law, and thereby reduces the work incentives for more than 9 million families in the House version and 11 million in the Senate bill.

It eliminates the EITC entirely for childless workers, knocking out 4 million people making between $350 and $750 a month who otherwise would have received an average benefit of $15 a month and a maximum of $27 a month.

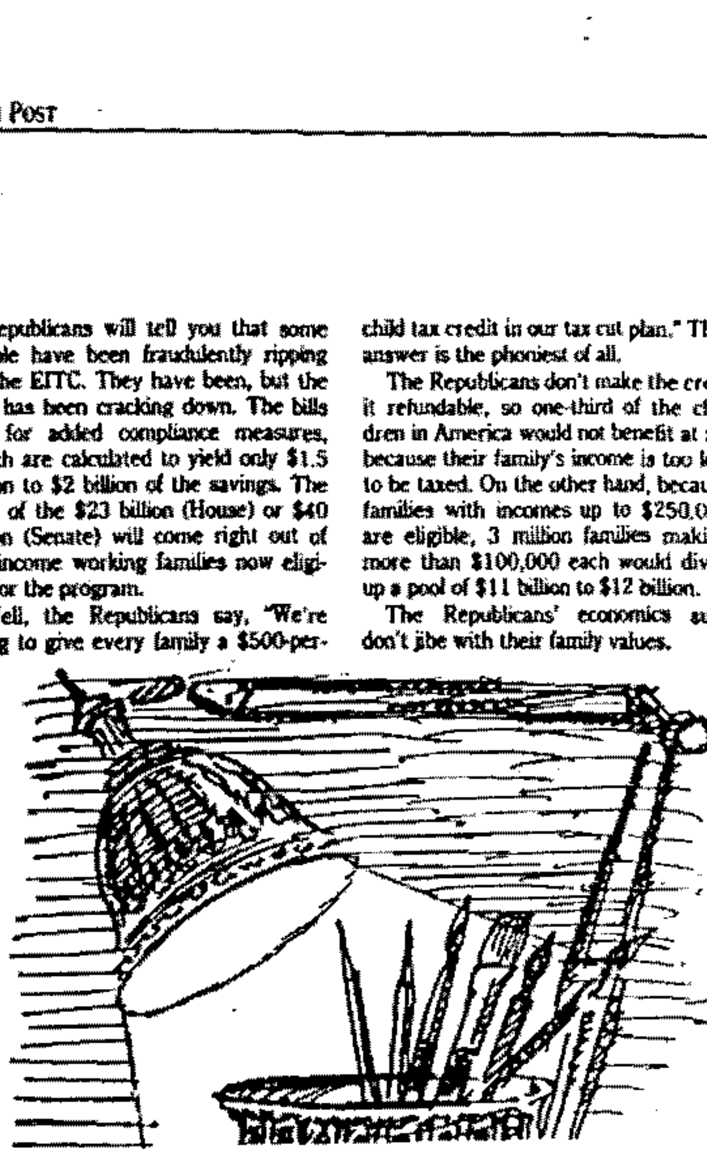
The Republicans say the EITC benefits should go "only to those families with qualifying children." Ask yourself if you have ever heard a Republican argue that capital gains tax cuts should go "only to those families with qualifying children." The wealthy retirees living off their investment income at their favor-

Republicans will tell you that some people have been fraudulently ripping off the EITC. They have been, but the IRS has been cracking down. The bills call for added compliance measures, which are calculated to yield only $1.5 billion to $2 billion of the savings. The bulk of the $23 billion (House) or $40 billion (Senate) will come right out of low-income working families now eligible for the program.

Well, the Republicans say, "We're going to give every family a $500-per-child tax credit in our tax cut plan." That answer is the phoniest of all.

The Republicans don't make the cred it refundable, so one-third of the chil dren in America would not benefit at all, because their family's income is too low to be taxed. On the other hand, because families with incomes up to $250,000 are eligible, 3 million families making more than $100,000 each would divvy up a pool of $11 billion to $12 billion.

The Republicans' economics sure don't jibe with their family values.



THE WALL STREET JOURNAL THURSDAY, SEPTEMBER 28, 1995

A21

The GOP on the Working Poor: Let Them Eat Cake

Politics & People

By Albert R. Hunt

The House has approved the Contract for America's call to restore a $30 billion tax break for more affluent Social Security recipients, while Senate Republicans move to ensure that a $500-a-child tax credit is available to all families making more than $200,000.

Simultaneously, the House Ways and Means Committee has endorsed a $23 billion cut in the earned income tax credit for the working poor—tantamount to a hefty tax hike for that group. Senate Republicans hope to whack these low income families even more, with cutbacks of $41 billion in the EITC over the next seven years.

Republicans work themselves into a lather when they see Democrats demogoguing against the rich. Bob Dole rants about the Clinton administration's "constant appeal to envy and class warfare." Influential Sen. Don Nickles (R., Okla.) insists any cap on the $500 child credit is class warfare.

But class warfare is fine to these politicians if it's directed at have-nots, who include the working poor. Senate Finance Committee Chairman William Roth, for example, describes the EITC as a "boon for tax cheats and rip-off artists."

This juxtaposition of pushing tax measures, with little economic or social rationale, that benefit small groups of affluent taxpayers while using the working poor as the front line in the battle to balance the budget has prompted White House Chief of Staff Leon Panetta to talk about the GOP's "Marie Antoinette" tax approach.

The two-decade-old EITC, which gives low income workers a credit against taxes—income, payroll or sales—has long enjoyed Republican support. Many conservatives hail it as far preferable to the minimum wage or other government subsidies; since the EITC goes only to those who work, it is seen as a genuine antidote to welfare. As recently as this February, the EITC was praised by House Majority Leader Dick Armey—no bleeding heart—for "rewarding work . . . without destroying jobs."

But the program, which has grown to $23.3 billion this year, was just too appetizing when congressional Republicans looked for cuts to meet their other promises. To do this and to meet the demands of conservative populists, like John Kasich, to attack corporate welfare, House Ways and Means Committee Chairman Bill Archer vowed to close corporate tax loopholes. The upshot: Of the $38 billion of net tax revenue gain over the next seven years, 60% of it comes from the working poor by paring back the EITC. Apparently, to Mr. Archer, corporate welfare includes $17,000-a-year working families.

To justify this hypocrisy, the Republican National Committee recently put out "talking points," charging this is an out-of-control program with skyrocketing costs and widespread fraud.

Bob Greenstein of the liberal but highly reliable Center on Budget and Policy Priorities, picks these charges to pieces. —

The contention that this is, as Sen. Nickles says, "the most out of control entitlement we have" is nonsense. Costs have soared because Congress, usually with the support of many GOP members and the past two Republican Presidents, three times in the past decade voted to expand the benefits for this successful program. After these mandated expansions are over, starting next year, the EITC will grow at a 4% clip for the next eight years, or considerably less than the 6.9% projected annual growth for entitlements overall.

CcRf

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GOP

This isn't Medicare or Medicaid.

It's undeniable that the EITC was rife with fraud. But the Internal Revenue Service has successfully cracked down on a lot if it and the fraud rate is dropping sharply. Moreover, as Mr. Greenstein notes, only 7% of the proposed cuts in the House and only 4% of those in the Senate are aimed at curbing fraud; the rest—roughly 95%—are real cutbacks, affecting more than 10 million working poor families with more than 20 million children.

Other Republicans charge the credit is a disincentive to work; while exaggerated considerably, there's a little to this. But Mr. Greenstein conclusively points out this primarily affects wives in two-earner families who, largely because of the EITC, stop working to spend time with their children. Doesn't that promote family values?

Reverse Robin Hood

[illegible] the Contract With America and the House Ways and Means Committee-approved [illegible]

	CURRENT LAW	GOP PROPOSAL	CURRENT LAW	GOP PROPOSAL
Adjusted gross income	$15,000	$15,000	$200,000	$200,000
Payroll tax:	2,295	2,295	12,017	12,017
Income tax before credits:	0	0	38,333	36,199
$500 child tax credit:	0	0	0	1,000
EITC:	2,842	2,776	0	0
NET CHANGE	+[illegible]		-$3,134	

Source: [illegible]

To see how this affects real people, take one Bob Greenstein-supplied example. A married couple, with one child, that earns $18,000 and pays $200 a month for child care would, under current law, next year have a tax liability, payroll and income, of $240. If the House Ways and Means Committee-approved cutbacks in the EITC were enacted, that tax bill would climb to $370; the couple would owe the government almost $830 more in taxes over the next seven years. Under the more onerous Senate provision, the tax hike would be closer to $1,700 over the next seven years.

Even some conservatives are dismayed. Rep. Thomas Petri, a Wisconsin Republican and long-time champion of the EITC, favors some reforms like denying the credit to childless couples. But these changes "go too far, especially in the Senate," he claims, and argues that the Republican-prized $500-a-child tax credit should be made refundable so it benefits working poor families too. Such families have no income tax liability but do pay regressive payroll and sales taxes.

Yet while Sen. Nickles is proposing to ensure this credit goes to families making more than $200,000, the GOP backtracked on making it refundable. As a result, one-third of American children would not be covered by this tax credit, hailed by groups like the Christian Coalition as the centerpiece of a pro-family policy.

The GOP legitimately assails some Democrats for playing the class warfare game. Soak-the-rich proposals usually are bad public policy and are dishonest in suggesting that reams of revenue can be gained to pay for other causes.

But today the Republicans are even more shamefully playing a reverse Robin Hood: While Republicans plan a more than $200 billion tax cut, the latest Treasury distribution figures show that if the EITC is cut back, those making less than $10,000 a year would actually face a tax hike. As President Clinton said during a luncheon with reporters this week: "I don't believe it's a great idea to raise taxes on working families making $15,000 a year to lower taxes on me." Any dissenters on that?

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Senator D'Amato's Chance

The House leadership proposes to cut the earned-income tax credit — a Federal rebate to low-paid workers — by about $20 billion (or 15 percent) over seven years. The cuts would undermine the worthy policy of the Clinton Administration to "make work pay" by using tax policy to assure that minimum-wage workers earn enough to lift their families out of poverty.

The House plan is misguided, but Senate Republicans are considering something far worse. William Roth Jr., the new chairman of the Finance Committee, proposes whacking over $60 billion out of the tax credit. That would devastate the smartest anti-poverty weapon Congress has ever devised.

The credit will add up to $3,560 next year to the take-home pay of low-wage workers. The credit will be phased out for families earning more than $11,620. The House G.O.P. proposes to include, for the first time, Social Security income as part of a family's earnings. On its own that may appear to be a reasonable provision. But it really puts the Republicans in the callous position of advocating lower taxes on Social Security income for non-poor elderly and higher such taxes on the working poor. The House proposal would end the credit for four million childless workers and phase out the credit faster as a worker's income rises, thereby discouraging workers from going after higher-paying jo

What Mr. Roth has in mind is even worse th the House proposal. Under current law, the inco threshold at which the credit begins to phase ou adjusted for inflation. Under Mr. Roth's propos inflation protection would be stripped away, red ing millions of additional working Americans poverty-level incomes. He would also reduce size of the credit. The Center on Budget and Pol Priorities, a liberal advocacy group, calculates t a family with two children earning $15,000 wo under the Roth plan, pay about $1,750 more in ta by the year 2002.

If that same family lives in New York St however, its predicament would be far worse. Ta would rise by more than $2,000 in 2002. Here i chance for Alfonse D'Amato, New York's Repu can Senator on the Finance Committee, to def the state's economic interests by protecting the credit from the deep cuts favored by Senator R

Almost one million New York families dep on the credit to stay out of poverty. Every on these families includes someone who works. Republicans are supposed to be the party t encourages work. But they have come up wit plan to tax away the incentive to chose employm over welfare.

The Washington Post

AN INDEPENDENT NEWSPAPER

Making the Wrong People Pay

IN THEIR search for funds to balance the budget and carry out the rest of their agenda, the congressional Republicans seem about to make substantial cuts in the main form of federal support for the working poor. It's the wrong cupboard to be opening, absolutely the last place they ought to be looking for the large amounts of money they still need for their other purposes.

The people who benefit from the earned-income tax credit, as the aid is called, are the ones the politicians of all persuasions are always rightly saying the government ought to help the most. They're mainly lower-income working families with children who are playing by the rules, trying not to rely on handouts but to be self-supporting. It's an uphill fight; they mostly work in the reaches of the economy where wages have been weak in recent years, in part because the value of the minimum wage has been allowed to decline. Instead of increasing the wage, Congress has increased the credit on grounds that it was the better targeted and more efficient way of rewarding work. Both parties concurred in the increases; George Bush signed one, Bill Clinton another. Does the government now back away from the credit as well?

The credit serves to increase not actual wages but take-home pay by reducing the income taxes that eligible families owe. If their incomes are so low that they owe no taxes, they receive the benefit as a direct payment. The amounts aren't large, but they're large enough to make an enormous difference to the families involved. The maximum credit this year for a family with one child is $2,100; the most the family can make and still get that is about $11,600 a year, after which the benefit tails off. A family with more than one child is eligible for about $1,900 more. The amounts are indexed; the current cost to the Treasury of the obscure but powerful mechanism is about $25 billion a year.

Like any large-scale federal program, it could be tightened a little around the edges. In the last two years it already has been, in part to combat what had become a problem with fraud. The new proposals in the Senate particularly go beyond a tightening-up. Both the House Ways and Means and Senate Finance committees are short of the vast amounts they need to meet their obligations under the congressional budget resolution. To help in making up the difference, Ways and Means Chairman Bill Archer announced last week that he would try to extract more than $20 billion from the earned-income program over the next seven years. Not all beneficiaries would be affected alike, but overall the proposal would amount to a cut of about 10 percent—and that's the least that seems likely.

New Finance Committee Chairman William Roth is co-sponsor of a bill to take three times that, in part by cutting out indexation. By the seventh year, his proposal would reduce the value of the credit by more than half. The Republicans are opposed to tax increases but here propose what would amount to a sizable tax increase for low-wage people only. It's wrong. A Congress struggling to pass a welfare bill that emphasizes the value of work would here reduce the take-home value of working. That's wrong, too. The budget ought to be balanced on other backs than these.

Republican Senator and Two of His Constituent Illustrate Debate on Tax Break for Working Poo

By DANA MILBANK
Staff Reporter of THE WALL STREET JOURNAL

WILMINGTON, Del. — To Republican Sen. William Roth, the major federal program to aid the working poor is a disaster. To his Delaware constituents Melinda Heck and Donna Bratton, it's a godsend.

Sen. Roth has introduced legislation to make vast cuts in the Earned Income Tax Credit, a tax break for low-income workers that until recently was hugely popular on both sides of the aisle. His two constituents receive the credit and stand to lose it. The views of these three people capsulize much of the current debate in Congress over whether the huge tax-credit program needs to be drastically overhauled.

Sen. William Roth

Ms. Heck, a recently divorced mother of three says she needs her $1,500-a-year credit for child care so she can keep her job, pay the mortgage and stay off welfare. "If I lose this, it could be the last straw," she says.

Ms. Bratton, another single mother, saves her annual credit of about $700 for when the pipes burst or the heating breaks in her mobile home and her $19,000 income won't cover it. "It's like being punished," she says. "I'm trying as hard as I can."

But to Mr. Roth, both are beneficiaries of a program gone awry. Their incomes, above the poverty line, are higher than those originally targeted. Recent and planned expansions of the credit have turned what was once a cushion against payroll taxes into the fastest-growing poverty program. Costs will hit $27 billion next year. Conservatives who have soured on the EITC say the growth has invited vast fraud and given money to the less needy.

"The program was basically to help the poor get off welfare and into meaningful jobs," Sen. Roth says. He declines to comment on Ms. Heck and Ms. Bratton. But "in these days of limited resources, we're trying to scale this back to help those it was intended to help," he says.

Sen. Roth's bill would take $66 billion out of the program over seven years, mostly by cutting off those at the top and ending inflation-indexing. Ms. Heck would lose her credit immediately under Mr. Roth's changes. Ms. Bratton would lose hers gradually. A smaller Senate proposal would cut $21 billion.

But even some conservatives worry about badly wounding a rare species: a

Melinda Heck and Family

welfare program that, on balance, succeeds. Only those who work qualify. The Center on Budget and Policy Priorities says the Roth bill would ultimately cut the program in half, amounting to a tax increase on 19 million of America's poorest working families. Most of these families, because they don't pay income tax, wouldn't benefit from a proposed $500-a-child credit.

Mr. Roth says the EITC is "probably the most abused program on the books," with fraud and error rates in the 30% to 40% range. This has been a huge problem because the Internal Revenue Service didn't check children's Social Security numbers and verify earnings. But after a clampdown this year, the IRS says violations are "rapidly approaching" the 14% to 17% of other tax programs.

That leaves the argument about whether the program is benefiting the right people. Because there's no test for assets, interest income or child support, Mr. Roth argues, the EITC "lacks a sense of fairness." The credit benefits thre groups: those earning less than $9,000 (fo a two-child family), who get an increasin credit for each dollar they earn; thos earning $9,000 to about $12,000, who get th maximum credit of $3,560; and those earn ing about $12,000 to $28,000, who receive a declining credit.

Just about everyone agrees the firs and second groups have a strong incentiv to work, and the cuts would have a smal ler impact on them. The dispute is over th third group—twice as large as the first—which has a slight disincentive to wor more and, arguably, may not need th money as much.

Drive up to Mindy Heck's $100,00 three-bedroom home in north Wilmingto and it seems to justify the complaints. Sh has a computer, a microwave, a refigera tor with an ice maker and two air cond tioners running. Since learning of th credit, she has amended old returns to ge more money. Her income—which she ask not be disclosed — puts her in the uppe EITC bracket. "I'm a borderline case," sh concedes. If her child-support income wer included it would boost her earnings 50 and keep her out of the program entirel Critics call excluding sizable support pay ments the "Ivana Trump loophole."

But look into her finances as she dis plays them on the kitchen table, an another story unfolds. She's 10 days lat with a mortgage payment but doesn't hav enough in the bank. Ms. Heck would hav lost the house since her divorce two year

cont. 7

Poor

ago if not for her mother, who has paid much of the mortgage and given her a station wagon to drive. Even so, Ms. Heck got into trouble with debt and had to have it restructured; she now has difficulty getting credit.

The family's furniture and clothing come from Goodwill Industries, where she works, bought with coupons she wins for hitting sales goals. She puts house-brand cereal in a Rice Krispies box so her kids think they're getting the real thing. "Another few dollars is life or death to me," she says.

The EITC, she says, averted disaster after her divorce. Her child support didn't cover her day-care costs of $400 a month for her three kids. Without the extra $1,500, she says, she couldn't afford the child care. "If I can't afford child care, I lose my job, lose the home, and I'm on mom's front porch," she says. "I'm getting to the point where maybe I can keep my house and keep my kids in day care without bouncing checks."

Still Needing the Credit

Some of Ms. Heck's co-workers at Goodwill make half as much as she does and are in the lower EITC bracket. But she figures she needs the credit just as much. "Maybe my house is in a nicer neighborhood, but I'm in the same boat," she says.

Working as a secretary in a Wilmington office park a few miles from Ms. Heck's home, Donna Bratton also thinks she should get the credit. Unlike Ms. Heck, Ms. Bratton freely concedes she could survive without her credit, which is all of $692 a year. But she feels she deserves it. "I'm not asking the government to give me anything I didn't earn," she says.

The proud Ms. Bratton, who has a three-year-old daughter, has never received welfare benefits and never expects to. Even with her credit, she still winds up giving the government money, not taking it. Her credit didn't offset Social Security taxes of $1,202 last year, Medicare taxes of $281 and hundreds in state taxes.

