The Earned Income Tax Credit (EITC): An Overview

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Summary

The Earned Income Tax Credit (EITC or EIC) began in 1975 as a temporary program to return a portion of the Social Security tax paid by lower income taxpayers, and was made permanent in 1978. In the 1990s, the program became a major component of federal efforts to reduce poverty, and is now the largest anti-poverty cash entitlement program. Childless adults in 2008 (the latest year for which data are available) received an average EITC of $252, families with one child received an average EITC of $1,996, and families with two or more children received an average EITC of $3,105.

A low-income worker must file an annual income tax return to receive the EITC and meet certain requirements for income and age. A tax filer cannot be a dependent of another tax filer and must be a resident of the United States unless overseas because of military duty. The EITC is based on income and whether the tax filer has a qualifying child.

The EITC interacts with several nonrefundable federal tax credits to the extent lower income workers can utilize the credits to reduce tax liability before the EITC. Income from the credit is not used to determine eligibility or benefits for means tested programs. However, 23 states and the District of Columbia now offer an EITC for state taxes, and most of them are based on the federal EITC. Any change in the federal EITC would flow down to impact the state EITC.

Policy issues for the EITC, which reflect either the structure, impact, or administration of the credit include the work incentive effects of the credit; the marriage penalty for couples filing joint tax returns; the anti-poverty effectiveness of the credit (primarily a family size issue); and potential abuse (i.e., compliance with credit law and regulations).

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA; P.L. 107-116) made several changes to the credit, including simplifying the definition of earned income to reflect only compensation included in gross income; basing the phase-out of the credit on adjusted gross income instead of expanded (or modified) gross income; and eliminating the reduction in the EITC for the alternative minimum tax.

The American Recovery and Reinvestment Act of 2009 (ARRA; P.L. 111-5) created the category for families with three or more children, with a credit rate of 45%, for tax years 2009 and 2010 only. The ARRA also increased the phase-in amount for married couples filing joint tax returns so that it is $5,000 higher than for unmarried taxpayers in tax year 2009, and $5,010 in tax year 2010.

The changes to the credit made by EGTRRA and ARRA will expire on December 31, 2010.

H.R. 4853, as amended, passed the House on December 2, 2010. H.R. 4853 as amended, would make permanent the EGTTRA changes noted above, and the higher phase-in amount for married couples provided by ARRA.

H.R. 4853, as amended by the Senate, passed the Senate on December 14, 2010. H.R. 4853, as amended, would extend the EGTRRA and ARRA provisions for two years (through 2012).

This report will be updated as warranted.

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The Earned Income Tax Credit (EITC or EIC) program began in 1975 as a temporary and small (6.2 million recipients) program to reduce the tax burden on working low-income families. The program has grown into the largest federal anti-poverty cash program with 24.8 million tax filers receiving $50.7 billion in tax credits for tax year 2008. In FY2008, states reported spending $8.6 billion on basic cash assistance under the Temporary Assistance for Needy Families (TANF) block grant. During FY2008, the cash assistance workload under TANF was a monthly average of 1.7 million families. **Appendix A** outlines the history of the EITC and **Appendix B** shows how the parameters for calculating the EITC have changed since the original enactment in 1975.

Eligibility

The EITC is a refundable tax credit available to eligible workers earning relatively low wages. Under current law there are two categories of EITC recipients: childless adults and families with children. Because the credit is refundable, an EITC recipient need not owe taxes to receive the benefits. An EITC eligible family may also receive a portion of the credit in the form of advanced payments. Eligibility for, and the size of, the EITC is based on income, age, residence, and the presence of qualifying children.

Families with Children

For a family to receive the EITC, the family must have adjusted gross income (AGI) and earned income below the amount which reduces the EITC to $0, and have investment income no greater than $2,200 (indexed for inflation). Investment income includes interest income (including tax-exempt interest), dividends, net rent and royalties that are from sources other than the filer's ordinary business activity, net capital gains, and net passive income.

Earned income includes wages, tips, and other compensation included in gross income and self-employment income after the deduction for self-employment taxes. Earned income does not include pension or annuity income; income for nonresident aliens not from a U.S. business; income earned while incarcerated (for work in prison); and TANF benefits received while a TANF assistance recipient participates in work experience or community service activities.

Although gross (and earned) income for tax purposes does not generally include certain combat pay earned by members of the armed forces, members of the armed forces may elect to include combat pay for purposes of computing the earned income. Using combat pay to calculate the EITC does not make the combat pay taxable income.

