

POLICY PRINCIPLES: TAX CREDITS FOR LOW-INCOME WORKERS

About the Tax Alliance for Economic Mobility

The Tax Alliance for Economic Mobility, co-led by CFED and PolicyLink, convenes racial justice advocates, asset-building advocates, tax reform experts, and researchers to identify near- and longer-term policy priorities to expand savings and investment opportunities for lower-income households through reform of the U.S. tax code. The Alliance includes a coalition of national organizations that have agreed on shared principles and are working to educate and engage their networks about why equitable, inclusive, and progressive tax reform is crucial to building the long-term security of families, communities, and the national economy.

This document reviews the role of tax credits for low-paid workers and their families—primarily the Earned Income Tax Credit (EITC) and Child Tax Credit (CTC)—in promoting economic mobility, examines ways to strengthen the tax credits, and proposes a set of policy principles.

The principles outlined in this document were developed by the Workers’ Tax Credits working group and may not reflect the views of individual members of the Tax Alliance for Economic Mobility.

The Importance of Tax Credits for Working Families for Financial Security and Opportunity

The Earned Income Tax Credit is a federal tax credit for low- and moderate-income workers that rewards work and offsets federal payroll and income taxes. The credit is “refundable,” meaning that if the value of the credit exceeds a worker’s federal income tax liability, the IRS will refund the balance. The Child Tax Credit is a federal tax credit designed to help working families offset the cost of raising children. It is worth up to \$1,000 per eligible child, and is partially refundable.ⁱ

Unlike many other poorly-designed tax exemptions and deductions that deliver the bulk of their benefits to the highest-income filers, the EITC and CTC can be accessed by low-income working families. Twenty-six states, plus the District of Columbia, have established their own EITCs to supplement the federal credit.ⁱⁱ

Policy Principles Snapshot

1. Build on the opportunity-boosting successes of the EITC and CTC by strengthening these credits and making them more inclusive.
2. Build on the success of the federal EITC by expanding it at the state level.
3. Increase take-up and improve accessibility.
4. Protect honest working families when strengthening program integrity.

Together, both credits are powerful tools for building financial security and boosting opportunity for working families. In 2014, they lifted more than 10 million people out of poverty, including more than 5 million children, and lifted another 21 million people closer to the poverty line.ⁱⁱⁱ Research shows families use the credits to not only pay routine bills and afford basic needs, but also to pay down debt, including avoiding evictions, which are lowest in February.^{iv} Families also save, build assets, and make other investments that help build mobility, such as spending on training or education, or home ownership and home repairs.^v

In addition to encouraging work, a substantial body of research suggests the income from these credits helps to build opportunity for children in families that receive the credits at virtually every stage of life. Research indicates that children in families receiving the tax credits perform better in school, are likelier to attend college, and have increased earnings and work effort in adulthood. Research also finds that the EITC is linked to improvements in the health of infants and mothers.^{vi}

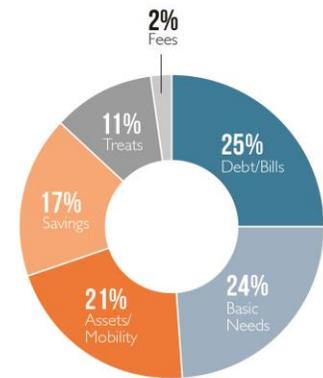
The EITC and CTC work together with other aspects of the tax code that improve opportunity for working families, including the Child and Dependent Care Tax Credit for families caring for children and other dependents, the Saver's Credit for retirement savings, and tax incentives that make higher education more affordable (as discussed in complementary Tax Alliance policy principles).^{vii}

Strengthening Tax Credits for Workers

The EITC and CTC can be strengthened to build on their successes. For example:

- The EITC has a glaring gap for “childless workers”— adults not raising dependent children in the home. The credit completely excludes young childless workers below the age of 25 who are trying to get a toehold in the economy, and those over age 65. Largely because low-income childless workers and non-custodial parents are either completely ineligible for the EITC or receive only a small EITC, they are the lone group that the federal tax code taxes into or deeper into poverty.^{viii}
- The CTC is only partially refundable—it only begins to phase in after \$3,000 of earnings, and then only at a rate of 15 cents for each additional dollar of earnings up to the \$1,000-per-child maximum. This limits the value of the tax credit for the poorest families: for example, families with two children do not receive the full tax credit until their earnings reach \$16,333. As a result, children in the poorest families qualify for only a very small CTC or no tax credit at all, even though they are the children who need it most and for whom it would have the largest beneficial impact. This is particularly true for the youngest children, who have higher poverty rates than older children and for whom research finds even modest improvements in family income can have big developmental impacts.^{ix}

HOW FAMILIES SPENT THEIR TAX REFUNDS



Based on interviews with 115 EITC recipients. See Sarah Halpern-Meekin et. al, *It's Not Like I'm Poor*, 2015.

Policy Principles

The EITC and CTC provide crucial support to millions of families each year. They are well-targeted to reduce poverty, and are proven to encourage work and support children’s development throughout life. Unlike many other tax incentives that primarily benefit higher-income taxpayers, the EITC and CTC are well-targeted and progressive. They also are proven to encourage work and support children’s development throughout life. As a result, the credits do not need broad restructuring. Rather, reforms should focus on building on their successes by closing gaps in who the credits reach and improving their effectiveness. To accomplish these goals, policymakers should:

1. **Build on the opportunity-boosting successes of the EITC and CTC by strengthening these tax credits and making them more inclusive.** The EITC and CTC should be expanded to workers that are currently excluded or receive disproportionately small benefits, and are thus largely locked out of the tax credits’ proven successes. A key priority in this area is extending the EITC’s pro-work success to childless adults and non-custodial parents by strengthening the EITC for these workers.