For her, the credit is like two extra weeks of pay each year. "To me, it's safe money in case of emergency, and there's always an emergency," she says. "For me the extra $60 a month means an extra week of day care or a new muffler and oil change, or two weeks of groceries, or if I have to call a plumber if the pipes burst."

Unlike Ms. Heck, Ms. Bratton gets no child support. But she — or people like her at the upper end of the EITC income limit — would be phased out of the program in the next few years.

Ms. Bratton finds laughable the senator's claim that the credit discourages her from working or getting married and encourages her to lie about income. "I work more to get more money — I don't have a job to get the credit," she says. She's struggling to reduce a few thousand dollars of credit-card debt and is paying off her car.

Ms. Bratton plans on marrying her boyfriend in a couple of years. Though it means losing her credit because of the EITC's "marriage disincentive," she isn't worried. "It's $692 vs. $17,000," she says, referring to his income. "I'd rather have him there."

Sen. Roth, she figures, is missing the point. "If the senators really want to know what's going on," she says, "they should make the money of a single parent."

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24 Sept. 95

THE WORKING POOR

Tax credit still vital

Congress wants to prey on the working poor with drastic reductions in an effective federal program to help families stay off welfare. Of all the choices about where to get cash for the federal till, going after the Earned Income Tax Credit is among the most foolish.

The credit assists the very people politicians of all stripes say should be helped. The credit goes to low-income Americans who try to be self-supporting in an economy where the minimum wage is not a living wage.

The credit increases take-home pay by reducing income taxes for eligible families according to an index of income and number of family members. If income is so low that a worker or family owes taxes, they receive a direct payment.

This Congress has decided on a budget that requires it to find massive amounts of savings to fund deficit reduction and puts tax cut priorities higher up the economic ladder. So the $25 billion a year that goes into the Earned Income Tax Credit became a target. The House version of an earned income credit reduction says it should shrink by 16 percent over seven years. The Senate wants to hack it by half.

In Minnesota, according to the Treasury, the credit helps almost 220,000 workers and their families, or 10.2 percent of taxpayers. In Wisconsin, almost 270,000 workers and their families, or 10.9 percent of taxpayers, use the credit. The Treasury estimates the Senate proposal would increase taxes in the year 2002 for more than 191,000 Minnesotans.

The credit also helps keep a promise. It was agreed during tax reform in 1986 not to use the tax code to push more people into poverty.

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For Those Most in Need of Tax Break, Guess What

Marie Cocco

BY NOW IT IS well established that congressional Republicans never met a tax break they didn't like. That is, unless it goes to people in low-wage jobs who are trying to stay off welfare. For those people, Congress has a surprise: They may well be the only Americans headed for a tax hike.

While they're busy crafting deep, retroactive tax cuts for investors, rewriting laws so that profitable corporations escape taxes and jockeying to give a $500-per-child credit to families with incomes of $200,000 and more, key Republican tax-writers are working to curtail the earned-income tax credit for the working poor.

Like other programs the New Wave Republicans are seeking to dismantle, the earned-income tax credit started out as one blessed by their own partisans. Its concept — that low-income families headed by workers shouldn't be pushed into poverty by taxes — was championed by none other than Ronald Reagan back when he was California governor.

The federal credit, a refund meant to offset income, payroll and excise taxes, was signed into law by Republican President Gerald Ford. President Reagan then expanded its reach in 1986, lifting 6 million families above the poverty line by ensuring that their federal taxes didn't push them below it. President George Bush, backed by conservative think tanks interested in promoting work and bolstering families, broadened it in 1990. And President Bill Clinton expanded it again in 1993.

Veronica Johnson, a 28-year-old single mother in Philadelphia, claimed the credit this year. Johnson grew up in a family on welfare. But since graduating from high school she has worked full-time at a day-care center. Last year, her income of about $13,000 from her assistant teacher's job allowed her to claim the earned-income credit. With the $1,000 check, she bought a bed, a dresser and clothes for her 21-month-old son, Seth.

"I'd rather be home with my son," she said in an interview. "But I make more money working than sitting home doing nothing." The tax credit, she said, has at times been spent on her son's shoes, food and other necessities. Without it, "he'd be doing without a lot of things. I'd hate to lose it."

Claiming that expenses for the credit are mushrooming "out of control" and that the program is riddled with error and fraud, Republicans are working to scale it back. The Senate included a rollback in its balanced-budget plan; House and Senate tax-writing committees are both under pressure to trim it back dramatically next month during work on the bill to provide huge tax cuts for many. The most far-reaching plan to curtail the credit is sponsored by Senate Finance Committee members William Roth (R-Del.) and Don Nickles (R-Okla.). Their potential hit: An average tax hike of $516 next year for a low-income family with two or more children.

Costs are indeed growing rapidly. But they are expected to level off once the 1993 changes are fully phased in.

Those expansions were meant to prepare for welfare reform that forces more poor families to work. Because welfare recipients stand to lose benefits — like food stamps and, eventually, Medicaid health insurance — the idea was to offset the losses and make work more attractive.

That unravels in the Roth-Nickles plan. It would freeze the size of the credit and stop indexing eligibility thresholds with inflation. So the "bracket creep" that used to push taxpayers into higher and higher brackets as inflation boosted their incomes would return, but only for the poorest taxpayers.

Those claiming the credit would have to report as income money that's not taxable for anyone else. Thus child support, certain pension benefits, tax-exempt interest and the non-taxable portion of Social Security would be counted in determining eligibility.

Nickles' tax aide, Hazen Marshall, said changes are needed to prevent fraud. But some reforms enacted by Congress and others already implemented by the Internal Revenue Service have reduced errors substantially. The IRS says "noncompliance" is now about 25 percent, the same as throughout the tax code.

Nickles, meanwhile, also has introduced a measure to give a $500-per-child tax credit to all families, lifting the $200,000 income limit even those wacky House Republicans had the sense to impose. But low-wage workers who don't make enough to pay income taxes wouldn't get it.

"I think families should be able to keep more of what they earn," Nickles says. That is, unless they happen to be poor.

NEW YORK NEWSDAY 8/17/95

A slap in the face for the working poor

WASHINGTON, DC

REAL bipartisan consensus on most issues is rare in Washington, rarer still on tax policy, and just about inconceivable when it comes to helping the poor. Which is why the earned-income tax credit (EITC) always seemed such a miracle. For two decades the left, right and centre all lauded the EITC, which uses the tax system to supplement the wages of poor and near-poor working families by up to $3,500 a year, as smart social policy and sensible economics. But with Republicans desperately scraping together cash to balance the budget, the party has abandoned sound consensus in favour of crass expediency: the EITC is on the chopping-block.

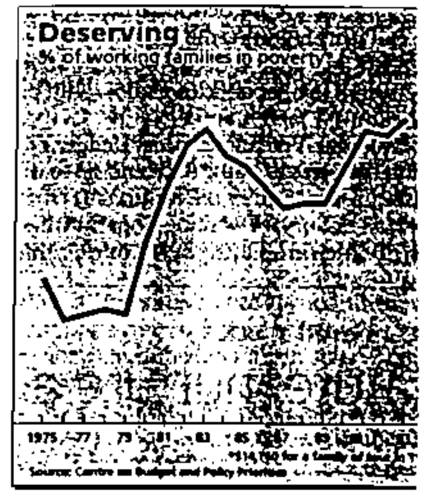
How crass? The concept behind the EITC was originally advanced in 1972 by California's then-governor, Ronald Reagan. A decade after it became law, Mr Reagan signed the first expansion of the EITC in 1986, calling it "the best anti-poverty, the best pro-family, the best job-creation measure to come out of Congress." In 1990 George Bush pushed through the second expansion, which was endorsed by the conservative Heritage Foundation. Together with enthusiastic Democrats (such as Bill Clinton, who signed the final expansion in 1993), Republicans turned the EITC into the federal government's main tool for helping the working poor.

Balanced-budget victim

The plight of that group was—and is—acute. Between 1977 and 1993, the poverty rate for working families with children rose from 7.7% to 11.4% (see chart). The main reason, most economists agree, has been the steady erosion of wages for low-paid work. Faced with this, conservatives embraced the EITC as a remedy which (a) has none of the job-destroying side-effects of raising the minimum wage; (b) creates an incentive to work rather than go on the dole; (c) helps intact families and not just—as with welfare—single mothers; and (d) requires no new bureaucracy. Meanwhile, liberals love the EITC because it furthers a cherished aim: raising every family of four with a full-time, full-year worker at least to the poverty line.

The scheme does all this by providing a refundable tax credit for every dollar earned up to a certain limit. The structure of the credit includes an up-slope, a plateau and a down-slope. For a family with two or more children, the credit reaches the $3,500 maximum when the family's income is $8,900. It then remains constant until the family's earnings hit $11,600, from which point it gradually declines to zero (for earnings of $27,000). After the last of the three expansions is fully phased in next year, the EITC will go to more than 21m workers and their families, at a cost of $25 billion.

Therein lies the rub. Led by Senators Judd Gregg of New Hampshire and Don Nickles of Oklahoma, Republicans claim, in Mr Nickles's words, that the EITC is the "fastest-growing welfare programme",



and that it suffers "massive" losses fr "fraud and error". Ostensibly on th grounds, and at the recommendation c task force chaired by Mr Gregg, Republic plan to cut the EITC by $21 billion o seven years. Mr Nickles wants to go furtl He is pushing a bill to slash the credit b staggering $120 billion between now a 2005.

Republicans use two main argument justify these plans. The first, that the EIT "out of control", is based on a fact: the p gramme has grown rapidly, by 300% si 1990. Yet this growth was the entirely p dictable result of the 1990 and 1993 exp sions, both of which received broad bipa san support in Congress. Once th expansions are fully phased in (next ye the programme's cost will not only flat but actually decline as a percentage of economy for the rest of the century.

Moreover, as Robert Greenstein of Centre on Budget and Policy Priori points out, the EITC's growth reflects a d sion by politicians of all stripes to m away from the minimum wage and from rect public assistance as a means of help the working poor. For instance, many sta which used to pay some welfare benefit single mothers who worked part-time longer do so. As a result, the average disp able income for a single mother of tw lower now in real terms than it was in 1 before the EITC was even created.

The second Republican argument cutting the EITC is that it is riddled v fraud. Again, there is truth here. A I study by the Internal Revenue Serv found that 26% of EITC benefits w claimed in error. But the IRS reckons t nearly half those errors were mistakes, fraud. And the 26% figure measures onl rant claims, not payments. Partly becaus such findings, the IRS has begun some sweeping changes to tighten up the system, which it estimates should push the error rate below 20%—and hence below the error rate for taxing capital income.

No doubt that rate is still too high, and more reforms are needed to reduce it further. But simply cutting the EITC will not accomplish that goal. Indeed, the most obvious effect of the Republican plans would be to chalk up a large number in the savings column of their balanced-budget ledger.

But the price of doing so would be to increase the tax burden on millions (14.4m, says the Treasury) of working-poor families, most of which are playing by the rules, while the party intends at the same time to offer a new tax credit to families earning as much as $250,000, whether or not they work. Meanwhile, cutting the EITC would undermine the efforts of Republican governors such as Tommy Thompson of Wisconsin and John Engler of Michigan, whose welfare-reform efforts rely on the EITC as part of the benefit package that makes work more attractive than the dole.

When Republicans say they are not balancing the budget on the backs of the poor, that they are serious about work-based welfare reform, and that their tax policies are not skewed to favour the rich, think of the EITC, and reach for the salt.

CLINTON DEFENDS INCOME TAX CREDIT AGAINST G.O.P. CUT

NEW POLITICAL OFFENSIVE

Republicans, Citing Abuses, Want to Curtail Program for the Working Poor

By TODD S. PURDUM

WASHINGTON, Sept. 18 — Casting himself as a defender of the working class and the American work ethic, President Clinton today sharply attacked Republican proposals to curb tax breaks for low-income families, warning that he might veto any such plan as "inconsistent with those basic, bedrock values this country should be standing for."

At the same time, Mr. Clinton praised the welfare overhaul efforts of Senate Republicans and said he believed Congress and the Administration would eventually compromise on an overall budget agreement, though probably not before the start of the next fiscal year on Oct. 1.

Mr. Clinton's comments, in a brief Oval Office interview with The New York Times suggested by the White House, amounted to the spearhead of an Administration-wide offensive against House and Senate proposals to limit the earned-income tax credit, a Federal rebate intended to help low-income workers keep more of their wages. Mr. Clinton expanded the credit significantly as part of his first budget in 1993.

The earned-income tax credit has a far lower political profile than popular behemoths like Medicare, and its fate is almost certain to become entangled in more sweeping budget measures Mr. Clinton already opposes. But Mr. Clinton has long cited the expansion of the credit as a major underappreciated accomplishment of his Administration, and attacking the Republican proposals lets him not only defend the interests of a core Democratic constituency, but also highlight Republican plans to cut taxes for the affluent.

Republicans contend that the tax credit program is subject to significant waste and abuse and that families earning well above the supposed limit — in 1996, about $28,500 for a family with two or more children — manage to benefit from the credit, in part because Social Security and pension benefits are not included in the limits. The House measure would count such income, and thus reduce eligibility for the credit.

"It's basically an income redistribution scheme that this Administration has greatly expanded, in my opinion, without really looking at its costs," said Senator Don Nickles, an Oklahoma Republican and co-sponsor of the principal Senate proposal.

The President said he, too, was committed to weeding out abuses, but the White House said the Senate Republican proposal for curtailing the benefit would increase taxes for 18 million taxpayers in 2002, with the increase averaging $655. Mr. Clinton said that ran counter to the Republicans' professed desire to lower taxes.

"If there are problems in the administration of the program, let's fix those," Mr. Clinton said. "But let's don't raise taxes on working people while we're lowering taxes on everybody else in the country. It just does not make sense, and it is inconsistent with rewarding work and responsibility and strengthening families. It's inconsistent with those basic bedrock values this country should be standing for now."

About 45 million people benefit from the program, the Administration estimates, including about 15 million families and about 4.5 million people without children to whom the benefit was extended for the first time under the Clinton plan. The Republicans would eliminate the benefit for individuals and reduce it, to varying degrees, for families. Under current law, the income threshold at which the credit is phased out is adjusted for inflation, and the Senate proposal would also eliminate that provision, which the Administration contends would punish millions of workers.

The President casts himself as a champion of the work ethic.

In all, about 35 percent of American families benefit from the credit, and last year, 24,000 families with incomes above $50,000 a year got some benefit. That figure is expected to rise to 36,000 by next year, according to Congressional estimates. Before the 1993 expansion, the program was expected to cost about $20 billion next year; without changes, it is now expected to cost about $25 billion in 1996.

The program began in 1975 under the Ford Administration and was expanded by both George Bush and Ronald Reagan, a bipartisan legacy that Mr. Clinton took pains to point out today.

"You know, President Reagan said it was the best anti-poverty program ever devised," Mr. Clinton said.

Mr. Clinton spoke out today because the proposed changes in the tax credit are part of a much larger tax bill that the House Ways and Means Committee began considering tonight. The measure includes dozens of changes in the taxation of businesses, but it would not appreciably change the taxes owed by most individuals. The vote on the proposed changes in the tax credit will probably be on Tuesday or Wednesday.

Mr. Clinton said cutting the tax credit was particularly inconsistent with bipartisan efforts to encourage work and reduce the welfare rolls.

"I think it will substantially undermine our ability to move people from welfare to work," Mr. Clinton said. "And more importantly, it will make

Cont.

Cut

a statement that we're backing off of this value that we want people to succeed as workers and as parents. And if — that if they're willing to work, no matter how meager their incomes, we want to lift them above poverty, if they work full time."

The White House contends that counting Social Security benefits as part of the income limits could have harsh effects on older poor people, who often care for grandchildren born to single mothers.

Representative E. Clay Shaw Jr., Republican Florida, a sponsor of the House measure to reduce the credit, said he had no quarrel with making it available to those with incomes below about $11,600 a year. But he said he wanted to reverse the growth that Mr. Clinton undertook and to count Social Security and interest income toward the eligibility limits.

"We're trying to take what basically was originally a Republican program and smooth it out a little bit and just bring it down a little bit," he said. "I think this should include all your resources. If you have $2,000 a year from a C.D. account, that should certainly be included."

ROUNDUP

About the Earned-Income Tax Credit

HISTORY Enacted in 1975 to give adults with children incentives to work instead of relying on welfare. For those who qualify, it provides a tax credit of 7 to 40 cents on each dollar earned. The criteria for who qualifies were expanded in 1986, 1990 and again in 1993.

WHO IS ELIGIBLE On average, 35 percent of all families with children take advantage of the credit in any given year. Here are the broad criteria for receiving the credit:

Group	Income must be less than	Maximum 1995 credit
Families with two or more children	$25,296	$2,528
Families with one child	$23,755	$2,038
Families with no children	$9,000	$306

Through the end of July, the Internal Revenue Service had received 18.5 million claims and paid out $20.6 billion for the year, with the average claim about $1,113. Under the 1996 benefit schedule, the credit would lift about 4.5 million Americans above the poverty line, according to the Urban Institute.

HOW IT WORKS Taxpayers must fill out a one-page form to accompany a completed 1040 or 1040A form. The refund can be received either in a lump sum or spread out over a year.

EXCEPTIONS In 1994, 24,000 families with incomes over $50,000 received a credit. In 1996, the figure is expected to rise to 36,000. Most of these families get the bulk of their income from Social Security or private pensions. The credit is also available to low-income workers who do not have children.

EITC

CENTER ON BUDGET AND POLICY PRIORITIES

Revised June 16, 1995

THE ROTH-NICKLES PROPOSAL TO REDUCE THE EITC BY $66 BILLION

Senators Roth and Nickles recently introduced legislation to reduce the Earned Income Tax Credit (EITC), which they may offer on the Senate floor as an amendment to the welfare reform bill. Treasury Department estimates show that this legislation would cut the EITC by $66 billion over seven years — or about *triple* the size of the EITC reduction reflected in the Senate budget resolution. Senators Roth and Nickles have said that over 10 years, their proposal reduces the EITC by $120 billion.

The Roth-Nickles bill contains nearly all of the EITC reductions assumed in the Senate budget resolution and adds to them an array of additional cuts, some of which are very large. This analysis covers the proposals included in the Roth-Nickles package that are *not* also reflected in the Senate budget resolution.[1] These include: ending inflation indexing of the EITC; reducing the EITC for families that receive child support or Social Security; and eliminating the EITC for some families with savings.

These proposals represent deep EITC reductions. The Treasury Department estimates that by tax year 2000, some 19 million low-income working households would be adversely affected by the proposal and have their EITC reduced an average of more than $600 a piece that year. Eight million working families with two or more children would lose an average of $886 in 2000, according to the Treasury analysis, while seven million families with one child would lose an average of $563. In addition, more than four million poor workers without children would have their EITC terminated, losing an average of $173 each. (See table on page 3; the size of these EITC benefit reductions is expressed in 1996 dollars.)

Much of this reduction in the EITC would take the form of increases in the tax burdens of low-income working households. For example, a married couple with two children that earns $16,500 in 1996 (or just slightly above the poverty line) would, under current law, pay $2,525 in payroll taxes next year. The couple also would receive an EITC of $2,532, which would offset the payroll tax. Under the Roth bill, however, the family's EITC would be $500 lower than this in 1996. As a result, the family's net tax liability would rise by more than $500.

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[1] In addition to the EITC reductions discussed here, the Roth-Nickles bill also includes the following EITC changes assumed in the Senate budget resolution: repeal of the scheduled 1996 expansion of the EITC for families with two or more children, a reduction of up to $89 per family below current EITC levels for families with two or more children, and the elimination of the EITC for poor workers without children. Along with Senators Roth and Nickles, Senator Pressler is a co-sponsor of the proposal.