The family must reside in the United States unless in another country because of U.S. military duty. The child (or children) must meet three of the requirements for a qualifying child (for the dependency exemption):

- relationship—the child must be a son, daughter, step child or foster child (if placed by an authorized agency or court order), brother, sister, half brother, half sister, step brother, step sister, or descendent of such a relative;
- residence—the child must live with the taxpayer for more than half the year in the United States (the 50 states and the District of Columbia); and

- age—the child must be under age 19 (or age 24, if a full-time student) or be permanently and totally disabled.

If more than one tax filer can claim the child for the EITC, the tax filers can decide which of them claims the child. If they cannot agree and more than one tax filer claims a child for the EITC the tie breaker rules apply. The tie breaker rules are:

- if a child qualified for more than one tax filer, the tax filer who is the child's parent claims the child for the EITC;
- if neither of the tax filers is a parent of the child, the tax filer with the highest AGI claims the child for the EITC;
- if both tax filers are parents of the child, the parent the child resided the longest with during the tax year claims the child; or
- if the child resided with each parent for the same period of time during the tax year, the tax filer with the larger AGI claims the child for the EITC.[1]

Childless Adults

Childless adults must reside in the United States unless in another country because of U.S. military duty. A childless adult must be at least 25 years of age, but not more than 64 years of age to be eligible for the EITC, and cannot be claimed as a dependent on another person's tax return. Childless adults may include married couples if both persons meet eligibility requirements.

Credit Amount

Calculation of EITC Amount

Claimants receive an EITC in one of four ways:

- as a reduction in income tax liability;
- as a year-end cash payment (refund) from the Treasury if the family has no income tax liability;
- as a combination of reduced taxes and direct payments (refunds); or
- as advance payments by adjusting withholding.[2]

[1] An eligibility rule that an unmarried filer must meet the requirements for "head of household" tax filer status to be eligible for the EITC was dropped by Omnibus Budget Reconciliation Act (OBRA) of 1990. This status was difficult for many low-income working mothers to meet at the time since many of them received more than half their cash income from AFDC, which was not regarded as self-support income by the IRS in determining "head of household" status.

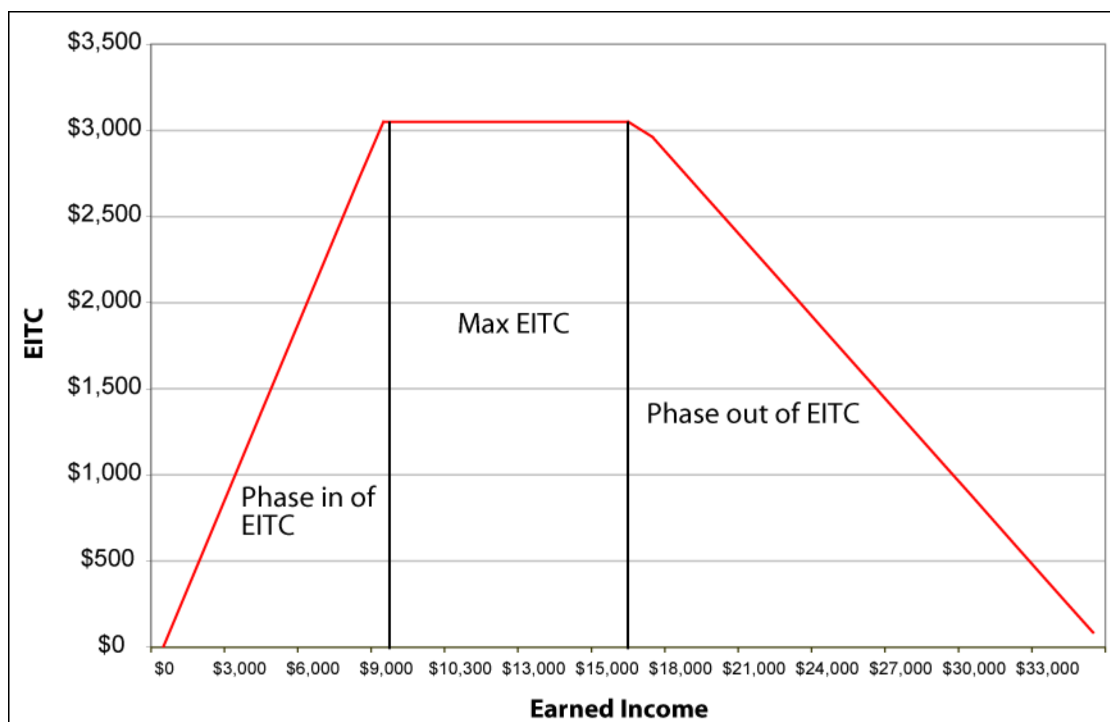
[2] Childless adults cannot receive the EITC through advance payments.

