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The Earned Income Tax Credit: Current Issues and Benefit Amounts

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Summary

The earned income tax credit (EITC), established in the tax code in 1975, offers cash aid to working parents with relatively low incomes who care for dependent children. (Smaller credits began in 1994 for low-income workers with no children.) The EITC is the only federal cash aid available to all working poor families with children. For eligible filers with income tax liability, the EITC reduces their taxes. However, most of the credits go to those who owe either no taxes or amounts smaller than their credits. These people receive lump-sum credits in the form of U.S. Treasury checks at the end of the tax year. A small minority (less than 5%) of EITC claimants receive advance credits with their paychecks. To be eligible for the advance EITC, the employee must have a qualifying child. In January, 2000, President Clinton announced a proposal to expand the EITC. In its FY2001 budget, the Administration estimates the cost of that proposal to be $11.5 billion over 5 years. Most recently, the President vetoed marriage penalty legislation (H.R. 4810), which included provisions to modify the EITC. This short report is updated periodically as legislative activity and new program data require.

Recent Developments

On August 5, 2000, President Clinton vetoed the Marriage Tax Relief Reconciliation Act of 2000 (H.R. 4810). The Senate had approved the conference report on July 21, 2000, one day after the House approved the measure. The bill would have increased the EITC phase-out limit for married couples filing joint returns by $2,000, in an effort to prevent low-income couples who marry and file jointly from seeing a reduction in their EITC benefits. This provision would have become effective in tax year 2001 and would have sunset on December 31, 2004.

Earlier, on June 28, 2000, the Senate Committee on Finance approved a version of the Marriage Tax Relief Reconciliation Act of 2000 that would have increased the EITC income phase-out limit for married couples filing joint returns by $2,500, rather than the $2,000 amount agreed to in conference and included in the bill vetoed by the President. With the exception of the sunset date, the provision as reported out of committee mirrored *that which was included in an earlier bill (S. 2346, the Marriage Tax Relief Act of 2000) which was reported by the Senate Committee on Finance on April 4, 2000 (S.Rept. 106-253), but received no final action.*

Senator Rockefeller introduced legislation (S. 2825) on June 29, 2000, which would expand the EITC by creating a third-tier of EITC benefits (like that outlined in the Administration's proposal described below) for families with three or more children. The bill (S. 2825) would also simplify the credit by modifying the definition of earned income and simplifying the definition of dependent child for the purposes of claiming the EITC. Under current law, the definition of dependent child for the purposes of claiming the EITC is similar, but not identical to, the definition used for the purposes of claiming the dependency exemption. Broader tax legislation (S. 2642, The Tax Ease and Modernization Act) introduced by Senator Hatch on May 25, 2000, also contains these provisions.

Administration Proposal

On January 12, 2000, President Clinton announced a proposal to expand the EITC. The Administration's estimated cost of the proposal, included in its FY2001 budget request released February 7, 2000, is $11.5 billion over 5 years. The proposal includes four major provisions. One, it would establish a third level of benefits, this for families with **three** or more children, by increasing the credit rate for these families to 45% (from the current 40% for families with **two** or more children). Two, it would increase the amount which a married couple can earn (by an additional $1,450 above current law) before their EITC benefit begins to phase out. Three, it would decrease the phase-out rate for families with two or more children, meaning that their EITC benefit is reduced by only 19 cents (rather than the current 21 cents) for each dollar they earn above the maximum creditable earnings amount. Also, it would eliminate 401(k) contributions and other forms of nontaxable earned income from the calculation of the EITC.

Legislation in the 104th and 105th Congresses

Proposals in the 104th Congress focused on reducing the EITC's cost as part of the effort to balance the federal budget by FY2002. Concern over a high incidence of fraudulent EITC claims also led to legislative initiatives in both the 104th and 105th Congresses.

The welfare reform law, enacted August 22, 1996 (P.L. 104-193) changed the processing of tax returns to deter undocumented aliens from claiming the EITC. It also broadened the income definition used to phase out the credit by disregarding certain investment losses. In March 1995, P.L. 104-7 had disqualified from the EITC any filer with investment income above $2,350. That law denied the EITC to filers with excess income from interest, dividends, rents, and royalties. P.L. 104-193 reduced the limit to $2,200, provided for its automatic adjustment for inflation (the 1999 limit is $2,350), and broadened the income to which it applies to include capital gains and passive investment income. P.L. 104-193 will save $3.2 billion in EITC costs over FY1996-FY2002.

The substantial rise in the EITC's cost led Congress to seek other savings from the credit in the Balanced Budget Act of 1995 (H.R. 2491). However, President Clinton vetoed the bill, opposing EITC changes such as the elimination of the credit for childless adults, as well as other provisions in the bill unrelated to the EITC. The EITC measures included in the bill would have saved another $25.2 billion over FY1996-FY2002. However, the loss of EITC dollars would have been offset for many EITC eligibles by two other measures in H.R. 2491: a $500-per-child tax credit; and a provision to mitigate the extra tax burden some married couples face compared to two single individuals.

The Taxpayer Relief Act of 1997 (P.L. 105-34) included several EITC provisions. Concern over high error rates associated with EITC claims and the increasing cost of the credit prompted initiatives to improve EITC compliance procedures and modify the rules for calculating adjusted gross income (AGI) for the purpose of the EITC. The child tax credit established with this legislation is calculated independent of the EITC computation.