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Robert Greenstein, Executive Director

The tax increases the bill would generate would grow larger with each passing year due to the provision of the bill that ends indexation of the EITC. The Treasury Department estimates that by the year 2000, the tax liability of the family of four that earns $16,500 in 1996 would climb by $1,290 if the family's earnings simply kept even with inflation and the family's standard-of-living did not rise.

The legislation also would substantially weaken the EITC's effectiveness in making work more remunerative than welfare. By the year 2000, according to the Treasury Department estimates, the maximum EITC for a family with two children would drop more than $1,000 compared to current law. Families with two or more children that receive the maximum benefit have incomes between $8,900 and $11,600 (in 1996 dollars). This is precisely the income range into which many families fall if they leave welfare for full-time, low-wage work.

Finally, some of the proposals in the bill would add substantial new complexities to the EITC and be difficult to administer. As a result, they would be likely to cause an increase in errors. A discussion of the specific provisions of the bill follows.

Ending Inflation Indexing of the EITC

- President Reagan proposed indexing the EITC in the mid-1980s; his proposal was enacted as part of the Tax Reform Act of 1986. The Roth-Nickles proposal, however, would end indexation. Meanwhile, indexation of the tax brackets and the personal exemption for those at higher income levels would remain.

  Higher-income families thus would continue to enjoy protection against the effects that inflation would have on their tax burdens, while working poor families would no longer have this protection. (Moreover, the House tax bill would extend indexing to capital gains, the gift and estate tax, and depreciation allowances, three tax code provisions that primarily benefit the wealthy and large corporations.)

- If EITC indexing is eliminated, millions of working families will face tax increases. Families with incomes between about $11,000 and $27,000 whose wages simply keep pace with inflation will find that their EITC *decreases* each year while their payroll taxes rise. The increases in tax burdens they will face as a consequence will grow larger with each passing year.

  For example, if a family's income keeps pace with inflation and EITC indexing has ended, a family with two or more children and income of $12,000 in 1996 will, five years later, receive an EITC $460 smaller than the credit it received in 1996. The family's EITC will be more than $1,000 lower than it would have been if the EITC had continued to be adjusted for

TREASURY ESTIMATES OF EFFECTS OF EITC REDUCTIONS IN THE SENATE BUDGET RESOLUTION AND THE ROTH-NICKLES BILL

	Senate Budget Resolution in 1996	Roth-Nickles Bill In 1996	Roth-Nickles Bill In 2000*
Total EITC Recipients			
Number of Affected Taxpayers	14 million	19 million	19 million
Average Reduction	$239	$311	$602
Taxpayers with Two or More Children			
Number of Affected Taxpayers	8 million	8 million	8 million
Average Reduction	$305	$516	$886
Taxpayers with One Child			
Number of Affected Taxpayers	2 million	7 million	7 million
Average Reduction	$137	$166	$563
Taxpayers without Children			
Number of Affected Taxpayers	4 million	4 million	4 million
Average Reduction	$173	$173	$173

Source: Department of the Treasury, Office of Tax Analysis

* Figures in this column are expressed in 1996 dollars. The much larger reductions in the year 2000 than in 1996 are due to the removal of indexation

inflation. And while its EITC is falling, the family's payroll tax will have climbed $167.

The purchasing power of this family's EITC will decline 27 percent in the five-year period. Moreover, for some working families, the decline would be even steeper. Families that earn $20,000 and whose wages simply keep pace with inflation will find that the purchasing power of their EITC declines *more than 50 percent* over five years if indexation ends.

- The Treasury Department estimates that by the year 2000, nearly 18 million low-income working households would be adversely affected by this proposal. This one proposal would reduce the EITC by *$32 billion over seven years.*

- Senator Roth argues this provision will reduce fraud and is needed to prevent EITC income limits from growing too much. Ending indexing, however, would not curb fraud. Fraud is best curtailed by the types of steps the IRS instituted this year to tighten the processing of tax returns claiming the EITC — such as checking all Social Security numbers on these returns to ensure no child is claimed twice — not by cutting the EITC for hard-pressed working families whose incomes barely keep pace with inflation.

Furthermore, the EITC income limits for families with one child were not raised at all by the 1993 EITC expansions. The income limits for these families continue to be those that President Bush supported and signed into law in 1990, adjusted only for inflation.

The income limits for families with two or more children were raised modestly — about 14 percent — in the 1993 reconciliation act. This was done for a sound reason — that Act increased the EITC benefit for families with two or more children to move close to a longstanding goal that had been espoused by conservatives and liberals alike and by organizations such as the Heritage Foundation — namely, that if a parent works full-time throughout the year the parent should not have to raise his or her children in poverty. The increase in the EITC benefit for families with two or more children necessitated modestly raising the EITC income limit for these families. Otherwise, EITC benefits would have to phase down too rapidly as earnings increased, raising marginal tax rates too high.

Once the changes enacted in 1993 for families with two or more children are phased in fully, the EITC income limits for *all* types of eligible families will simply rise with inflation, just as the income tax brackets do for families at all income levels including families at high income levels.

Cutting the EITC for Families that Receive Child Support or Social Security

The Roth-Nickles proposal would cut between $6 billion and $8 billion over five years by counting Social Security, child support, and several smaller items as part of adjusted gross income for EITC purposes and thereby reducing or eliminating EITC benefits for families that receive Social Security or child support.

Counting child support payments would be problematic, as it would be difficult and burdensome to administer and would add inequities to the tax code. It also would sharply reduce the EITC for many families headed by a divorced working mother.

- The IRS has no information on the child support payments that a custodial parent receives and lacks a reliable means of securing this information. The GAO recently took note of the administrative difficulties such a proposal would cause. This proposal thus would be difficult for the IRS to enforce. An almost-certain result would be higher error rates.
- In addition, counting child support in this manner would essentially lead to income being taxed twice. *Non*-custodial parents already pay income tax on the income from which child support payments are made. Under this proposal, receipt of child support payments also would increase the tax burdens of *custodial* parents by reducing their EITC payments, effectively taxing the same income a second time.
- This change also would be likely to lessen child support collections. Some of the non-custodial parent's child support payments would effectively be taxed away, thereby lessening the non-custodial's parent's incentive to make such payments.

Counting Social Security benefits as part of adjusted gross income also raises a number of issues. The Social Security beneficiaries affected would primarily fall into three groups: families in which one parent works while the other is disabled and receives Social Security disability benefits; elderly individuals who have modest earnings and are raising a grandchild; and families containing a child who receives Social Security survivors benefits because one of the child's parents has died.

- While the Social Security benefits these families receive represent income, counting these benefits in adjusted gross income when calculating EITC benefits could subject Social Security beneficiaries who are raising children to larger taxes on their Social Security benefits than some other Social Security beneficiaries at higher income levels.

- In addition, the bill would count *all* of Social Security benefits in adjusted gross income. Yet a portion of Social Security benefits represent funds that beneficiaries themselves have paid in to the Social Security system.

Eliminating Some Families with Savings

Legislation enacted earlier this year eliminated EITC eligibility for families with interest, dividend, rent, and certain other income of more than $2,350. The Roth-Nickles proposal would sharply lower this limit to $1,000, slicing several billion dollars more from the EITC. The $1,000 level would not be indexed; it thus would tighten over time, disqualifying more families with each passing year.

This would eliminate the EITC for many low-income working families with modest savings who are saving for such reasons as to send a child to college, purchase a home (possibly in a less dangerous neighborhood), start a business, or meet a medical emergency — a growing concern as the proportion of low-income working families that lacks health insurance continues to rise. In 1994, the average downpayment on the median-priced home purchased by a first-time homeowner exceeded $17,000, while the cost of a four-year education at a typical state university exceeded $25,000.

This proposal would compel many low-income families who are saving to invest in their futures to choose between losing their EITC and consuming enough of their assets to stay below the EITC limit. Prudent policy would not punish low-income working families if they save, nor induce them to consume rather than to save.

- This proposal also poses equity problems. Working families saving to purchase a modest home could be disqualified; families that already own a home — and thus do not need to amass as much in savings — would remain eligible.

- Supporters of this provision may draw an analogy to the stringent assets limit in AFDC. Such a comparison would be inappropriate. AFDC is primarily for families that do not work. By contrast, the EITC is for families that do work. It is designed to provide them tax relief and to encourage them to work and save so that they can pull themselves and their children into the economic mainstream.

Delaying EITC Benefits

The Roth-Nickles legislation also would delay payment of a family's EITC benefit until the Internal Revenue Service is able to match information on the tax return with information on W-2s. While the intent of this proposal is laudable, the proposal is not practicable at this time; it would cause extremely long delays between the filing of a tax return and receipt of an EITC payment.

In an analysis issued June 7, the Joint Tax Committee noted that this proposal "could result in delays of many months between the filing of tax returns and the issuance of refunds...." At present, the matching of tax returns and W-2s for tax returns filed in a given year does not occur until the next calendar year. Even if this process could be greatly accelerated, the delays could not be shortened in the foreseeable future to less than six months.

Delays of this length in issuing EITC payments are likely to weaken the perceived link between work and EITC receipt. Rather than mandating that IRS undertake a procedure for which it lacks the technology and staff to perform in a reasonable timeframe, Congress should concentrate on moving forward with IRS plans for Tax Systems Modernization so that the IRS obtains the technology to institute additional procedures in the future to improve compliance with both the EITC and other aspects of the tax code.

Conclusion

These proposals represent deep cuts in the EITC and would impose large tax increases on millions of low-income working families who rely on the credit to offset their payroll and income taxes and to boost their limited wages so they can raise their children more adequately. The proposals also would make low-paid work less remunerative and thereby lessen the rewards of working over receiving welfare.

Finally, the proposal would tax a significant number of near-poor working families into poverty and tax millions more who already are poor deeper into poverty.

Earned Income Tax Credit:
Rewarding Work for Working Families

Department of the Treasury
May 5, 1995 version

Overview

- General Description and Goals of EITC
- Bipartisan History of EITC
- Current Law
- Error Rates
- 12 Administration Measures To Improve the EITC and Reduce Error Rates
- Congressional Proposals to Cut the EITC
- State-by-State Data

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 7 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 taxes they owe.

- In 1996, the EITC will provide a tax credit averaging nearly $1,400 for over 21 million workers and their families earning up to $28,500 per year.

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.

Moving Families From Welfare To Work

- Social Security taxes and various means-tested benefits create economic disincentives for welfare recipients to move 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. It encourages families to work two ways.

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

  -- 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.

- The EITC is a non-bureaucratic way to encourage work over welfare. There are no middlemen and no long lines at government offices. The tax refund is provided by the IRS directly to the working families.

Rewarding America's Working Families

- People who work hard and play by the rules shouldn't lose the game.

  -- 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, while in 1996 the real value of the minimum wage will decline to its lowest real value in 40 years.

  -- The poverty rate for working families with children grew by nearly half from 1979 to 1993.

  -- The bottom 40% of American families by income--those earning less than $30,000 in 1993-- made 10% less in real terms in 1993 than in 1979.

- The EITC <u>rewards work</u> and offsets the increase in payroll taxes and the decline in the minimum wage. But there is still more to do:

  -- The EITC and Food Stamps are nearly enough--but not enough--to raise a family of four with a full-time minimum wage worker above the poverty line.

A HISTORY OF BIPARTISAN SUPPORT FOR THE EITC

Leading Republicans Have Supported the EITC

- The EITC has enjoyed bipartisan support since Russell Long helped create it in 1975. Republicans and Democrats alike have viewed the EITC as a non-bureaucratic way to make work pay better than welfare.

- President Reagan called the EITC, "The best anti-poverty, the best pro-family, the best job creation measure to come out of the Congress."

- Senator Packwood said in 1991 that the EITC is "a key means of helping low-income workers with dependent children get off and stay off welfare."

- Senator Domenici said in 1990, "The EITC is a great way to help low income families with the costs of raising their children. It sends assistance to those in need; to those who work hard and yet struggle to make a living and provide for their children."

- Others who have expressed especially strong support for the EITC include Senators Dole, Hatch, and Grassley; Representatives Armey and Petri; and former Representative Kemp.

A Decade of Bipartisan Development

- 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 <u>incomes over $25,000</u> (1996 dollars).

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

  -- the EITC credit rate exceeds 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, and H.R. 831. The Administration has taken other administrative actions to improve and strengthen the integrity of the EITC.

CURRENT LAW

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 credit 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 credit was increased from 25 cents to 40 cents.

  -- The maximum credit was increased by nearly $1,500.
  -- Eligibility for the credit was extended to families with two or more children that have incomes of up to $28,524 (or about $3,000 above the prior law level).[1]

- 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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[1] Some critics of the program have argued that the EITC should not be available to families with incomes of $28,500. 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, raising the marginal tax rate too high. 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 1996, the median income for a family of four will be nearly $50,000.

OBRA 1993 Achieved Goals of Program

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

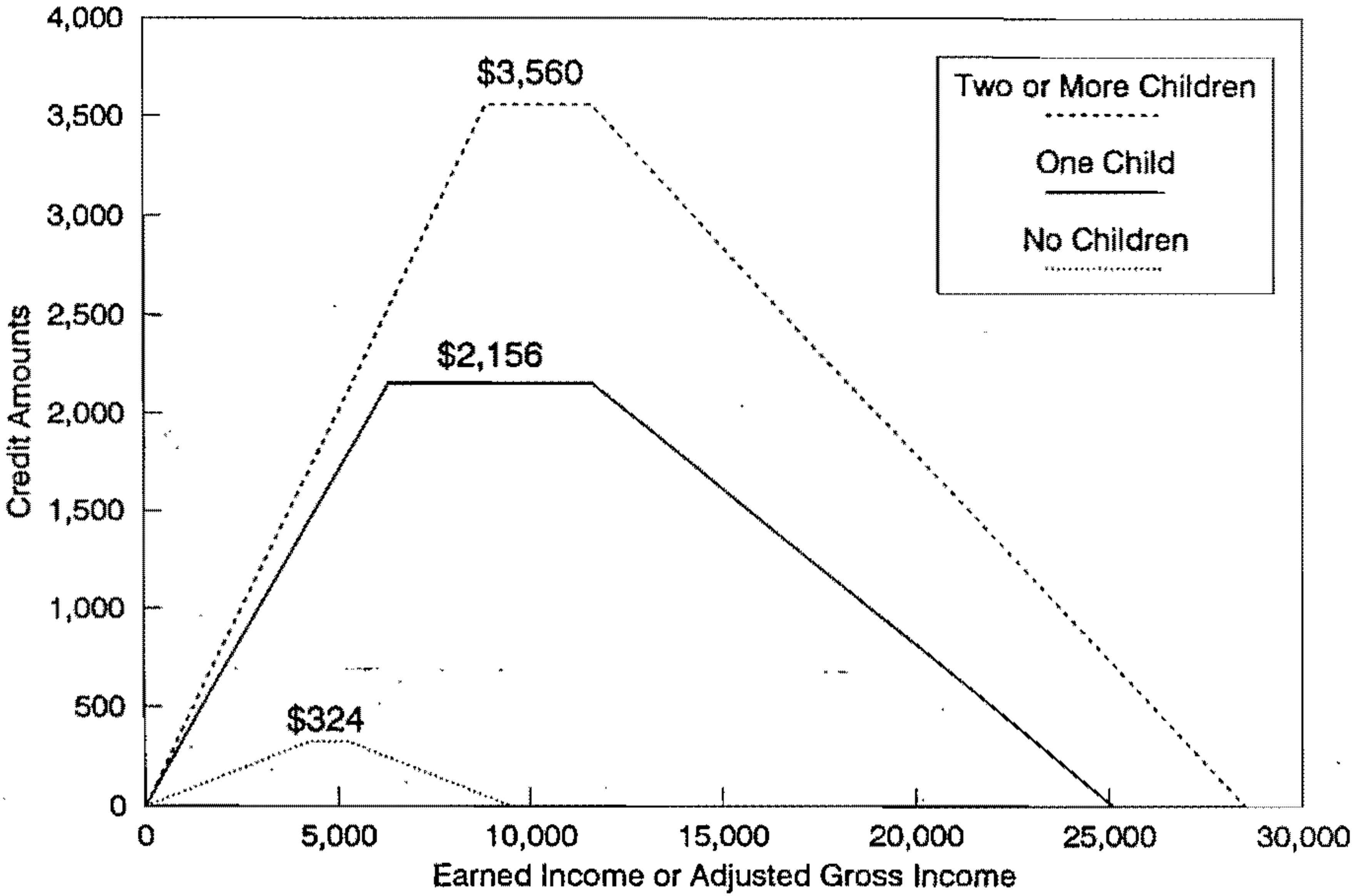
  -- From every added dollar a low-income family earns, payroll taxes take 15.3 cents while Food Stamp benefits decline by 24 cents. For a low-wage family with two children, the EITC fully offsets these effects by providing a 40 cent credit for every dollar earned.

- 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.

  -- Since the minimum wage has not kept pace with inflation, the job is not completed yet. That is why the President has proposed that the minimum wage be increased over two years by 90 cents.

- In addition, OBRA-1993 simplified the EITC by repealing the two complex supplemental credits for health insurance coverage and for taxpayers with children under the age of one.

The Earned Income Tax Credit, 1996



Earned Income Tax Credit: Number of Recipients and Average Credit

Current Dollars; Calendar Years

	Income Eligibility	Total Number of Recipients	Average Amount
All Recipients with Children			
Calendar Year 1993	up to $23,050	15.3 million	$1,028
Calendar Year 1994	up to $25,296	15.6 million	$1,356
Calendar Year 1995	up to $26,673	16.1 million	$1,567
Calendar Year 1996	up to $28,524	16.7 million	$1,705
Calendar Year 1997	up to $29,455	17.0 million	$1,756
Calendar Year 1998	up to $30,386	17.2 million	$1,810
Calendar Year 1999	up to $31,374	17.5 million	$1,863
Calendar Year 2000	up to $32,363	17.8 million	$1,917
Recipients without Children			
Calendar Year 1994	up to $9,000	4.4 million	$168
Calendar Year 1995	up to $9,230	4.4 million	$169
Calendar Year 1996	up to $9,510	4.4 million	$173
Calendar Year 1997	up to $9,810	4.4 million	$178
Calendar Year 1998	up to $10,130	4.4 million	$184
Calendar Year 1999	up to $10,460	4.4 million	$190
Calendar Year 2000	up to $10,780	4.4 million	$196

Department of the Treasury
Office of Tax Analysis

May 5, 1995

Note: These estimates do not reflect H.R. 831.

EITC Growth Rate

- Some have claimed that EITC growth is "explosive" or "out of control."

- The EITC is growing as it was designed to grow because of expansions signed into law by Presidents Clinton, Bush, and Reagan. As soon as those expansions are fully phased in, the rapid growth in the EITC will cease.

  -- After 1997, EITC costs will grow in tandem with population growth.

ERROR RATES

False Claims about Error Rates

- Some in Congress are using the issue of error rates to justify deep cuts in the EITC--which are big tax hikes for working families. For example, some have claimed that a preliminary IRS study shows that 35 percent to 45 percent of EITC payments are made erroneously.

- This is **<u>untrue</u>**--for two basic reasons. That number is about 25 percent--but more important, any use of the preliminary study to make broad claims about error rates depends on outdated information and misread data.

1. <u>Outdated Information</u>. The study is based on outdated information (January 1994) and takes into account virtually none of the **<u>12</u>** aggressive Administration steps to cut the error rate (outlined shortly) that are now in place.

2. <u>Misread Data</u>. The study measures amounts <u>claimed</u>, not amounts <u>paid out</u> after IRS enforcement. Many erroneous claims would be caught by IRS and not paid out. In addition:

   -- The study is limited to electronic filers who filed in the first two weeks of the tax filing season. These filers are not representative of the EITC population as a whole.