Policymakers should oppose proposals that go in the *wrong* direction by denying tax credits to hard-working families and their children. For example, proposals to deny the CTC to immigrant parents who pay their taxes using an IRS Individual Taxpayer Identification Number (ITIN) should be rejected. Many of these families are mixed status, and several million of their U.S. citizen children would be affected.^x In addition to increasing hardship, such proposals likely would have long-lasting harmful effects on children impacted, given the research linking workers’ tax credits with positive impacts on children’s development.

2. **Build on the success of the federal EITC by expanding it at the state level.** More states should join the 26 states, plus the District of Columbia, that currently boost incomes for working families by supplementing the federal EITC with a state credit. States that already have an EITC should consider making it more generous by increasing the share of the federal credit that it matches or increasing its refund-ability.^{xi}
3. **Increase take-up and improve accessibility.** About four of five eligible workers claim the EITC nationwide, but more can be done to ensure that all workers claim the tax credits they have earned. Federal support for the Volunteer Income Tax Assistance, which helps low-income taxpayers file their returns, should be strengthened. Researchers and policymakers should also explore options for allowing filers additional choice about how to receive the EITC (such as periodic options), while ensuring that they allow filers to continue to choose to receive their tax credits in the way that makes the most sense for their families. Policymakers should also continue to improve coordination of the credits with initiatives to improve emergency and long-term savings, such as the split refund and *myRA* programs, and other financial security and opportunity-building initiatives that can be accessed at tax time.

Proposals that would *reduce* the accessibility of the credits—and would increase hardship and reduce their effectiveness at improving opportunity—should be rejected. Examples include proposals that would significantly increase the paperwork burden on honest low-income families seeking to file for the tax credits that they have earned—barriers that do not exist for tax credits and subsidies that go to high-income families and businesses.

4. **Protect honest working families when strengthening program integrity.** The EITC and CTC are among of the most complex elements of the tax code that individual taxpayers face. This means that working families filing for their taxes can make honest mistakes. Untrained or unscrupulous commercial tax preparers that lack credentials are also a leading source of error. Commercial preparers file a majority of EITC returns, and a majority of EITC overpayments occur on commercially prepared returns.^{xii}

At the end of 2015, Congress enacted a series of measures to reduce errors that Senate Finance Chairman Hatch called the most robust program integrity provisions in nearly 20 years. Many of these provisions are still coming into effect, and policymakers should gauge their impact, as well as provide the IRS adequate resources to administer these and other program integrity measures effectively.

Policymakers can also take other responsible measures to reduce error and overpayments that *do not* reduce accessibility or cut tax credits for honest working families—and would in fact better protect these families. A prime example is that policymakers should provide the IRS the authority it needs to reduce errors by commercial preparers, many of whom do not currently have to meet any minimum competency standards. A number of EITC and CTC rules can also be simplified in ways that might reduce errors and improve accessibility.

In seeking to reduce error, policymakers should avoid dubious proposals purporting to address error or fraud. In particular, lawmakers should reject measures that are primarily eligibility restrictions masquerading as error-reduction proposals — measures that cut tax credits for large numbers of working families who are honestly and accurately claiming their credits. Lawmakers should also reject proposals for onerous new paperwork and filing requirements that would deter or prevent working families from claiming credits for which they qualify.

ⁱ For more, <http://www.cbpp.org/research/federal-tax/policy-basics-the-child-tax-credit>

ⁱⁱ For more, <http://www.cbpp.org/research/federal-tax/policy-basics-the-earned-income-tax-credit>

ⁱⁱⁱ <http://www.cbpp.org/research/federal-tax/chart-book-the-earned-income-tax-credit-and-child-tax-credit>

^{iv} <http://scholar.harvard.edu/files/mdesmond/files/desmond.evictionpoverty.ajs2012.pdf>

^v http://cfed.org/assets/pdfs/The_Rainy_Day_EITC.pdf

^{vi} For a summary of the research, see <http://www.cbpp.org/research/federal-tax/eitc-and-child-tax-credit-promote-work-reduce-poverty-and-support-childrens>

^{vii} For more, <https://www.taxallianceforeconomicmobility.org/wp-content/uploads/2016/11/TAEM-Housing-Reform-Principles.pdf>, <https://www.taxallianceforeconomicmobility.org/wp-content/uploads/2016/11/TAEM-Higher-Education-Reform-Principles.pdf>, <https://www.taxallianceforeconomicmobility.org/wp-content/uploads/2016/12/TAEM-Retirement-Reform-Principles.pdf>

^{viii} <http://www.cbpp.org/research/federal-tax/strengthening-the-eitc-for-childless-workers-would-promote-work-and-reduce>

^{ix} <http://www.cbpp.org/research/federal-tax/a-top-priority-to-address-poverty-strengthening-the-child-tax-credit-for-very>

^x <http://www.pewhispanic.org/2011/02/01/iii-births-and-children/>

^{xi} <http://www.cbpp.org/research/state-budget-and-tax/states-can-adopt-or-expand-earned-income-tax-credits-to-build-a>

^{xii} <http://www.cbpp.org/research/federal-tax/reducing-overpayments-in-the-earned-income-tax-credit>