Legislative History[1]

The EITC was conceived in 1971 as a "work bonus" alternative to President Nixon's proposal to provide cash welfare to poor two-parent families. While EITC bills were considered in 1972, 1973, and 1974, none was enacted until the Tax Reduction Act of 1975 (P.L. 94-12). The EITC was then seen as a way to lighten the burden of Social Security taxes on low-income workers. The temporary EITC created in 1975 was extended through 1978 by P.L. 94-164, P.L. 94-455, and P.L. 95-30 and finally made permanent by the Revenue Act of 1978 (P.L. 95-600). The credit amount was increased by the Deficit Reduction Act of 1984 (P.L. 98-369), and increased again and indexed for inflation by the Tax Reform Act of 1986 (P.L. 99-514). Additional benefits were approved in the Omnibus Budget Reconciliation Act (OBRA) of 1990 (P.L. 101-508). Credits were further increased over the years 1994-1996 by OBRA of 1993 (P.L. 103-66). That law also established a small EITC for childless workers and eliminated supplemental credits available in 1993 to families with infants and/or health insurance costs. Coverage was extended to military families stationed abroad by P.L. 103-465.

Program Costs and Benefit Amounts

The EITC was claimed by an estimated 19.4 million tax filing units for tax year 1998. The projected cost for 1998 is $29.4 billion; all but $4.1 billion of that is in the form of cash payments in excess of tax liability. The average credit is estimated at $1,797 for filers with children and $179 for childless adults. Recent cost increases were driven largely by a legislated credit rate increase for families with two or more children.

Credit amounts depend on earned income, adjusted gross income (AGI), and number of children. As shown in **Table 1**, the basic credit in 2000 is 34.0% of the first $6,920 of annual earnings (40.0% of the first $9,720 for families with 2+ children, 7.65% of the first $4,610 for childless adults). Thus, the maximum EITC amounts in 2000 are $2,353 for a one-child family, $3,888 for a larger family, and $353 for a childless adult age 25-64. For those with AGI above $12,690 ($5,770 for childless adults), the credit phases out at a rate of 15.98 cents per dollar in excess of $12,690 (21.06% for families with more than one child, 7.65% for childless adults). The credit disappears at an AGI of $27,413

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[1] For more detail on the EITC's history, see: CRS Report 95-542, *The Earned Income Tax Credit: A Growing Form of Aid to Low-Income Workers,* by James R. Storey.

($31,152 for families with more than one child due to the 21.06% rate, $10,380 for childless adults).

Table 1. Factor Used to Determine 2000 EITC Amount by Type of Filing Unit (figures apply to filing unit's tax year)

EITC factor	Filing unit with: No children	One child	Two or more children
Credit percentage	7.65%	34.00%	40.00%
Max. creditable earnings	$4,610	$6,920	$9,720
Max. EITC amount	$353	$2,353	$3,888
Phase-out rate	7.65%	15.98%	21.06%
Income above which phase-out occurs	$5,770	$12,690	$12,690
Income above which EITC disappears	$10,380	$27,413	$31,152

Table 2 and **Table 3** show EITC benefit amounts for eligible childless adults and families with children, respectively. *In using **Table 2** and **Table 3**, please note that the actual tax tables developed by the Internal Revenue Service may differ slightly from the amounts shown. It should also be noted that these examples assume that a filing unit's income is entirely from earnings. Benefit schedules by income level are different for filers who have other types of income such as investment income in addition to their earnings. In particular, filing units with 2000 investment income greater than $2,400 are excluded from EITC eligibility.*

Table 2. 2000 EITC Annual Amounts for Childless Adults

Filing unit's earnings	EITC amount	Filing unit's earnings	EITC amount
$0	$0	$5,770	$353
1,000	77	6,000	335
2,000	153	7,000	259
3,000	230	8,000	182
4,000	306	9,000	106
4,610	353	10,380	0

Note: The maximum credit amount of $353 applies for earnings between $4,610 and $5,770.

Table 3. 2000 EITC Annual Amounts for Families with Children

Filing unit's earnings	EITC amount with one child	EITC amount with two children	Filing unit's earnings	EITC amount with one child	EITC amount with two children
$0	$0	$0	$11,000	2,353	3,888
1,000	340	400	12,000	2,353	3,888
2,000	680	800	12,690	2,353	3,888
3,000	1,020	1,200	13,000	2,303	3,823
4,000	1,360	1,600	14,000	2,143	3,612
5,000	1,700	2,000	15,000	1,984	3,402
6,000	2,040	2,400	18,000	1,504	2,770
6,920	2,353	2,768	20,000	1,185	2,349
7,000	2,353	2,800	22,000	865	1,927
8,000	2,353	3,200	25,000	386	1,296
9,000	2,353	3,600	27,413	0	787
9,720	2,353	3,888	30,000	0	243
10,000	2,353	3,888	31,152	0	0

Note: The maximum credit amount of $2,353 for a family with one child applies when earnings are between $6,920 and $12,690. The maximum credit amount of $3,888 for a larger family applies when earnings are between $9,720 and $12,690.