   -- Even if the study were up-to-date, the very large numbers would include both underpayments and overpayments, and would refer to the percentage of <u>claims filed</u> in error, not the percentage of <u>benefits paid</u> in error--the standard meaning of "error rate." Preliminary data from the study indicate that about 25 cents of every dollar claimed exceeded the proper amount--but this number does not represent the EITC today.

More Misconceptions about Error Rates

- Some say that no other part of the tax code has as many errors as the EITC.

  -- In 1992, IRS estimated that for all non-farm self-employed individuals, the gross tax gap--the gap between the amount of tax owed and the amount voluntarily paid--was $37.2 billion.

  -- That is <u>more than the entire EITC in 1996.</u>

- Some say that all of the errors in the EITC are due to fraud.

  -- In fact, a large share of the errors are unintentional--resulting from the ordinary mistakes that taxpayers make on all kinds of tax returns.

12 ADMINISTRATION MEASURES TO IMPROVE THE EITC AND REDUCE ERROR RATES

Simplicity and Verifiability

- The Clinton Administration recognizes that error rates are a problem and has acted aggressively to reduce them.

- Specifically, the Clinton Administration is committed to structuring the EITC so that deserving and eligible individuals--and only those individuals--are able to claim and receive the EITC.

- Two key means to this end are the <u>simplicity</u> and <u>verifiability</u> of EITC claims.

  -- If eligibility rules are simple, taxpayers can more accurately claim the EITC and avoid costly errors.

  -- If eligibility rules are verifiable, the IRS can better ensure that the EITC is paid only to those who are eligible.

- The Administration has taken <u>12</u> measures to ensure the simplicity and verifiability of the EITC and to reduce erroneous or undeserved claims.

OBRA 1993

1. The EITC was simplified by repealing the complex supplemental credit for health insurance coverage.

    -- Some taxpayers made mistakes in their claims because they did not understand the complicated eligibility criteria.

2. The EITC was further simplified by repealing the supplemental credit for children under the age of one.

    -- This should also improve EITC compliance, as taxpayers could not understand the eligibility criteria for the young child credit, and the IRS could not administer the credit.

3. The EITC was <u>denied to nonresident aliens</u>.

   -- Under prior law, nonresident aliens could receive the EITC based on their earnings in the United States, even though they are not required to report their worldwide income to the IRS.

4. Prisoners will not be eligible for the EITC based on their earnings while incarcerated.

   -- The EITC was never paid to prisoners, and this ensures that it will not be paid to them, now or in the future.

5. Taxpayers will be required to provide a <u>taxpayer identification number</u> for each EITC qualifying child, <u>regardless of age</u>.

   -- This will allow the IRS to verify eligibility for each child claimed by the taxpayer.

6. The Department of Defense is required to report to both the IRS and military personnel non-taxable earned income paid during the year that is included in computing the EITC.

   -- This will ensure that military personnel receive the benefit for which they are eligible.

H.R. 831

7. The recent bill extending the health insurance deduction for self-employed individuals included a variation of a Clinton Administration proposal to deny the EITC to taxpayers with $2,500 of taxable interest and dividends. Many of these taxpayers have significant assets and do not need the EITC.

   -- Under H.R. 831, the EITC will be denied to taxpayers with investment income in excess of $2,350. The investment income cap is not indexed, as the Administration has proposed.

Verifying and Delaying Questionable Refunds

8. The IRS has instituted a series of tough new administrative measures to reduce error and fraud in the EITC. The IRS now scrutinizes the social security numbers of all EITC qualifying children.

   -- Children's social security numbers are checked to make sure the numbers are valid, and no child is claimed more than once.

   -- Last year, the IRS only validated the social security numbers of children claimed on EITC returns filed electronically. This year, the IRS is tightening its validation tests and checking all returns--whether they are filed electronically or on paper.

   -- Refunds on returns with missing, invalid, or duplicate social security numbers will be delayed, while the IRS investigates further.

9. EITC refunds may also be delayed if the IRS has questions regarding the validity of the claim.

   -- Taxpayers may be required to provide additional documentation to verify that their EITC claim is valid before the credit is awarded.

Intensifying Scrutiny of Electronic Return Originators

10. Beginning with the 1995 filing season, the IRS is no longer providing direct deposit indicators (DDIs) to preparers of electronic returns (EROs).

-- In prior years, the IRS would let electronic return originators know quickly if a taxpayer had an outstanding debt to the federal government--the so-called direct deposit indicator (DDI). If the taxpayer owed the Federal government money, the refund could be held back to repay some of the taxpayer's debt. Often, the ERO did not engage in other credit checks to determine if the taxpayer was a good credit risk before advancing a loan on an EITC refund. The IRS would go after the taxpayer if the EITC claim was erroneous--not the ERO. The ERO generally would get paid if the DDI showed there was no refund offset.

-- Because the IRS no longer provides DDIs, the EROs must scrutinize EITC returns more carefully to determine if the taxpayer is a good credit risk for a refund anticipation loan. By encouraging EROs to do a more careful job of verifying EITC eligibility, we can prevent erroneous claims from being paid out.

-- In its enforcement activities, the IRS has also found that some EROs have been responsible for refund fraud. The IRS has taken several steps to stop this practice:

   -- Fingerprint and credit checks are conducted on certain new ERO applicants.
   -- IRS is conducting additional compliance checks to ensure that EROs are meeting new, stricter requirements for participation in the program.
   -- The IRS is working with the Justice Department to prosecute preparers and EROs who take advantage of the EITC to defraud the Federal government.

Preventive Actions

11. The 1994 Schedule EIC was shortened and simplified to make it easier for low-income taxpayers to understand if they are eligible for the credit.

12. Taxpayers were also warned on the cover of the 1994 tax return that they would be required to provide valid social security numbers for all dependents and EITC qualifying children.

    -- In December 1994, over 180,000 taxpayers who filed in 1994 with incorrect or invalid social security numbers received letters from the IRS alerting them to be more careful on their 1995 tax returns.

    -- IRS participated in extensive media campaigns before and during the filing season to emphasize the need for accurate SSNs.

Additional Proposals To Reduce Errors Still Pending

- The Administration submitted additional proposals as part of the President's FY 1996 budget which are still pending final legislative action.

- The EITC would be denied to undocumented workers.

- The IRS would be authorized to use simpler and more efficient procedures when taxpayers fail to supply a valid social security number.

- In combination, these provisions would strengthen the IRS's ability to detect and prevent erroneous refunds from being paid out. In addition, the proposals would improve the targeting of the EITC by providing the credit only to individuals who were authorized to work in the United States.

- The FY 1996 budget for the IRS contains funding for the continuation of its taxpayer systems modernization (TSM) program. TSM is vital to the long-run efficiency of the IRS's collection functions. TSM will also enhance the IRS's ability to detect erroneous EITC claims.

  -- We hope that Congress will act on these proposals soon.

CONGRESSIONAL PROPOSALS TO CUT THE EITC

1. The Gregg Option To End Indexation of the EITC

- Senator Gregg recently proposed ending the indexation of EITC thresholds for inflation.
- President Reagan first introduced indexation to the EITC by signing the bipartisan 1986 tax reform.
- This proposal represents a large tax hike for millions of working families.
- It is unfair to propose eliminating indexing for this major tax break for the poor while proposing to add indexing to tax breaks for the wealthy.
- Should Republicans pursue these proposals, they would raise taxes on the working poor in order to pay to cut taxes for the very wealthy.

A Tax Hike for Working Families

- Eliminating indexation for inflation represents a tax hike for millions of working families, as the real value of the EITC will steadily decline over time.

  -- Eliminating indexation will reduce the benefits of millions of taxpayers, particularly those with incomes between $9,000 and $28,000.

  -- By 2000, about 17.8 million taxpayers (80 percent of total recipients) would be adversely affected by this proposal. On average, benefits would be reduced for affected taxpayers by <u>over $600</u>.

- Indexation is necessary to ensure that taxpayers do not lose eligibility for the EITC simply because their wages keep pace with inflation.

  -- Under current law, an estimated 21.1 million taxpayers will claim the EITC in 1996. If indexation is suspended participation will shrink to 18.2 million--<u>declining by nearly 3 million taxpayers</u>.

De-Indexing the EITC Is Unfair

- Since President Reagan signed the 1986 tax reform, the most basic features of the tax structure have been indexed: the tax brackets, the standard deduction, the personal exemption, and the EITC.

- Now, Republicans are considering repealing indexation for the EITC. Yet at the very same time, their Contract with America proposes to index six tax proposals, including three that almost exclusively benefit the wealthy:

  -- The Capital Gains Tax Cut, which provides about 75% of its benefits to the top 10% of taxpayers.

  -- The Gift and Estate Tax, which will only benefit those making gifts or leaving inheritances over $600,000.

  -- A Neutral Cost Recovery System, effectively a new system of depreciations for large companies.

- The "Contract with America" tax bill provides more benefits for the wealthiest 1 percent than the bottom 60 percent. The EITC provides 100 percent of its benefits to the working poor and middle-class.

2. Repealing the 1993 EITC Expansion

- Some have proposed rolling back the EITC expansion included in OBRA 1993.
- Like deindexation, this proposal represents a tax hike for working families.
- For a family of four with one parent working full-time at the minimum wage, this proposal would reduce the EITC--and raise taxes--by $1,500 in 1996.
- The negative effect would extend to moderate-income families as well. For a family of four with two children earning $18,000--just above the poverty line--this proposal would represent a tax hike over $900.

Cut Error Rates, Not the EITC

- Democrats and Republicans can continue the EITC's long history of bipartisan support by working together to strengthen the credit and further reduce error rates.

- It is wrong to use error rates as a smokescreen to raise taxes for working families in order to pay for tax cuts for the wealthy.

STATE-BY-STATE DATA

U.S. Individual Income Tax and Earned Income Tax Credit (EITC)
By State, 1993
(Money Amount in Thousands)

State	Number of Returns Total	Number of Returns with EITC	Percent with EITC	Amount of EITC
Alabama	1,760,213	387,945	22.0%	433,371
Alaska	350,473	19,498	5.6%	16,129
Arizona	1,707,024	269,853	15.8%	281,772
Arkansas	994,988	204,792	20.6%	215,613
California	13,218,412	2,173,191	16.4%	2,299,819
Colorado	1,688,397	175,344	10.4%	173,633
Connecticut	1,552,730	84,856	5.5%	76,668
Delaware	330,809	37,687	11.4%	38,275
DC	289,362	51,008	17.6%	52,944
Florida	6,282,136	917,427	14.6%	967,982
Georgia	3,022,938	549,650	18.2%	588,797
Hawaii	556,041	39,586	7.1%	35,792
Idaho	468,361	64,264	13.7%	64,534
Illinois	5,308,701	620,805	11.7%	623,879
Indiana	2,548,815	281,929	11.1%	280,074
Iowa	1,256,442	116,687	9.3%	111,355
Kansas	1,108,625	116,422	10.5%	112,078
Kentucky	1,549,407	230,984	14.9%	229,824
Louisiana	1,699,646	401,001	23.6%	430,509
Maine	548,592	58,023	10.6%	54,691
Maryland	2,306,649	250,520	10.9%	251,623
Massachusetts	2,783,535	179,203	6.4%	167,088
Michigan	4,141,907	395,860	9.6%	371,386
Minnesota	2,060,951	159,225	7.7%	150,069
Mississippi	1,056,684	314,347	29.7%	352,801
Missouri	2,283,031	293,809	12.9%	292,282
Montana	375,861	47,362	12.6%	45,831
Nebraska	740,824	76,983	10.4%	75,155
Nevada	684,067	83,430	12.2%	82,434
New Hamp.	536,568	40,280	7.5%	38,481
New Jersey	3,759,633	372,590	9.9%	374,370
New Mexico	698,914	134,613	19.3%	136,783
New York	7,844,199	901,122	11.5%	894,023
North Carolina	3,165,227	540,444	17.1%	572,128
North Dakota	283,759	28,180	9.9%	27,178
Ohio	5,101,148	500,825	9.8%	481,711
Oklahoma	1,328,928	214,892	16.2%	215,985
Oregon	1,357,284	153,144	11.3%	151,898
Pennsylvania	5,378,327	491,233	9.1%	467,144
Rhode Island	446,625	39,880	8.9%	38,897
South Carolina	1,581,259	311,953	19.7%	337,848
South Dakota	320,834	38,933	12.1%	38,444
Tennessee	2,253,718	380,887	16.9%	392,653
Texas	7,715,165	1,542,209	20.0%	1,636,999

State	Number of Returns Total	with EITC	Percent with EITC	Amount of EITC
Utah	747,636	85,277	11.4%	85,185
Vermont	264,347	25,279	9.6%	23,397
Virginia	2,940,159	339,793	11.6%	350,772
Washington	2,401,163	224,143	9.3%	214,658
West Virginia	695,300	101,229	14.6%	99,323
Wisconsin	2,294,126	189,831	8.3%	182,548
Wyoming	214,119	24,373	11.4%	23,617
Other 1/	1,056,738	17,951	1.7%	14,965
Total	115,060,797	15,300,754	13.3%	15,675,410

Source: Internal Revenue Service
SOI Bulletin, Spring 1995 (forthcoming)

Notes:

1/ Other includes, for example, returns filed by members of the armed forces stationed abroad and other U.S. citizens currently abroad.

EITC

TESTIMONY OF ROBERT GREENSTEIN, EXECUTIVE DIRECTOR CENTER ON BUDGET AND POLICY PRIORITIES

Senate Committee on Government Affairs
April 5, 1995

I appreciate the opportunity to testify before the Committee today. I am executive director of the Center on Budget and Policy Priorities, a non-profit public policy organization that examines federal and state fiscal policies with an emphasis on policies affecting low- and moderate-income families. The Center is funded by foundations. Last year, I also served as a member of the Bipartisan Commission on Entitlement and Tax Reform.

The Center has been engaged in analyzing issues related to the earned income credit for a number of years. In a related aspect of our work, we also work closely with the IRS, the National Governors Association, the United Way, and a number of businesses, charities, and other non-profit organizations in distributing information about EIC eligibility rules and filing procedures to state and local agencies and organizations that work with low-income working families, so that eligible families may be apprised of their eligibility for the credit and so that ineligible families will not seek to receive it. Through this work, we also occasionally learn of abuses related to the credit; when this occurs, we seek to bring these abuses to light so action may be taken to correct them.

In 1992, for example, we learned of abuses involving the EIC health insurance credit. We notified the IRS and the congressional committees of jurisdiction of our findings, and the oversight subcommittee of the House Ways and Means Committee mounted an investigation that confirmed these findings. The health insurance credit was repealed later in 1993, a course that we, among others, had recommended.

There is now a growing focus on the EIC. In my testimony today, I would emphasize several points.

- The EIC's biggest problem involves error rates. While significant progress in reducing error was made in the 1990 reconciliation bill, more needs to be done. The EIC provision in last year's GATT bill should help. More important, in the last several months, the IRS has taken some badly needed and overdue steps that hold strong promise for making significant reductions in error rates. Legislation the Treasury submitted with the budget also should help reduce errors.

- While seeking to reduce EIC error rate problems, we should also be mindful that the EIC has considerable strengths. It addresses one of the key trends that has caused a substantial increase in child poverty in recent years, the erosion of wages for low-paid work. It also helps substantially in making work more remunerative than welfare. It is an important building block for welfare reform that places some limitations on cash assistance and seeks to move families to work.

- Certain reforms in the EIC eligibility structure, including both the provisions of S.831 (with some modification) and proposals to bar EIC receipt for tax filers in which either the parent or the qualifying child is residing here illegally, should be made.

- Some EIC proposals need to be regarded with considerable caution. A proposal to end the indexing of the EIC, for example, would cause large increases over time in the tax burdens of millions of low-income working families whose wages are simply keeping pace with inflation and would conflict with the goals of work-based welfare reform. Also, some proposals to lessen marriage penalties in the EIC could have perverse effects, lessening the attraction of work over welfare and transferring large sums from working poor families to middle-class families. Finally, some proposals would make the EIC significantly more complicated and be likely to increase errors as a result.

In short, we need to be mindful of the strengths of the EIC as well as of the areas where it has weaknesses that need strengthening. We need to improve the integrity of the EIC, and we need to do so in ways that do not lessen the credit's positive effects.

The Basis for the EIC

The need for and growth of the EIC in recent years is closely related to the erosion of wages for low-paid work. Between 1977 and 1993, the poverty rate for families with children in which a family member (usually a parent) works grew by nearly half. More than 60 percent of all poor families with children contain a worker.

A study by Northwestern University economist Rebecca Blank, a former staff member of the Council of Economic Advisers during the Bush Administration, found that wage erosion exceeded all other factors in importance in explaining why poverty rates did not decline more during the economic recovery of the 1980s. In addition, Census data show that the proportion of full-time year-round workers paid a wage too low to lift a family of four to the poverty line rose by one-third between 1979 and 1993 (from 12 percent of full-time year-round workers in 1979 to 16 percent in 1993).

Eroding wages for low-skilled work reduce living standards and increase child poverty. They also lessen incentives to work and decrease the gains from working relative to receiving welfare. Starting in the mid-1980s, these trends led to a bipartisan policy emphasis on increasing the remuneration from low-wage work, with the EIC as the principal policy instrument.

President Reagan proposed a major EIC expansion in 1985, which was included in the 1986 Tax Reform Act. President Bush and Congress passed a further expansion in 1990. President Clinton proposed a final expansion that Congress passed in 1993.

These expansions signaled an increased reliance on the EIC and a decreased reliance on the minimum wage as an instrument of wage policy. The purchasing power of the minimum wage is now at its second lowest level since 1955. By next year, it will be at its lowest level since 1955.[1]

The expansions also reflected sharply deceased reliance on AFDC as a means of supplementing the wages of poor single parents with children and increased reliance on the EIC. In 1972, before the EIC was created, 49 states provided AFDC as a wage supplement to a mother with two children whose earnings equaled 75 percent of the poverty line. Today, just three states do.

The expansions also reflected, in part, increases in payroll taxes, which the EIC is designed to offset.

Finally, the EIC expansions were the principal means to attain the bipartisan goal that if a parent worked full-time year-round, the parent and his or her children should not live in poverty. The goal has been that wages (net of payroll taxes) from full-time year-round minimum wage work should, when combined with the EIC and food stamps, lift a family of four to the poverty line. When the 1993 EIC expansions are phased in fully, we will be close to attaining this goal. (The goal would be reached with a modest increase in the minimum wage.)

I would make one final observation about these expansions. A few policymakers have recently commented that the EIC is one of the fastest growing federal benefit programs and have suggested it is "out of control."

The growth rate, however, is *not* due to uncontrollable or unanticipated factors but rather to the explicit policy decisions made by Congress and three Presidents. As noted, the EIC was expanded on a bipartisan basis at the request of President Reagan in 1986, with strong support from President Bush in 1990, and at the request of President Clinton in 1993. Each expansion was phased in over several years. The high growth rates are a direct result of these expansions.

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[1] Over time, too much pressure will be placed on the EIC if it has to carry all of this load and the value of the minimum wage continues to erode. A modest strengthening of the minimum wage would be desirable.

Once the phase-in of the 1993 expansion is complete, *the high rate of EIC growth will end.* CBO data show that after 1997, when the phase-in of the 1993 expansion is completed, the EIC growth rate will be less than 4.5 percent per year. Most of this growth will be due to inflation.

As a percentage of the Gross Domestic Product, EIC costs will decline after 1997. After that year, the EIC does not contribute to the projected growth in the federal deficit as a percentage of GDP.

This is a far cry from the situation in programs such as Medicare and Medicaid. In those programs, rapid rates of growth persist indefinitely and do *not* primarily stem from specific federal decisions to expand the programs.

It also should be noted that in the context of minimum wage erosion and the near elimination of AFDC as a wage supplement to poor single parents working half-time or more, the EIC expansions do not look so large. When the 1993 EIC expansions are phased in fully, single parents working at the minimum wage will still have *less* disposable income, after adjusting for inflation, than they did in the early 1970s before the EIC was created.

An analysis conducted last year by the Department of Health and Human Services found that with the fully phased-in EIC, the income for a mother with two children who works half-time year-round at the minimum wage will be nearly $3,000 lower — or 28 percent lower — than it was in 1972, after adjustment for inflation. (Disposable income, as used here, includes wages, AFDC, food stamps, and the EIC, minus federal income and payroll taxes.[2]) The loss of AFDC in many states, the erosion in the minimum wage, and the increase in payroll taxes more than outweigh the EIC increases of the past decade.

The HHS analysis found similar results for single parents with two children who work 30 hours a week throughout the year as well as for those who work 40 hours a week throughout the year. In both cases, the family's disposable income is at least $2,000 — or at least 24 percent — below 1972 levels in purchasing power.

In a nutshell, the workings of the private economy in pushing down wages for low-skilled work, combined with policy decisions in the minimum wage and AFDC areas, confronted policymakers with a need to increase the EIC substantially to avoid

[2] These figures reflect average weighted AFDC benefits across the 50 states. Figures for 1972 are adjusted for inflation using the CPI-U-X1 rather than the more rapidly rising CPI. All figures are in 1993 dollars.

Average Disposable Income For a Mother and Two Children
From Wages, AFDC, Food Stamps, EIC, and Federal Taxes
(in 1993 dollars)

Number of Hours Worked Per Week At Minimum Wage Throughout the Year

Year	20 Hours	30 Hours	40 Hours
1972	$13,482	$14,602	$15,656
1980	11,479	12,870	13,792
1990	9,830	10,467	11,509
1993 (with EIC at fully phased-in 1996 levels)	10,612	11,956	13,653
Percentage Change in Average Disposable Income for a Mother and Two Children			
1972-1993	-28%	-27.4%	-24.0%

Source: Department of Health and Human Services

large decreases in the living standards of working poor and near-poor families with children.

Beneficial Aspects of the EIC

The 1986, 1990, and 1993 EIC expansions reflected decisions to help cushion the erosion of wages for low-paid work, while placing less emphasis on the minimum wage and AFDC as mechanisms to accomplish this goal, as well as a desire on the part of policymakers to make work more remunerative than welfare and bring families with a full-time working parent closer to the poverty line. These expansions also reflected a recognition that with its faults, the EIC remains one of the soundest of the low-income transfer programs.

In designing income transfer programs, policymakers face a conundrum. If the benefit is means-tested and phases out as income rises, the program will inevitably create some work disincentive effects and probably also some marriage penalties. This can be avoided if the benefit is not means-tested and is made available at all income levels, without reductions in the benefit as income rises. But that would make the benefit prohibitively expensive. Thus, policymakers face trade-offs in designing these programs.

The EIC differs from most other means-tested transfer programs in several critical respects. First, it is limited to those who work. Non-workers may not receive it. It helps make work more remunerative than non-work rather than the other way around.

Second, the major EIC benefit — the EIC for families with children — is limited to parents that live with their children. Absent parents may not receive it.

Third, unlike welfare benefits that decline as soon as income starts to rise, the EIC increases as earnings rise up to about $8,500 a year (for a family with two or more children). The EIC benefit does not begin to decline until income surpasses $11,000. (These figures are in 1994 dollars.) It then declines at a more moderate rate than public assistance benefits do.

The result is that the EIC rewards work and encourages those not working to enter the labor market. It distinguishes the working poor from the non-working poor and custodial parents from absent parents. As will be discussed later, its marriage incentive and work effects are mixed, with some adverse side-effects and some beneficial effects. As Gary Burtless of the Brooking Institution has noted, the EIC probably has stronger beneficial effects and more modest adverse side-effects than most or all other programs to boost the incomes of low-income families.

Current EIC Issues

I would like to turn to several current issues relating to the EIC. These include questions relating to error and fraud in the credit, work incentives, marriage penalties, and the adjustment of the EIC for inflation. I also will offer some comments on several proposals to reduce EIC costs.

EIC Error Rates

EIC error rates are too high and need to be brought down. In discussing efforts to reduce error, I would offer a caveat. Congress needs to be careful not to institute reforms that make the EIC significantly more complicated for taxpayers and the IRS. Congress also should avoid changes that the IRS cannot administer or enforce. Such steps would almost be guaranteed to increase the error rate further.

We also need to be mindful of progress that has been made in reducing error rates as well as the substantial task that remains. In 1990, staff of the Senate Finance Committee, the House Ways and Means Committee, the Treasury, and IRS worked on a bipartisan basis to craft reforms to reduce the error rate. These reforms were enacted into law in that year's reconciliation bill.

The changes made in 1990 included a major overhaul and simplification of EIC eligibility rules, including the elimination of complex rules that were responsible for a significant share of the errors prior to 1990. The 1990 reforms also included the introduction of a new form — Schedule EIC — that taxpayers must file to receive the credit and that provides the IRS with key information relevant to EIC eligibility it had not previously obtained. Today, the IRS denies the credit to families that do not file Schedule EIC; in the past, it awarded the credit to families that appeared eligible whether the families indicated they were applying for the EIC or not.

These changes were significant. The IRS audits in 1985 and 1988 that found the EIC error rate to be high discovered that one of the principal reasons for the high error rate lay in a series of arcane IRS rules on household filing status that few low-income families could understand and the IRS could not enforce. Under these rules, a single parent with children could legally file as a head-of-household only if she provided more than half of her household's support. In determining whether she provided more than half of the household's support, the parent was supposed to calculate the household's total support and include in it any AFDC payments, child support payments, and the like the family received. The parent was then supposed to calculate the portion of overall household support that she herself provided, and in so doing, the parent was not supposed to count any income from AFDC or other public benefit payments. Similarly, the parent was not supposed to count, as support she provided, any child support payments she received. If, after completing these calculations, a single parent found that more than 50 percent of the household's support came from sources other than herself, she was supposed to submit her tax return as a single filer rather than as a head-of-household.

Most parents assume a single filer is someone who lives on his or her own, not a parent who heads a family with children. As a result, large numbers of single parents who were supposed to file as single filers submitted their returns as heads-of-households instead.

This contributed heavily to high EIC error rates since heads-of-households were eligible for the EIC but single filers were not. Adding further to the confusion — and to the EIC error rates — were complex rules on when single parents in such circumstances could claim children who lived with them as dependents.

The EIC law was rewritten in 1990 to address these problems. The new rules dropped the complex test involving AFDC, child support payments and certain other income sources and requiring a measurement of what share of household support the parent provided.

In September 1993, the GAO commented favorably on these changes, noting that "OBRA 1990 resolved the major administrative problems associated with complicated filing status and dependency determinations...." The GAO added that "The OBRA changes made it easier for IRS to administer the basic credit because there are no longer different eligibility rules for different filing statuses....Because this issue was the largest source of taxpayer errors in the pre-OBRA period, the change should substantially reduce the number of erroneous EIC claims."[3]

Also important was the requirement to file Schedule EIC. Prior to 1991, families needed only to file a tax return (the 1040 or 1040A form) to get the EIC. No specific EIC questions had to be answered, and no EIC-specific information provided. The EIC worksheet the IRS had designed was printed in the instructions section of the 1040 and 1040A tax booklets and was not submitted to the IRS. The result was that IRS never received some basic information needed to make accurate EIC eligibility determinations.

Examination of IRS audit findings identified these procedures as a significant contributor to the error rate. Accordingly, the IRS and Congress changed the procedures. Schedule EIC was created. Information needed to determine EIC eligibility, including information the IRS had never previously received, is provided on the schedule. This gives the IRS more of what it needs to make accurate eligibility determinations.

The GAO report took note of this change. "In the past," the GAO observed, "IRS returns processing procedures could not detect erroneous eligibility claims....in part because the tax return did not contain sufficient information. IRS also could not determine whether taxpayers who claimed the credit were eligible for it if the taxpayers failed to provide such information as the child's relation to the taxpayer or the length of time the child resided with the taxpayer."[4]

Exactly how much these changes may have reduced the EIC error rate is not yet known. The IRS does not yet have data comparable to its 1988 error rate data for a year since these changes were instituted. (The 1993 GAO report also noted that the 1990 law created some new complexities by adding two supplemental EIC credits. One, the health insurance credit, was particularly subject to abuse. Both of these supplemental credits were eliminated in 1993.)

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[3] General Accounting Office, *Earned Income Tax Credit: Design and Administration Could be Improved*, September 1993, pp. 58-59."

[4] GAO, p. 6.

The GAO on Problems Before the 1990 Law Changes

In its 1993 report, the GAO elaborated on how some of the problems in the EIC before the 1990 law changes:

> "...before OBRA, unmarried taxpayers with children had to file as head of household or qualifying widow(er) with dependent child to get the credit. To qualify as a head of household, a taxpayer had to provide over one-half the costs of maintaining a household; a qualifying widow(er) had to provide over half the support of the dependent child. If taxpayers did not meet the support requirement but still claimed the head of household filing status, IRS could not detect these errors when processing tax returns. Similarly, erroneous EIC claims that were based on ineligible dependents could not be detected when returns were processed. The only way IRS could detect EIC payments that were based on inaccurate return information was to audit the taxpayer's return.
>
> "IRS also could not determine whether taxpayers who claimed the credit were eligible for it when they did not provide complete EIC eligibility information on their returns, such as the relationship of the child or length of time the child resided with the taxpayer. These situations posed a dilemma for IRS. IRS could either assume that the taxpayers were entitled to the credit or it could deny the credit and correspond with the taxpayers for the missing information. If IRS granted the credit on the basis of incomplete information, it had no assurance that the taxpayers were entitled to it. On the other hand, if IRS denied the credit and corresponded with the taxpayers for the missing information, refunds would have been delayed or some eligible taxpayers may not have responded to IRS and would not have received the credit.
>
> "Faced with this dilemma, IRS adopted returns processing procedures that allowed most taxpayers who claimed the credit to get it even though they did not provide all the necessary eligibility information on their returns....if a taxpayer failed to provide information on the number of months the child resided with the taxpayer or the relationship of the child to the taxpayer, IRS would still grant the credit. We estimated that in about 21 percent of the EIC claims for tax year 1989 represented by our sample cases, the credit was granted even though the returns had incomplete EIC eligibility information.
>
> "IRS was faced with a similar dilemma when taxpayers did not claim the credit but appeared to qualify for it on the basis of the income, filing status, and dependency information on their returns. IRS adopted returns processing procedures to give these taxpayers the credit, instead of just informing them that they might be eligible for the credit. For tax year 1990, IRS gave the credit to about 564,000 taxpayers who did not claim it. IRS does not have data on how many of these taxpayers were actually entitled to the credit."[5]

These problems were addressed by the changes in eligibility rules made in the 1990 law and the introduction of Schedule EIC.

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[5] GAO, pp. 56-57.

The changes in law passed in 1990, however, addressed only part of the problem. More remains to be done. I believe a large part of what is needed now entails major changes in how the credit is administered. I am encouraged that this year, the IRS has radically altered its processing procedures. The new procedures are somewhat controversial, and it would have been preferable if the IRS had better prepared commercial tax preparers and taxpayers for them. But the new procedures hold strong promise for significant further reductions in the error rate.

Prior to 1991, the IRS did not even get the basic EIC eligibility information now contained on Schedule EIC. Up until this year, the IRS made limited use, before making EIC payments, of the information it did receive. Now this is changing.

Until this year, the IRS processed the EIC almost solely based on information on the tax return, without verifying any of this information before making payments. The validity of social security numbers for parents and children was not checked before EIC checks were mailed. No social security numbers were required for very young children. (This was due to statutory limitations.) EIC refunds were not held up while questionable information was verified.

Now, social security numbers are verified before payment is made. EIC returns are scrutinized, and those subject to question on any of a number of grounds are held up, and further information gathered on them, before the EIC is awarded. In addition, legislation enacted last fall extends the requirement for the provision of social security numbers to very young children as well.

These processing changes, along with other changes aimed at commercial preparers that use electronic filing, are the most sweeping changes in processing procedures since the EIC was instituted. They are likely to have a substantial effect.

In this vein, I believe at least one other procedural change may be needed. As recently as 1993, the IRS paid EIC refunds without checking the W-2 form to see if the taxpayer had already received an EIC advance payment. This led to double payment in some cases (although not in a great number of cases since use of advance payments is very small). I believe, but am not certain, that the IRS has resolved this problem as well. If not, the IRS should institute procedures to check W-2 forms to determine if advance payments are made before issuing an EIC refund. I believe the GAO has made a similar recommendation.

The EIC and Work Incentives

Important issues are frequently raised about the EIC and work incentives. Based on economic theory, it is generally assumed that the EIC encourages work among those working little or not at all while acting as a modest work disincentive for families whose income exceeds $11,000 and whose EIC benefit is reduced as their earnings rise.

These issues are sometimes oversimplified or misunderstood. We do not know whether the work disincentive effort is a significant one. For it to be, affected families would need to understand how the EIC affects their marginal tax rate, and it isn't clear that many do. If they know that they receive an EIC which lowers their overall tax burden but are not aware of its effect on their marginal tax rate — which is likely to be the case for a large number of families — the EIC could encourage rather than discourage them to work more. One recent analysis of labor market data finds that the EIC succeeds in increasing work among single mothers who have previously been out of the labor force and accomplishes this without diminishing work effort among single mothers whose EIC benefits decline as their earnings rise.[6]

Even if the EIC does have some disincentive effects upon the group of families whose EIC falls as their earnings increase, it is important to identify which types of families are affected. This point was emphasized by Robert Reischauer, former director of the Congressional Budget Office, and Henry Aaron, Director of Economic Studies at the Brookings Institution, at an American Enterprise Institute symposium on the EIC in 1990. Reischauer and Aaron noted that the families encouraged to work more by the EIC are likely to be quite different from the families that may be encouraged to work less. The families encouraged to work more, they observed, are heavily made up of single parents working little if at all — precisely the group whose work effort we most want to increase. By contrast, the families whose EIC benefits decline as their earnings rise — families with incomes over $11,000 — include a large number of two-parent families. Reischauer and Aaron emphasized that a major part of the EIC's effect in inducing modestly less work among families in this income range is likely to result from the credit's effect in enabling one parent in married families in which both parents are employed to work a little less so she can spend more time with her children.

Reischauer stressed that this should not be regarded as an adverse outcome and that it may be positive for a parent in two-parent working families to spend more time with her children. He cautioned that lumping increased work effort among single mothers who worked little with reduced work effort among married mothers in two-parent working families — and producing a negative number on the EIC's net effect on hours worked — could confuse rather than illuminate this issue.

Reischauer's point is supported by data provided in a GAO analysis. The GAO estimated that the percentage reduction in hours worked as a result of the EIC is four

[6] Nada Eissa (University of California, Berkeley) and Jeffrey B. Liebman (Harvard University), "Labor Supply Response to the Earned Income Tax Credit," December 5, 1994.

times greater among wives in two-parent families than among husbands in such families. In addition, the GAO's estimates showed no significant percentage reduction in work effort among single parents.

It also is important to place the estimates of the EIC's effects on work effort in perspective. The conclusion the GAO drew in Congressional testimony in 1993 is noteworthy in this regard. The GAO testified: "[The earned income tax credit] works. It offsets payroll taxes, increases progressivity of the tax system, and provides a positive work incentive to the lowest income group with only a slight disincentive to other recipients."[7]

The EIC and Marriage Penalties

The issue of the EIC and marriage penalties is another complex area. The EIC penalizes marriage for some and rewards it for others. It does not represent an unambiguous marriage penalty. In addition, some proposals to reduce the marriage penalty are unwise because they would substantially lessen the EIC's work incentive efforts among poor single-parent families, diminish the attractiveness of work as compared to welfare, and shift large sums from working poor families to middle-class families.

Sometimes, hypothetical cases are cited in which the EIC imposes a very large marriage penalty. The example most commonly cited involves two potential marriage partners who each are custodial parents with at least two children living with them and each earn about $11,000. This hypothetical case does not provide the best basis for policymaking. It is the hypothetical case in which the marriage penalty is greatest. This case rarely exists in the real world.

There are few cases in which two people who wish to marry are both single custodial parents who each live with at least two children and each have incomes in this range. Most male single parents are *not* custodial parents and are not eligible for the EIC — and thus do not lose any EIC benefits if they marry.

Census data indicate that of all marriages that occurred in 1990, *fewer than two-tenths of one percent involved a man with two or more children marrying a woman with two or more children*. The likelihood of such a marriage in cases in which both parties are custodial parents *and* also have incomes around $11,000 appears to be close to zero.

[7] GAO testimony before the Subcommittees on Select Revenue Measures and Human Resources, House Ways and Means Committee, March 30, 1993.

This does not mean the marriage penalty issue is not significant but that more reasonable examples should be used in discussing the issue. The most common example in which the EIC can penalize marriage involves a single working mother with one child who is considering marrying a man who earns modest wages but does not live with a child or receive the EIC. The EIC that such a couple would receive if they marry could be lower than the EIC the mother currently gets. If a single mother with one child who earns $5,000 working part-time marries a male earning $10,000, the EIC benefit in 1996 would drop $82.[8] If she marries a man earning $15,000, the EIC would decline $881.

If the mother earning $5,000 has *two* children, marrying a man earning $15,000 would cause a smaller EIC loss — about $200. And if such a mother marries a man earning $10,000, the EIC benefit would *increase* about $850.

On the other hand, if the mother earns $10,000 herself and has two children, the EIC benefit loss becomes larger. For example, if she marries a man earning $10,000, the loss is $1,760.

The EIC thus can penalize marriage. What is less well known is that it also can reward marriage substantially. The EIC offers a sizeable marriage incentive to a single mother who has no earnings and receives AFDC. This is significant, since marriage is one of the principal routes out of welfare.

In the absence of the EIC, a mother on AFDC who does not work and is contemplating marrying a man with low earnings risks losing a great deal. If she marries, she and her children will become ineligible for AFDC and also lose some of their food stamps. In addition, she likely will become ineligible for Medicaid. Depending on her children's ages and her husband's earnings, some or all of her children may lose Medicaid coverage as well. The marriage penalties embedded in the welfare system are strong.

The EIC helps to offset these losses and ease these penalties. By marrying, the couple will gain an EIC benefit of up to $2,157 if they have one child and up to $3,564 if they have two or more children. This will partially — and in some states, wholly — make up for the mother's loss of AFDC benefits when she marries.

For poor single mothers with little or no earnings, the EIC thus significantly lessens the marriage penalties in the welfare system. It provides these women an incentive to marry and leave welfare. This point is sometimes overlooked when the EIC and its effects on marriage are discussed. It is not accurate to speak of the EIC as

[8] All figures in this analysis are for 1996, when the EIC expansions enacted in 1993 are phased in fully.

simply penalizing marriage. It penalizes it for some and rewards it for others, including the group for which there is the greatest concern for encouraging marriage, single mothers on welfare.

CHANGE IN EITC BENEFITS IF MARRIAGE OCCURS

Mother Has One Child

	Male's Earnings are		
Mother's Earnings	**$5,000**	**$10,000**	**$15,000**
0	+1,376	+2,157	+1,618
5,000	+133	-82	-881
10,000	-863	-1,338	-2,137

Mother Has Two Children

	Male's Earnings are		
Mother's Earnings	**$5,000**	**$10,000**	**$15,000**
0	+1,676	+3,564	+2,854
5,000	+1,240	+854	-199
10,000	-1,034	-1,763	-2,816

Reducing the Marriage Penalty

One option recently suggested to ease the marriage penalty is to restructure the EIC in a budget-neutral manner so EIC benefits for two-parent families are essentially double those of single-parent families. The credit for a married couple with children would be twice as high as the credit for a single-parent family with the same income and the same number of children.

This would eliminate the marriage penalty for some of those for whom the EIC now creates such a penalty and lessen the penalty for others among this group. But in so doing, this change would have other, undesirable effects. If the credit for two-parent families is to be made twice as large as the credit for single-parent families and this is to be done without increasing its cost, the credit provided to single-parent working families — most of whom are low-income families working at low wages and not collecting AFDC — must be cut sharply. The result would be to lessen incentives to leave welfare for work. The problems that would result from restructuring the EIC in this manner are significant.

- *Such an approach would necessitate making two-parent families with incomes well above $30,000 eligible for the EIC.* To provide larger credits to two-parent families, the maximum credit for these families would have to be raised substantially. As a result, the income level at which the credit phased out entirely would have to be increased as well; otherwise, benefits would be reduced too rapidly as earnings climbed, pushing marginal tax rates too high. Under current law, the EIC will be available to families with two or more children that have incomes up to about $28,500 in tax year 1996. If the EIC is restructured so the credit for two-parent families is double that for single-parent families, the income limit for two-parent families would have to be raised substantially, probably to somewhere in the $30,000 to $40,000 range.

  As the EIC income limit is increased for two-parent families, the credit will reach into a "dense" part of the income distribution; a large proportion of families with children have incomes between $30,000 and $40,000. As the credit's income limit is raised, the credit becomes much more costly since a rapidly increasing number of families gain eligibility for it. This means that as the EIC income limit for two-parent families rises, the credit for single-parent families must be cut still more sharply to pay for it.

- *Incentives for families to leave welfare for work would be reduced significantly.* With EIC benefit levels for single-parent working families being cut sharply, the incentives for parents to leave welfare for work would be lessened. Poor single-parent families who work their way off welfare would receive substantially smaller EIC benefits and have less after-tax income than under current law. Bipartisan efforts of recent years to make work pay more than welfare would be set back, and part of the underpinning for work-based welfare reform would weaken.

- *Billions in EIC resources would be shifted from working poor families and their children to middle-income families.* Single-parent families on EIC constitute a much poorer group than do the two-parent families receiving this benefit. Data from the 1993 *Green Book* show that single-parent families account for more than two-thirds of the EIC families with incomes below $10,000, while two-parent families constitute a majority of the EIC families with incomes above $20,000. The effect of reducing the EIC for single-parent families, increasing it for two-parent families, and extending it to two-parent families at higher income levels would be to shift large amounts of income from poor or near-poor single-parent working families to two-parent families in the middle-income range.

Both the effect of the EIC on marriage and efforts to ease the marriage penalties are thus more complex than they may initially seem. This is a thorny area in which policy should move with caution.

Assets

Another question is whether assets limits should be included in the EIC eligibility criteria. On the one hand, taxpayers with very substantial assets do not need the EIC. On the other hand, assets tests of the sort used in some other means-tested programs are cumbersome and costly to administer and cannot be administered through the tax code.

The approach reflected in H.R. 831 addresses these issues in a reasonable way. I would, however, recommend one modification to H.R. 831.

The $2,350 limit on interest, dividends, rents and royalties should be indexed. Otherwise, this limit will erode in real terms over time and compel families with a legitimate need for the EIC to stop saving and consume enough of their liquid assets each year to remain eligible for the EIC. Also, as the $2,350 limit erodes each year, it will disqualify families with steadily lower amounts of assets. I would suggest reducing the $2,350 limit to a level that, when indexed, yields the same level of savings over five or 10 years as the provision in H.R. 831.

I would not recommend reducing this limit below a $2,000 indexed limit. A lower limit would disqualify some poor and near-poor working families that are saving for such legitimate reasons as sending a child to college, purchasing a home, or meeting a medical emergency, an increasing concern as the proportion of low-income working families lacking health insurance rises. We should not force such families to choose between losing their EIC (if their modest assets simply keep pace with inflation) and "dissaving" so they remain below the EIC limit. (Also, homeowners are not disqualified for the EIC, and it would pose equity problems to disqualify those who are saving so they can purchase a modest home while those who already own such a home can receive benefits.)

The EIC and Inflation Adjustments

The final proposal I would like to examine is a proposal recently suggested by Senator Gregg to halt indexation of the EIC. I commend the effort to determine if the Consumer Price Index is overstating inflation and, if so, to correct for this matter. Such a correction would affect the EIC, along with a range of other provisions of the tax code (such as the personal exemption, the standard deduction, and tax brackets) and many entitlement benefits, including Social Security.

But ending the indexation of the EIC would be a unwise course to follow. It would diminish the effectiveness of the EIC and, over time, result in substantial tax increases for large numbers of low-income working families with children. Millions of working poor and near-poor families would find that if their earnings simply kept pace with inflation, their payroll taxes would rise each year while their EIC — which is intended, in part, to offset payroll taxes — declined each year. The result would be steadily increasing tax burdens for working families that had experienced no increase in purchasing power. Moreover, because other key parts of the tax code are indexed, higher-income families would continue to be shielded from the effects of inflation on their tax burdens while working poor and near-poor families faced substantial tax increases.

This proposal also would be inconsistent with welfare reform goals because over time, it would reduce the advantages of working rather than receiving welfare. It also would sharply raise marginal tax rates on large numbers of low-income working families.

Indexing and the Federal Tax Code

Ending the indexation of the EIC would violate a principle advanced by President Reagan and enacted into law in the 1980s — that the basic features of the income tax code should be indexed so taxes do not creep up for working families whose incomes are rising only at the pace of inflation. It was President Reagan who proposed the EIC be indexed for inflation.

In some ways, indexing is even more important in the EIC than in the personal exemption and standard deduction. Indexing those two features of the tax code keeps a family's tax burden constant as its income rises with inflation. For certain EIC recipients, this is the effect of indexing as well. But for millions of other EIC families, indexing the credit is necessary to ensure that the EIC these families receive is not *cut* when their income rises at a rate equal to or less than inflation.

Indexing avoids cuts in the EIC benefits of millions of low-income working families because of basic features of the EIC's design. The EIC is phased out above a certain income threshold. For a family with two or more children, the threshold will be about $11,600 in 1996. For every dollar a family earns above $11,600, the EIC is reduced 21 cents. This income threshold is indexed for inflation.

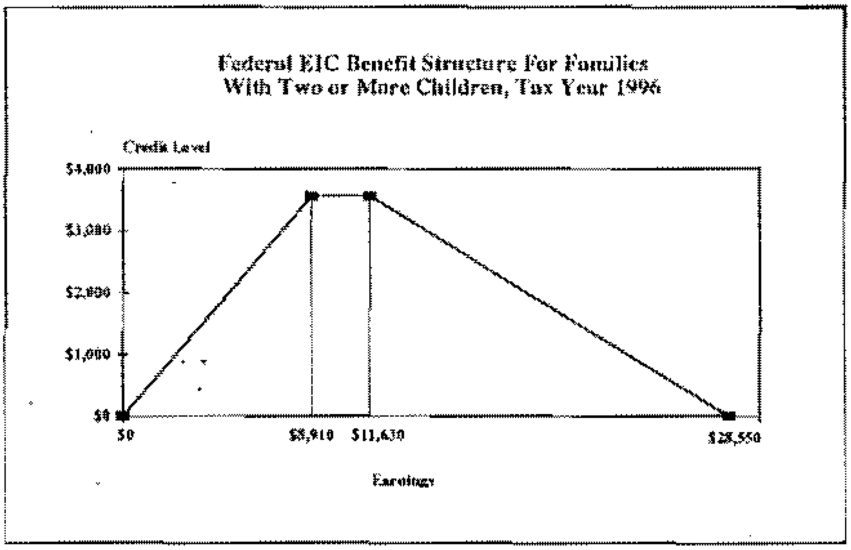
The Structure of the EIC and EIC Indexing

The structure of the EIC includes an "upslope," a "plateau," and a "downslope." For each dollar a family earns up to a certain level, the value of the EIC is increased. In a family with two or more children in 1996, the EIC equals 40 percent of earnings for each dollar this family earns up to $8,910. Thus, a family with two children and earnings of $5,000 would receive a credit of $2,000. A family earning $8,910 would receive a credit of $3,564.

As the family's income rises above $8,910, the EIC remains constant (at its maximum level of $3,564) until income reaches $11,630. This is the plateau.

Once a family's income passes $11,630, the EIC drops by 21.06 percent — or about 21 cents — for each additional dollar of income. This is the downslope. When family income reaches $28,550 the value of the credit falls to zero.

Both the dollar level at which the EIC stops increasing as earnings rise ($8,910 for a family with two or more children in 1996) and the dollar level at which the EIC starts falling as income rises (about $11,630 in 1996) are indexed for inflation. This indexation feature of the EIC was proposed by President Reagan and enacted in 1986 as part of that year's Tax Reform Act.



If the indexation feature is repealed, a family with income at or above $11,600 whose income rises at the rate of inflation will find that its EIC falls in absolute terms (i.e., not just in inflation-adjusted terms) even though the family's purchasing power has not increased. This family also will owe more in payroll taxes. For each dollar its earnings rise, its payroll tax will increase 7.65 cents while its EIC drops 21 cents.

These effects are illustrated by the following examples, which use CBO's inflation forecast.

- Take the case of a family of four with two children and earnings of $12,000 in 1996. This family's earnings will leave it more than $4,000 below the poverty line next year; the family's income will equal a little less than 75 percent of the poverty line. The EIC the family receives bridges part of this gap. After the family's EIC and payroll taxes are figured in, the family's income will equal about $14,570, or about 90 percent of the poverty line.

  The poverty line rises with inflation. Under current law, if the family's wages keep pace with inflation, its payroll taxes and its EIC rise with inflation as well — and the family's income, after taxes, remains at 90 percent of the poverty line.

  But if the EIC is *not* indexed and the family's income keeps pace with inflation, its EIC will decline while its payroll taxes are rising and the poverty line is increasing. After five years, if the family's income simply keeps pace with inflation, its EIC will have fallen $460 below what the family received in 1996, while its payroll taxes have climbed $167.

- Near-poor families would be affected as well. Under current law, a family with two children earning $20,000 will receive an EIC of about $1,800 in 1996. (The family's credit will offset most but not all of the family's payroll taxes of $1,530 and its federal income tax liability of $430.) Under current law, if the family's earnings rise to $20,680 in 1997 — an increase equal to the projected inflation rate — its EIC also will rise in tandem with inflation, to $1,860.

  If the EIC is not indexed, however, the family's EIC will fall from $1,800 in 1996 to $1,660 in 1997, a $140 decline. The EIC will fall because the family loses 21 cents of its EIC for each additional dollar of income.

  At the same time that the family's EIC would be falling, its payroll taxes would be rising. Although this family's income would not have risen faster than inflation, its net tax bill would increase.

- This effect would grow larger with each passing year. If a family's income simply kept pace with inflation and the EIC was not indexed, the family with income equal to $20,000 in 1996 would receive an EIC five years later that was *$767 smaller* than the EIC it received in 1996. Its EIC would be $1,094 lower than it would have been had the EIC been adjusted for inflation. In real terms, the purchasing power of its EIC would decline by *51 percent* in only a five-year period even though its real income had not risen at all.

Working poor families at still-lower earnings levels, such as those working full time year round at little more than the minimum wage, also would be adversely affected. Consider a family that earns $4.50 an hour in 1996, or $9,000 a year, and is far below the poverty line. If the family's earnings keep pace with inflation, its EIC will rise with inflation as well, under current law. If indexing is eliminated, the purchasing power of its EIC will erode. After five years, its EIC will have lost 15 percent of its purchasing power. After 10 years, the purchasing power of the family's EIC would have fallen by 32 percent. Meanwhile, the family's payroll taxes would have increased every year, and the poverty line would have risen. The family would have fallen steadily deeper into poverty.

Ending the indexation of the EIC consequently would make millions of working poor families with children poorer over time. It also would turn a steadily increasing number of near-poor working families into poor families, by pushing them below the poverty line, and reduce the EIC for millions more who work hard and are modestly above the poverty line.

Ending the indexation of the EIC would be inconsistent with the goals of "making work pay" and promoting work over welfare. If the EIC is not adjusted for inflation, as its real value declines, the gain from working at a low-wage job rather than relying on welfare will erode.

Failure to index the EIC would undermine the EIC's effectiveness in one other way as well, by weakening the work incentive features of the credit. Currently, families earning $10,000 or $11,000 a year do not face an increase in their marginal tax rates when their earnings rise with inflation. But if EIC indexing ends, such families would be pushed above the point where their EIC begins to drop 21 cents for each additional dollar earned. The marginal tax rate these families face would rise 21 percentage points.

Some of these families already face substantial marginal tax rates because they receive other benefits such as food stamps that decline as earnings rise. To raise their marginal rates another 21 percentage points due to failure to index the EIC could raise their marginal tax rates to disturbingly high levels.

Finally, ending EIC indexation would be inconsistent with other Congressional action. There is no discussion of ending the indexation of other features of the tax code such as the personal exemption, the standard deduction, or the tax brackets. In addition, the House of Representatives is likely to pass legislation to index capital gains tax benefits. Some policymakers also are proposing various tax cuts. It is difficult to discern how ending EIC indexing fits in with these other policies unless the principle is that investors and middle- and upper-income families need protection against the effects of inflation on their taxes but low-income working families do not. (Furthermore, if EIC indexation is ended while various tax cuts also are approved, low-income working families would face tax increases while families at higher income levels received tax cuts.)

Other Proposals

Finally, I would offer brief comments on several other proposals.

- There are arguments both for and against including Social Security in adjusted gross income (AGI) for purposes of determining eligibility and benefit levels for the EIC. EIC savings are desired, this option probably warrants investigation.

- It would be a mistake to attempt to include child support in AGI for EIC purposes. Attempting to count child support payments as part of AGI would pose serious problems for the IRS. Such a rule would not be enforceable to any substantial degree. The result would be higher error rates and further damage to the EIC's integrity and reputation. Furthermore, attempting to count child support payments in this manner would cause double-counting of income, since non-custodial parents pay income tax on the income from which child support payments are made.

- I would strongly recommend against reinstating the type of complex, error-prone rules that contributed to high error rates in the 1980s and were repealed in the 1990 reconciliation act. This includes rules such as the "support test," which is largely unenforceable.

- To further reduce error, I would urge consideration of a proposal made several years ago by Senator Packwood, and praised by the GAO, to modify the rules for claiming the personal exemption for a child so they match the rules for determining when a child is a "qualifying child" for EIC purposes. This would simplify tax rules and should reduce errors in both the EIC and the personal exemption areas.

Conclusion

While steps have been taken in recent years to reduce EIC error rates, more needs to be done. Some other EIC changes also warrant consideration.

We should not, however, lose sight of the EIC's virtues. The EIC is boosting the incomes of millions of poor and near-poor families with children that are working and staying off welfare. With the steady erosion of wages for low-paid work over the past 20 years and the likely continuation of this trend in the future, the EIC is a critically important element of the tax code. The EIC also provides an important underpinning for welfare reforms to move families from welfare to work. It is part of the welfare reform strategies of policymakers such as Governor Engler of Michigan.

In addition, the EIC has helped change the tax system into a system that helps lift working families out of poverty instead of pushing more working families into poverty. The Department of Health and Human Services testified that in 1984, the tax system pushed into poverty 1.8 million people who lived in families with children. When the recent EIC expansion is fully phased in, HHS estimates the tax system will lift more than two million such people out of poverty.

The EIC needs significant improvement to reduce error and fraud. But the EIC's mission remains as important as it ever. Deep reductions in the EIC benefits of honest low-income working families would not be a desirable part of the EIC reform agenda.

EITC

CENTER ON BUDGET AND POLICY PRIORITIES

April 4, 1995

ASSESSING THE GREGG OPTION TO END THE INDEXATION OF THE EARNED INCOME TAX CREDIT

Senator Judd Gregg recently outlined a series of options for entitlement reforms, including a proposal to scale back the earned income tax credit (EIC). According to materials that Senator Gregg has distributed, his EIC options would reduce the credit by $27 billion over five years.

A reduction of this magnitude would reduce EIC expenditures over the five-year period by almost 20 percent. These cuts would grow steadily larger with each passing year. By the fifth year, they appear to constitute a reduction of considerably more than 20 percent.

The Gregg options include proposals contained in the Clinton budget to bar families with significant interest and dividend income, as well as illegal immigrants, from receiving the EIC.[1] It also includes Clinton budget proposals aimed at reducing error and fraud. These various Clinton budget proposals save slightly more than $3 billion over five years. The bulk of the savings in the Gregg proposal, however, stems from another EIC option — eliminating the "indexation" of the EIC.[2] Indexation is the process by which the amount of the EIC is adjusted each year so its value does not fall — and taxes on the working poor do not rise — when their earnings simply keep pace with inflation.

This component of the Gregg proposal would seriously diminish the effectiveness of the EIC and, over time, result in substantial tax increases for large numbers of low-income working families with children. Millions of working poor and near-poor families would find that if their earnings simply kept pace with inflation, their payroll taxes would rise each year while their EIC — one goal of which is to help offset payroll taxes — declined each year. The result would be steadily increasing tax burdens for families that had experienced no increase in purchasing power. Because other key parts of the tax code are indexed, higher-income families would continue to

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[1] A version of the proposal to make families with significant interest and dividend income ineligible for the EIC has passed both the Senate and the House and is likely to become law soon. The savings from this proposal will help pay for the extension of the health insurance tax deduction for the self-employed. The version of this EIC proposal that Congress is expected to approve is more restrictive than the Clinton proposal.

[2] It is unclear if eliminating indexing in 1996 will provide $24 billion in savings over five years. The options paper does not describe how it arrived at the $27 billion figure.

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Robert Greenstein, Executive Director

be shielded from the effects of inflation on their tax burdens, while working poor and near-poor families faced substantial tax increases.

This proposal also would signal the abandonment of what for a decade has been a goal strongly supported across the political spectrum by conservatives and liberals alike — that if a parent works full time throughout the year, the family should not live in poverty. Failure to index the EIC would cause many low-wage working families to fall further below the poverty line with each passing year.

Finally, this proposal would undermine bipartisan welfare reform goals. Over time, it would reduce the advantages of working rather than receiving welfare. It also would sharply raise marginal tax rates on millions of low-income working families, which could lessen incentives to work.

1. Indexing and the Federal Tax Code

Ending the indexation of the EIC would be inconsistent with a principle advanced by President Ronald Reagan and enacted into law in the 1980s with bipartisan support — that the basic features of the income tax code should be indexed so taxes do not creep up for working families whose incomes are rising only at the pace of inflation. As part of the tax legislation signed by President Reagan in 1981 and 1986, fundamental features of the income tax code — such as the standard deduction, the personal exemption, the EIC, and the tax brackets — were indexed for inflation.

Indexing is even more important in the EIC than in the personal exemption and standard deduction. Indexing those two features of the tax code keeps a family's tax burden constant as its income rises with inflation. For certain EIC recipients, this is the effect of indexing as well.

For millions of EIC families, however, indexing the credit also serves another purpose. In addition to ensuring that the value of the EIC keeps pace with inflation, indexing also ensures that the actual dollar level of the EIC these families receive is not *reduced* when their income rises at a rate equal to or less than the inflation rate. Most of the families who would face cuts in their EIC if it is no longer indexed are families that work for modest wages and do not receive welfare.

Indexing avoids cuts in the EIC benefits of millions of low-income working families because of basic features of the EIC's design. (See the box entitled "The Structure of the EIC"). The EIC is structured in such a way that it is phased out above a certain income threshold. For a family with two or more children, the threshold will be about $11,600 in 1996. For every dollar a family earns above $11,600 the EIC is reduced 21 cents. This income threshold is indexed for inflation.

The Structure of the EIC

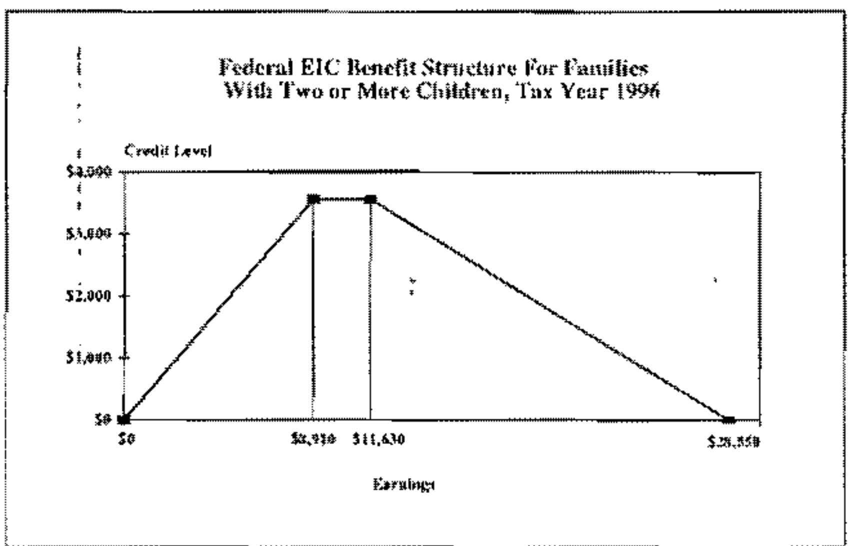
The value of the EIC varies by earnings and the composition of a household. Families with two or more children can qualify for the largest EIC. (Families with one child can qualify for a smaller — but still significant — EIC. Workers with very low incomes and no children can qualify for a very small EIC.)

The basic structure of the EIC includes an "upslope," a "plateau," and a "downslope." For each dollar a family earns up to a certain level, the value of the EIC is increased. In a family with two or more children in 1996, the EIC equals 40 percent of earnings for each dollar this family earns up to $8,910. Thus, a family earning $5,000 would receive a credit of $2,000. A family earning $8,910 would receive a credit of $3,564.

As the family's income rises above $8,910, the EIC remains constant (at its maximum level of $3,564) until income reaches $11,630. This is the plateau.

Once a family's income passes $11,630, the EIC drops by 21.06 percent — or 21 cents — for each additional dollar of income. This is the downslope. When family income reaches $28,550 the value of the credit falls to zero.

Both the dollar level at which the EIC stops increasing as earnings rise ($8,910 for a family with two or more children in 1996) and the dollar level at which the EIC starts falling as income rises (about $11,630 in 1996) are indexed for inflation. This indexation feature of the EIC was proposed by President Reagan and enacted in 1986 as part of that year's Tax Reform Act.



If the indexation feature is repealed, a family with income at or above $11,600 whose income simply rises at the rate of inflation will find that the size of the credit it receives will fall in absolute terms (i.e., not just in inflation-adjusted terms), even though the family's purchasing power has not increased. This family also will owe more in payroll taxes. For each dollar its earnings rise, its payroll tax will increase 7.65 cents while its EIC drops 21 cents.

These effects can be further illustrated by the following examples, all of which use CBO's projected rate of inflation of 3.4 percent per year.

- Consider the case of a family of four with two children and earnings of $12,000 in 1996. This family's earnings will leave it more than $4,000 below the poverty line next year; stated another way, the family will be below 75 percent of the poverty line. The EIC the family receives bridges part of this gap. After the family's EIC and payroll taxes are figured in, the family's income will equal about $14,570, or about 90 percent of the poverty line.

  The poverty line rises with inflation. Under current law, if the family's wages keep pace with inflation, its payroll taxes and its EIC both rise with inflation as well. As a result, the family's income, after taxes, will remain at 90 percent of the poverty line.

  But if the EIC is *not* indexed and the family's income increases with inflation, its EIC will fall at the same time its payroll taxes are rising and the poverty line is increasing. After five years, if the family's income simply keeps pace with inflation, its EIC will have fallen $460 below what the family received in 1996, while its payroll taxes have climbed $167. Its EIC will be nearly $1,100 less than if the credit had been indexed.

- Near-poor families would be affected as well. Under current law, a family with two children earning $20,000 will receive an EIC of about $1,800 in 1996. (The family's credit will largely, though not entirely, offset the family's payroll taxes of $1,530 and its federal income tax liability of $430.) Under current law, if the family's earnings rise to $20,680 in 1997 — an increase equal to the projected rate of inflation — its EIC will also rise in tandem with inflation, to $1,860.

  If the EIC is not indexed, however, the family's EIC will fall from $1,800 in 1996 to $1,660 in 1997, a $140 decline. (The EIC will fall because the family loses 21 cents of its EIC for each additional dollar of income.)

  At the same time that the family's EIC would be falling, its payroll taxes would be rising because of its increased earnings. Although this family's income would not have risen faster than inflation, its net tax bill would increase both because its EIC would drop and its payroll taxes would rise.

- This effect would grow larger with each passing year. If a family's income simply kept pace with inflation and the EIC was not indexed, the family with income equal to $20,000 in 1996 would receive an EITC five years later, in 2001, that was *$767 smaller* than the EIC it received in 1996. Its EIC would be $1,094 lower than it would have been if the EIC had been adjusted for inflation. In real terms, the purchasing power of its EIC would decline by *51 percent* in only a five-year period even though its real income had not risen at all.

Similar problems would arise for families now earning just below $11,600 a year. Currently, families with two or more children and income between $8,900 and $11,600 are on the so-called EIC "plateau" where all families receive the maximum EIC. If the EIC is no longer indexed, however, a family that earns $10,000 or $11,000 and whose income simply rises in accordance with inflation will not only have its EIC erode — because the maximum EIC declines in purchasing power — but it also soon will be pushed over the $11,600 point and start to have its EIC cut as its earnings keep pace with inflation. Under current law, this family would not face EIC reductions because the $11,600 level is adjusted annually for inflation.

The type of examples cited here would not be uncommon. Millions of poor or near-poor working families with children would be affected in this manner. In 1996, roughly 10 million families are projected to have incomes that place them at the very end of the "plateau" or on the "downslope" of the EIC.

Working poor families at still-lower earnings levels — such as those working full time year round at little more than the minimum wage — also would be adversely affected. Consider a family that earns $4.50 an hour in 1996, or $9,000 a year, and is far below the poverty line. If the family's earnings keep pace with inflation, its EIC will rise with inflation as well under current law. If indexing is eliminated, the purchasing power of its EIC will erode. After five years, its EIC will have lost 15 percent of its purchasing power. By the end of 10 years, the family's EIC would be $1,610 below what it would have been if the EIC had been indexed to inflation. After 10 years, the purchasing power of the family's EIC would have fallen by 32 percent. Meanwhile, the family's payroll taxes would have increased every year, and the poverty line also would have risen each year. The family would have fallen steadily deeper into poverty.

In short, ending the indexation of the EIC will make millions of working poor families with children significantly poorer over time, turn a steadily increasing number of near-poor working families into families that are poor by pushing them below the poverty line, and reduce the EIC for millions more who work hard and are only modestly above the poverty line.

2. **Ending the indexation of the EIC also would be inconsistent with the goals of "making work pay" and promoting work over welfare.**

If the EIC were no longer indexed for inflation, the goal of ensuring that full-time workers are not poor would, as time went by, become further from reach than it is today. In addition, the relative advantages of work over welfare would diminish.

In the past, basic means-tested benefits rose over time, although taken together these benefits rose more slowly than inflation. If the EIC is not adjusted for inflation, the gain from working at a low-wage job rather than relying on welfare will erode over time.

Failure to index the EIC also would undermine the EIC's effectiveness in another key way — it would weaken the work incentive features of the credit. It is widely recognized that high marginal tax rates can increase disincentives to work for low-wage working families. Currently, families earning $10,000 or $11,000 a year whose earnings keep pace with inflation do not face an increase in marginal tax rates, because their EIC remains constant. But if EIC indexing ends, such families would be pushed above the point where the EIC begins to drop more than 20 cents for each additional dollar earned. Stated another way, the marginal tax rate these families face would rise by more than 20 percentage points.

Some of these families already face substantial marginal tax rates because they receive other benefits such as food stamps that decline as earnings rise. To raise their marginal rates by more than 20 percentage points due to failure to index the EIC could raise their marginal tax rates to extremely high levels.

3. **Ending the indexation of the EIC would be inconsistent with other policies moving through Congress.**

Ending the indexation of the EIC also would be inconsistent with other Congressional action in several ways. There is no discussion of ending the indexation of other features of the tax code such as the personal exemption, the standard deduction, or the tax brackets. Moreover, the House of Representatives is likely to pass legislation to index capital gains tax benefits, which primarily benefit wealthier Americans. Some Members of Congress also are talking of cutting taxes for an array of groups ranging from middle- and upper-income families to major corporations and investors.

It is difficult to discern how ending EIC indexing fits in with these other policies unless the principle is either that wealthy investors and middle- and upper-income families need protection against the effects of inflation on their taxes but low-income working families do not, or that it is acceptable to raise rather than lower taxes so long as low-income working families are the ones who bear the tax increases. (It should be

Is the EIC Out of Control?

A principal argument the Gregg task force report makes for taking $27 billion out of the EIC is that the EIC is "out of control" and as a result, there will be "significant long-term fiscal hemorrhaging unless action is taken to contain [the EIC]" and to "restrain its unsustainable rates of growth." The conclusion that the EIC is out of control and will continue to grow at unacceptable rates unless action is taken is based on the fact that the EIC has grown at rapid rates in recent years.

This part of the Gregg report, however, reflects some misunderstanding of the causes and duration of EIC growth. The EIC is *not* out of control. It was expanded at the request of President Reagan in 1986, and on a bipartisan basis in 1990, with strong support from President Bush and Congressional leaders of both parties. A final expansion was proposed in 1993 by President Clinton and enacted. The 1986 and 1990 expansions phased in over several years, creating high rates of EIC growth in the late 1980s and early 1990s. Similarly, the 1993 expansion is now phasing in.

Once the 1993 expansion is phased in fully, substantial EIC growth will halt. CBO forecasts that after 1997, the EIC will grow at less than 4.5 percent, with growth in 1999 less than in 1998. This modest growth is due largely to inflation. As a percentage of the Gross Domestic Product, EIC costs will *decline* after 1997, according to the CBO forecast. This is a far cry from the situation in programs such as Medicare and Medicaid where rapid rates of growth persist indefinitely and do *not* primarily result from specific federal decisions to expand the programs.

noted that if EIC indexing is ended and a child tax credit is established or the personal exemption is raised, most low-income working families with children still will end up worse off — and facing an increase in federal tax burdens over coming years when payroll taxes are counted — because their incomes are not high enough to benefit from a non-refundable child credit or a rise in the personal exemption.)

4. The Earned Income Credit and the CPI

Finally, in the context of ending the indexation of the EIC, the point may be made that the Consumer Price Index appears to overstate inflation by a fraction of a percentage point per year. But that affects all benefits and components of the tax code that are indexed by the CPI — Social Security, federal retirement benefits, the tax brackets, the personal exemption, and the standard deduction, as well as the EIC. Action taken to address this matter should affect all indexed tax and benefit provisions in the same manner. That the CPI may modestly overstate inflation does not provide a strong rationale for singling out the EIC and ending all inflation adjustment in it.

How TO SAVE $ $ $ $

save two (2) billion dollars "per year"

A GOOD SUGGESTION

EITC

EXEMPTIONS AND DEPENDENTS "FRAUD" ON TAX RETURNS

: Federal law requires a "social security" number on a tax return for a dependent/exemption allowance.
: When this new anti-fraud law was enacted in 1986 it saved two (2) billion dollars "per year" in phony adult exemptions/child exemptions that disappeared off federal tax returns.
: The IRS always had the power and authority to implement this identification requirement long before the 1987 on tax return filing period.
: Fortunately, one U.S. Senator on the Senate Finance Committee made it statutory law, because the IRS failed to request this information although advised to.

PROBLEM:

: Today, child and adult (and earned income credit) exemption and dependent tax fraud on federal tax returns are again a problem on the rise because 75 millions of Americans are now mostly on government grants i.e. veterans (VA) benefits/full state workmen's compensation/federal SSI/ supplemental security income/ SSA/full social security/home relief (etc.) full unemployment benefits, yet, are being fraudently claimed as exemptions/dependents by third party non-relatives and relatives that frequently do not reside together. They do it with a social security number.

SOLUTION: A short exemption "question" on dependent's/other grants on federal tax returns in 1995 could be included.

Since IRS Form 1040's question No. 6 (c)(2) will no longer be necessary on 1995 tax returns (due to a change in law) then please substitute briefly, in place of the current 1994 tax question, No. 6 (c)(2) the following:

a) "List dependents Gov't grant initials (see page ___)

(Tax instruction booklets can use initials i.e. VA,SSA,SSI,WC,ADC, Pension, In Jail.)

or

b) "Enter dependents Gov't grant status (see page __)

or

c) "Itemize dependents Gov't grants" (see page __)

WHY: Since President Clinton and/or Congress are going to increase the "value" of exemptions/ dependents with new tax credits and other credits, exemption fraud will become more costly.

GOV'T SAVINGS: Estimated two billion dollars in the first year if IRS acts without waiting for Congress.

Form **1040** Department of the Treasury—Internal Revenue Service
U.S. Individual Income Tax Return (6) **1994**

IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 1994, or other tax year beginning , 1994, ending , 19 | OMB No. 1545-0074

Label

(See instructions on page 12.)

Use the IRS label. Otherwise, please print or type.

LABEL HERE

Your first name and initial	Last name	Your social security number
If a joint return, spouse's first name and initial	Last name	Spouse's social security number
Home address (number and street). If you have a P.O. box, see page 12.	Apt. no.	**For Privacy Act and Paperwork Reduction Act Notice, see page 4.**
City, town or post office, state, and ZIP code. If you have a foreign address, see page 12.		

Presidential Election Campaign (See page 12.)

	Yes	No	
Do you want $3 to go to this fund?			*Note: Checking "Yes" will not change your tax or reduce your refund.*
If a joint return, does your spouse want $3 to go to this fund?			

Filing Status

(See page 12.)

Check only one box.

1 Single
2 Married filing joint return (even if only one had income)
3 Married filing separate return. Enter spouse's social security no. above and full name here. ▶
4 Head of household (with qualifying person). (See page 13.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
5 Qualifying widow(er) with dependent child (year spouse died ▶ 19). (See page 13.)

Exemptions

(See page 13.)

6a **Yourself.** If your parent (or someone else) can claim you as a dependent on his or her tax return, do **not** check box 6a. But be sure to check the box on line 33b on page 2

b Spouse

→ OMIT IN 1995 (NEW LAW)

c **Dependents:**

If more than six dependents, see page 14.

(1) Name (first, initial, and last name)	(2) Check if under age 1	(3) If age 1 or older, dependent's social security number	(4) Dependent's relationship to you	(5) No. of months lived in your home in 1994

No. of boxes checked on 6a and 6b
No. of your children on 6c who:
• lived with you
• didn't live with you due to divorce or separation (see page 14)
Dependents on 6c not entered above
Add numbers entered on lines above ▶

d If your child didn't live with you but is claimed as your dependent under a pre-1985 agreement, check here ▶
e Total number of exemptions claimed

Income

Attach Copy B of your Forms W-2, W-2G, and 1099-R here.

If you did not get a W-2, see page 15.

Enclose, but do not attach, any payment with your return.

Line	Description		
7	Wages, salaries, tips, etc. Attach Form(s) W-2	7	
8a	**Taxable** interest income (see page 15). Attach Schedule B if over $400	8a	
b	**Tax-exempt** interest (see page 16). DON'T include on line 8a — 8b		
9	Dividend income. Attach Schedule B if over $400	9	
10	Taxable refunds, credits, or offsets of state and local income taxes (see page 16)	10	
11	Alimony received	11	
12	Business income or (loss). Attach Schedule C or C-EZ	12	
13	Capital gain or (loss). If required, attach Schedule D (see page 16)	13	
14	Other gains or (losses). Attach Form 4797	14	
15a	Total IRA distributions — 15a — b Taxable amount (see page 17)	15b	
16a	Total pensions and annuities — 16a — b Taxable amount (see page 17)	16b	
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	17	
18	Farm income or (loss). Attach Schedule F	18	
19	Unemployment compensation (see page 18)	19	
20a	Social security benefits — 20a — b Taxable amount (see page 18)	20b	
21	Other income. List type and amount—see page 18	21	
22	Add the amounts in the far right column for lines 7 through 21. This is your **total income** ▶	22	

Adjustments to Income

Caution: See instructions ▶

Line	Description		
23a	Your IRA deduction (see page 19)	23a	
b	Spouse's IRA deduction (see page 19)	23b	
24	Moving expenses. Attach Form 3903 or 3903-F	24	
25	One-half of self-employment tax	25	
26	Self-employed health insurance deduction (see page 21)	26	
27	Keogh retirement plan and self-employed SEP deduction	27	
28	Penalty on early withdrawal of savings	28	
29	Alimony paid. Recipient's SSN ▶	29	
30	Add lines 23a through 29. These are your **total adjustments** ▶	30	

Adjusted Gross Income

Line	Description		
31	Subtract line 30 from line 22. This is your **adjusted gross income.** If less than $25,296 and a child lived with you (less than $9,000 if a child didn't live with you), see "Earned Income Credit" on page 27 ▶	31	

Cat. No. 12598V

ALSO SAVE$
ON

Earned Income Credit
(Qualifying Child Information)

The Earned Income Tax Credi

To Qualify for Federal EIC

- You must have worked and earned some income during 1994.
- Your earned income and your federal adjusted gross income must each be less than $23,755 if you are a worker with one qualifying child, less than $25,296 if you have two or more qualifying children, or less than $9000 if you have no dependent children.
- To qualify for EIC at the dependent child level, you must have at least one child who:
  - is your son, daughter, adopted child, grandchild, stepchild or foster child:

NEED TO "REGULATE" EARNED INCOME CREDIT PHONY CHILD "EXEMPTIONS" BY NON-SUPPORTING FATHERS OR PARENT.

THE NATIONAL ALLIANCE TO END HOMELESSNESS, INC.

October 7, 1993

Mr. Bruce Reed
Deputy Assistant to the President
For Domestic Policy
Executive Office of the President
1600 Pennsylvania Ave., N.W.
Washington, D.C. 20500

Dear Mr. Reed:

Thank you for your participation in the Alliance Leadership Roundtable on September 29, 1993. Our members were glad to hear that you and President Clinton feel that the expansion of the Earned Income Tax Credit (EITC) is one of the most exciting things to happen thus far. Many Roundtable members including the Alliance were very active in encouraging Congress to support the EITC.

I think that we would all agree that programs need to give people the tools to become self-sufficient and get off of Welfare. However, it is of some concern that two years may be an arbitrary limit in which people are to gain these skills or tools. Roundtable members would like to work with the Taskforce to design standards for job training and education programs that would be available to welfare recipients.

Again, we believe the Roundtable provides an exceptional opportunity to discuss domestic policy, particularly welfare reform, with all of the relevant organizations dealing with the issue. Our members look forward to a continuing dialogue with you.

Thank you again.

Sincerely,

Thomas L. Kenyon

Thomas L. Kenyon
President

1518 K STREET NW SUITE 206 WASHINGTON, DC 20005 TELEPHONE (202) 638-1526 FAX (202) 638-4664

DEPARTMENT OF THE TREASURY
WASHINGTON

FACSIMILE COVER SHEET
ECONOMIC POLICY

Date 8/6/93

FAX Message Number ______

Number of Pages to Follow 8 + cover

TO: Bruce Reed

Domestic Policy Council

Addressee's FAX Number 456-7739

Addressee's Confirmation Number 456-6515

FROM: Alicia H. Munnell

Treasury Department

Sender's FAX Numbers (202) 622-2633

Sender's Confirmation Number (202) 622-2200

COMMENTS/SPECIAL INSTRUCTIONS:

UNCLASSIFIED

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

August 6, 1993

MEMORANDUM FOR MEMBERS OF THE WORKING GROUP ON WELFARE REFORM, FAMILY SUPPORT, AND INDEPENDENCE

From: Alicia Munnell AHM
Assistant Secretary for Economic Policy

Subject: Earned Income Tax Credit (EITC): Questions & Answers

Following up on the discussion of the earned income tax credit at the meeting of the Working Group last Wednesday, attached are three questions and answers dealing with the issues that were raised.

Please note that the Schedule EIC included in the package is for tax year 1992, and does not reflect the simplifying changes in the Reconciliation Act that are referred to in one of the answers.

Attachments

ADDRESSEES:

Bruce Reed
David Ellwood
Mary Jo Bane
Working Group Co-Chairs

Ken Apfel
Walter Broadnax
Ray Cortines
Marurice Foley
Ellen Haas
Madeleine Kunin
Doug Ross
Isabel Sawhill
Eugene Sperling
Joseph Stiglitz
Jeff Watson

Eleanor Acheson
Robert Carver
Joycelyn Elders
Thomas Glynn
Elaine Kamarck
Wendell Primus
Julie Samuels
Eli Segal
Michael Stegman
Fernando Torres-Gil
Kathi Way

Compliance Problems with the EITC

Question:

Just a few years ago, the IRS was reporting that about 46 percent of recipients were getting overpayments of the credit, and about 39 percent of total EITC payments were errors. Indeed, in most cases, claimants were not eligible for the credit at all. In the reconciliation bill, the Administration supported a large expansion of the EITC. Isn't it irresponsible to expand the EITC, given such large compliance problems?

Answer:

No. Those error rates were from 1985 tax returns. The Omnibus Budget Reconciliation Act of 1990 contained a comprehensive proposal to reduce these error rates.

In large part, these error rates were associated with complex eligibility rules. Taxpayers could not understand these rules, and the IRS did not have sufficient information from tax returns or independent information reports to verify eligibility before the refund checks were sent off.

-- Compliance data suggested a relationship between EITC overpayments and errors in reporting either filing status or dependents. To claim the EITC, a married couple had to file a joint return with at least one child dependent, while a single parent had to file as a head of household. But the rules governing the determination of filing status and dependency can be confusing to taxpayers and difficult for the IRS to administer. The compliance data seem to confirm this claim -- at least with respect to those eligible for the EITC.

-- Compare the situations of two single mothers who are neighbors. One of the mothers was on welfare for part of the year before she was able to find a job. Her neighbor worked the entire year. At the end of the year, the two neighbors believed that they were heads of households (as single parents) and that they were eligible for the EITC because of their jobs. In fact, one of the women might not have been eligible for the EITC under the pre-1990 rules. She could not have claimed the EITC (or head of household filing status) if over half of the costs of maintaining her home during the year came from welfare income.

  -- Even the IRS would initially have thought that both women were eligible. Both women probably received a check from the IRS because the agency could not detect that the former welfare recipient was ineligible based on the information provided on the tax return.

The 1990 provisions were designed, in part, to conform the EITC eligibility criteria with what people actually did. The 1990 Act replaced complex rules with simple tests for determining eligibility for the EITC.

-- Under the 1990 rules, both single mothers, in the example above, would qualify for the EITC and would be rewarded for their work effort.

We still do not have information regarding the effectiveness of the 1990 provisions. However, we are monitoring the compliance issue very carefully.

Background:

At the time of the 1990 Act, the most recent compliance data was from the 1985 Taxpayer Compliance Measurement Program (TCMP). Since then, data from 1988 TCMP has become available. Findings from the 1988 TCMP were generally consistent with the 1985 data. In 1988, 42 percent of EITC claimants may not have been entitled to the amounts paid. About 35 percent of the amounts paid were in excess of the credit owed to recipients. The 1988 data has not been reported.

Office of Tax Analysis
August 6, 1993

Recent Efforts to Improve Compliance

Question:

Does the reconciliation bill include any provisions which will reduce the error rates in the EITC?

Answer:

Yes. Eliminating the two supplemental credits -- for young children and for qualifying health insurance expenditures -- will reduce the complexity of the EITC.

-- These provisions add half a page of calculations to the Schedule EIC.

-- To receive the health insurance credit, both the credit recipient and the IRS must know how much an individual paid for health insurance and whether the policy covered at least one qualifying child.

-- Complicated "interaction" rules restrict recipients from claiming both the young child credit and the dependent care tax credit with respect to the same child. These rules are difficult to understand and can force filers to make duplicative calculations in order to determine which provision is more advantageous.

As we learned in 1990, credit claimants often do not understand complicated eligibility rules. The IRS also cannot easily verify eligibility when the credit is based on information which is difficult to obtain. Simplification of the credit reduces mistakes by both the taxpayer and the IRS.

The Ways and Means Oversight Subcommittee had a hearing earlier this year to review insurance marketing and sales techniques involving the EITC. At the hearing, the IRS testified on abuses in the marketing of insurance to workers eligible for the EITC.

-- In certain regions of the country, insurance salesmen are representing themselves as IRS employees and telling employers and workers that the only way to get the basic EITC is to purchase health insurance.

-- Such abusive practices will be stopped by the repeal of the health insurance supplement.

Office of Tax Analysis
August 6, 1993

EITC Schedule

Question:

Beginning in 1991, the IRS has required EITC recipients to attach a complicated schedule to their tax return in order to claim the credit. Doesn't this schedule discourage people from filing for the EITC?

Answer:

The IRS has devoted much time and resources to the development of the Schedule EIC. In June 1991, the IRS released a draft of the schedule for public comment. In addition, the schedule was tested among focus groups across the country. The schedule was revised to meet the concerns of taxpayers, practitioners, and low-income program advocates.

Based on the information available, IRS staff consider the implementation of the new schedule to be a success. The numbers of persons claiming the credit have increased by nearly 2 million since 1990. For tax year 1992, over 14 million persons are projected to have received the credit.

Background:

The Omnibus Budget Reconciliation Act of 1990 required that EITC recipients file a separate schedule to claim the EITC. This requirement was part of legislation aimed at reducing the high error rates in the EITC.

A separate schedule is necessary because eligibility for the credit is based on certain items which are not reported on the tax return.

-- The child who qualifies a parent for the EITC is not necessarily a dependent, and as a consequence a social security number for qualifying children must be reported on the schedule.

-- The new schedule also requires the taxpayer to report nontaxable earned income. (The credit is also based on nontaxable earned income).

The final version of the Schedule EIC is two pages and consists of four parts. On the first page, the tax filer must report information missing from the tax return which is necessary in determining eligibility for the credit. At the bottom of the first page, the filer is informed that he or she does not have to continue on; the remaining steps -- the calculation of the credit -- will be done by the IRS. However, if a filer prefers to determine the amount of the credit, a worksheet is provided on the second page.

Office of Tax Analysis
August 6, 1993

SCHEDULE EIC
(Form 1040A or 1040)
Department of the Treasury
Internal Revenue Service (X)

Earned Income Credit

▶ Attach to Form 1040A or 1040. ▶ See Instructions for Schedule EIC.

TIP: Why not let the IRS figure the credit for you? Give us only the information asked for on this page and we'll do the rest.

OMB No. 1545-0074
1992
Attachment Sequence No. **43**

Name(s) shown on return | Your social security number

Part I General Information

To take this credit:
- You MUST have worked and earned **LESS** than $22,370, **AND**
- Your adjusted gross income (Form 1040A, line 16, or Form 1040, line 31) MUST be **LESS** than $22,370, **AND**
- Your filing status can be any status **except** married filing a separate return, **AND**
- You MUST have at least one qualifying child (see boxes below), **AND**
- You cannot be a qualifying child yourself.

A qualifying child is a child who:

is your:		was (at the end of 1992):		who (in 1992):
son daughter adopted child grandchild stepchild or foster child	**AND**	under age 19 or under age 24 and a full-time student or any age and permanently and totally disabled	**AND**	lived with you in the U.S. for more than 6 months* (or all year if a foster child*)

*If the child didn't live with you for the required time (for example, was born in 1992), see the **Exception** on page 61 of 1040A booklet (or page EIC-2 of 1040 booklet).

Do you have at least one qualifying child?

No ▶ You cannot take the credit. Enter "NO" next to line 28c of Form 1040A (or line 56 of Form 1040).

Yes ▶ Go to Part II. But if the child was married or is also a qualifying child of another person, first see page 61 of 1040A booklet (or page EIC-2 of 1040 booklet).

Part II Information About Your Two Youngest Qualifying Children

If more than two qualifying children, see page 62 of 1040A booklet (or page EIC-2 of 1040 booklet). 1(a) Child's name (first, initial, and last name)	(b) Child's year of birth	For a child born BEFORE 1974, check if child was— (c) a student under age 24 at end of 1992	(d) disabled (see booklet)	(e) If child was born BEFORE 1992, enter the child's social security number	(f) Child's relationship to you (for example, son, grandchild, etc.)	(g) Number of months child lived with you in the U.S. in 1992
	19					
	19					

Caution: *If a child you listed above was born in 1992 AND you chose to claim the credit or exclusion for child care expenses for this child on Schedule 2 (Form 1040A) or Form 2441 (Form 1040), check here* . . . . ▶ ☐

Do you want the IRS to figure the credit for you?

Yes ▶ Fill in Part III below. AND ▶ Enter the amount from Form 1040A, line 16, or Form 1040, line 31, here. ▶ ....

No ▶ Go to Part IV on the back now.

Part III Other Information

2 If you had any **nontaxable earned income** (see page 62 of 1040A booklet or page EIC-2 of 1040 booklet) such as military housing and subsistence or contributions to a 401(k) plan, enter the total of that income on line 2. Also, list type and amount here. ▶ .... | 2 |

3 Enter the total amount you paid in 1992 for health insurance that covered at least one qualifying child. (See page 63 of 1040A booklet or page EIC-2 of 1040 booklet.) . . . . | 3 |

If you want the IRS to figure the credit for you, STOP!

Attach this schedule to your return. If filing Form 1040A, print "EIC" on the line next to line 28c. If filing Form 1040, print "EIC" on the dotted line next to line 56.

Part IV Figure Your Earned Income Credit—You can take ALL THREE parts of the credit if you qualify

BASIC CREDIT

4 Enter the amount from line 7 of Form 1040A or Form 1040 (wages, salaries, tips, etc.). If you received a taxable scholarship or fellowship grant, see page 64 of 1040A booklet (or page EIC-3 of 1040 booklet) for the amount to enter 4

5 If you had any **nontaxable earned income** (see page 62 of 1040A booklet or page EIC-2 of 1040 booklet) such as military housing and subsistence or contributions to a 401(k) plan, enter the total of that income on line 5. Also, list type and amount here. ▶ 5

6 **Form 1040 Filers Only:** If you were self-employed or reported income and expenses on Sch. C or C-EZ as a statutory employee, enter the amount from the worksheet on page EIC-3 of 1040 booklet 6

7 Add lines 4, 5, and 6. This is your **earned income**. If $22,370 or more, **you cannot take the** earned income credit. Enter "NO" next to line 28c of Form 1040A (or line 56 of Form 1040) ▶ 7

8 Use the amount on line 7 above to look up your credit in **TABLE A** on pages **65 and 66** of 1040A booklet (or pages **EIC-4 and 5** of 1040 booklet). Then, enter the credit here 8

9 Enter your **adjusted gross income** (from Form 1040A, line 16, or Form 1040, line 31). If $22,370 or more, **you cannot take the credit** . . . . . ▶ 9

10 **Is line 9 $11,850 or more?**

- **YES.** Use the amount on line 9 to look up your credit in **TABLE A** on pages **65 and 66** of 1040A booklet (or pages **EIC-4 and 5** of 1040 booklet). Then, enter the credit here 10
- **NO.** Enter the amount from line 8 on line 11.

11 If you answered "YES" to line 10, enter the smaller of line 8 or line 10 here. This is your **basic credit** . . 11

NEXT: *To take the health insurance credit, fill in lines 12–16. To take the extra credit for a child born in 1992, fill in lines 17–19. Otherwise, go to line 20 now.*

HEALTH INSURANCE CREDIT

—Take this credit **ONLY** if you paid for health insurance that covered at least one qualifying child.

12 Look at the amount on line 7 above. Use that amount to look up your credit in **TABLE B** on page 67 of 1040A booklet (or page **EIC-6** of 1040 booklet). Then, enter the credit here 12

13 Look at the amount on **line 9** above. **Is line 9 $11,850 or more?**

- **YES.** Use the amount on line 9 to look up your credit in **TABLE B** on page **67** of 1040A booklet (or page **EIC-6** of 1040 booklet). Then, enter the credit here 13
- **NO.** Enter the amount from line 12 on line 14.

14 If you answered "YES" to line 13, enter the smaller of line 12 or line 13 here. 14

15 Enter the total amount you paid in 1992 for health insurance that covered at least one qualifying child. (See page 64 of 1040A booklet or page EIC-3 of 1040 booklet.) 15

16 Enter the smaller of line 14 or line 15 here. This is your **health insurance credit** 16

EXTRA CREDIT FOR CHILD BORN IN 1992

—Take this credit **ONLY** if:

- You listed in Part II a child born in 1992, AND
- You did not take the credit or exclusion for child care expenses on Schedule 2 (or Form 2441 for the same child.

TIP: You can take both the basic credit and the extra credit for your child born in 1992.

17 Look at the amount on line 7 above. Use that amount to look up your credit in **TABLE C** on page **68** of 1040A booklet (or page **EIC-7** of 1040 booklet). Then, enter the credit here 17

18 Look at the amount on line 9 above. **Is line 9 $11,850 or more?**

- **YES.** Use the amount on line 9 to look up your credit in **TABLE C** on page **68** of 1040A booklet (or page EIC-7 of 1040 booklet). Then, enter the credit here 18
- **NO.** Enter the amount from line 17 on line 19.

19 If you answered "YES" to line 18, enter the smaller of line 17 or line 18 here. This is your **extra credit for a child born in 1992** 19

TOTAL EARNED INCOME CREDIT

20 Add lines 11, 16, and 19. Enter the total here and on Form 1040A, line 28c (or on Form 1040, line 56). This is your **total earned income credit** . . . . . ▶ 20

File: EITC

EITC FIRST DRAFT STONE

My goal has been to set a new economic direction for America. To raise incomes and create jobs and invest in the future so we can regain control of our economic destiny and leave our children the American dream.

But just as important, our economic plan aims to give millions of hard working American families the chance to control their economic destiny -- by making sure that if they work hard and play by the rules, they will never live in poverty. I am proud that our economic plan includes a dramatic expansion of the Earned Income Tax Credit, one of the most successful programs to lift people out of poverty ever devised.

EITC is not about more government or social workers or more services. It's about more groceries and more school clothes and more hope. Ultimately it will end poverty for working families with children by using a simple mechanism in the tax code. It is the most pro-family, pro-work, pro-traditional American values program in decades.

That is why it is part of our budget, and why I will do everything in my power to protect it and pass it and make it a permanent part of our plan in the next few days.

It's not a liberal idea. It's not a conservative idea. It's a revolutionary idea, it has bipartisan support, and it works.

It is also necessary. As important as cutting the deficit and increasing investment and growing this economy are, they are not the only problems we must solve if we hope to put this economy on a long path towards economic recovery.

We must also have a strategy for helping every American lift themselves out of poverty and into the world of work and dignity and prosperity. Without that strategy we cannot compete internationally, balance our budget, or make our neighborhoods livable. We cannot reduce childhood poverty, or childhood hunger, both of which have increased in the past decade. Without such a strategy, we cannot provide opportunity for all.

Our EITC program will be the cornerstone of that strategy, which also includes investments in children and immunizations, and will eventually include of course welfare reform and health care reform.

But, by simply expanding the Earned Income Tax Credit we can make certain that anyone who works full-time and has a child at home will get a refund through the income tax system and be lifted above out of poverty -- by their work.

There are some variations between the House and Senate versions. But in every version only working families qualify, and adjustments are made for family size so that large families are not penalized. Each version is refundable so that even those who are too poor to owe taxes will receive a tax break. Each version allows us to shelter many working poor families against the effects of whatever energy tax emerges. Most important, of course, each version greatly expands the credit itself.

This expansion must not be watered down in conference. We must set ourselves on a course to lifting every working American out of poverty by their own labor, and we must begin with this legislation. It is the best investment we will ever make in sustaining the values of hard work and devotion to family that built America.

Washington has said it values work. Office holders declare that government should reward work over welfare, and provide tax relief to those who carried the heaviest tax burdens through the eighties. Yet, poverty among working Americans continues to explode, especially the percentage of people working and still living in poverty.

There are now 20 million poor people in America who work. Eighteen per cent of all those who work full time go home at the end of the day poor. There are almost six million who work full time and live in poverty.

So inspite of the rhetoric, our policies have not worked, and we are going in the wrong direction. We need every American to compete and win in the global economy. We cannot afford more transfer payments and entitlements. We need strong families and more than ever. Yet by making it harder to work and support a family, Washington has been sending exactly the wrong signal. No wonder we haven't moved anyone from welfare to work. vo

If we value work, we must give work value. It must mean more than poverty. That is what the EITC does.

We need to instill two simple principles: people on welfare who can work should work, and people who work full time with a family at home shouldn't be poor.

We must have the courage to change and reward the values and the people that we penalized in the 1980's - the working poor. The EITC is a long overdue pay raise for them.

We know it will work. We know it will serve as a life-line for unskilled and semi-skilled workers in our cities, and for people in rural areas scrambling for scarce jobs.

The vast majority of those who benefit from the EITC work long hours at low skill jobs that have few benefits. These jobs probably don't have much of a future. But the children of the hard working people who do these jobs have a future -- if their parents can earn enough to stay out of poverty.

It is time we acted. The arguments in Washington about how to empower lower income Americans broke down years ago along an ideological fault line -- with those who prefer entitlement on one side and those who espouse abandonment on the other.

But neither works. The EITC is not a middle ground but a new higher ground, that makes work more attractive than welfare by rewarding it more than welfare.

For millions our increasingly competitive economy and the disincentives to work that we built in the welfare system have devalued work and the independence and dignity it brings.

Our proposal creates an entirely new economic and social dynamic. It is pro-work, pro-family, pro-children, and anti-big government. It vastly increases opportunities for the poor and near poor. It lets them do at last what you and I do every day and take for granted: get up every morning and go to work -- and do the right things for ourselves, our families, and our country.

I want it to be a defining principle   was a defining principle of

Rewarding work and individual responsibility ~~has been one of the most consistent themes of~~ my candidacy and my Presidency. We must demand the best from each other again, and in return honor those who do their best --- by providing them the tools they need to survive and to keep their families secure.

That is the purpose and the bold vision contained in the Earned Income Tax Credit. It is an idea whose time has come. And it is time Congress passed our economic plan, and the EITC, and lifted millions of hard working American families out of poverty and into dignity.

Thank you very much.