To receive an EITC, a person must file an income tax return at the end of the tax year, together with a separate schedule (Schedule EIC) if claiming a qualifying child. An eligibility certificate (Form W-5) must be filed with the employer to receive advance credits through the employer's payroll tax system. The option to claim the EITC in advance is little used. In FY2008, $51.8 million in advance credit was claimed.[3]

In general, the EITC amount increases with earnings up to a point (the maximum earned income eligible for the credit), then remains unchanged for a certain bracket of income (the plateau), and then (beginning at the phase-out income level) gradually decreases to zero as earnings continue to increase.

Figure 1 provides a graphic representation of EITC levels, by income level for a single parent family with one child.

Figure 1. EITC Levels by Income, Single-Parent Family with One Child, Tax Year 2010



Source: Figure prepared by the Congressional Research Service (CRS).

If the family (or childless adult) is eligible for the credit, the credit is based on the credit rate, which varies with the number of children, and the earned income. Up to the maximum earned income amount, the credit equals the earned income times the credit rate. During this phase-in period for the credit, for each additional $1 of earned income the recipient receives an additional credit equal to the credit rate. For example, in tax year 2010 for a family with one child, for each additional $1 of earnings (up to a total earned income of $8,970) the family receives an additional 34 cents in EITC.

[3] Internal Revenue Service, *2008 Data Book*, Table 5. Available at http://www.irs.gov/taxstats/article/0,,id=205182,00.html.

For earned income between the maximum earned income amount and the phase-out income level, the EITC is constant at the maximum credit. Above the phase-out income level, for each additional $1 of income the recipient loses credit at the phase-out rate. In tax year 2010, for a family with one child, for each $1 of income above the phase-out level of income ($21,460 for married couples, $16,450 for others), the recipient loses 15.98 cents of EITC. Graphically, the phase-in period for the credit is steeper than the phase-out period because the credit is increased faster during the phase-in than the credit is reduced during the phase-out.[4]

The parameters for calculating the EITC (credit rates, phase-out rates, maximum earned income amount, maximum credit amount, phase-out income level, and disqualifying investment income level) for tax years 2008, 2009, and 2010 are shown in **Table 1**.

The EITC is taken against total tax liability (regular, alternative minimum, and self-employment taxes) after several nonrefundable tax credits. Because the EITC is a refundable credit, on the tax return the line for the EITC can be found in the payment section after the lines for withholding and estimated tax payments. The individual income tax return booklet presents the EITC amounts in tables by income brackets (in $50 increments). This allows a tax filer to look up the correct amount of the EITC based on income, filing status, and number of children.

[4] The exception is for EITC recipients without children, where the credit rate and the phase out rate are the same (7.65%).

Table 1. EITC Parameters for Tax Years 2008-2010

	2008 ($)	2009 ($)	2010 ($)	Credit rate (%)	Phase-out rate (%)
No eligible children				7.65	7.65
Maximum earned income amount	5,720	5,970	5,970		
Maximum credit	438	457	457		
Phase-out income level	7,160	7,470	7,470		
Phase-out income level for married filing joint	10,160	12,470	12,470		
Income where EITC = 0	12,880	13,440	13,440		
Income where EITC = 0 for married filing joint	15,880	18,440	18,440		
One eligible child				34.00	15.98
Maximum earned income amount	8,580	8,950	8,950		
Maximum credit	2,917	3,043	3,043		
Phase-out income level	15,740	16,420	16,420		
Phase-out income level for married filing joint	18,740	21,420	21,420		
Income where EITC = 0	33,995	35,463	35,463		
Income where EITC = 0 for married filing joint	36,995	40,463	40,463		
Two or more eligible children				40.00	21.06
Maximum earned income amount	12,060	12,570	12,570		
Maximum credit	4,824	5,028	5,028		
Phase-out income level	15,740	16,420	16,420		
Phase-out income level for married filing joint	18,740	21,420	21,420		
Income where EITC = 0	38,646	40,295	40,295		
Income where EITC = 0 for married filing joint	41,646	45,295	45,295		
Three or more eligible children *(tax years 2009 and 2010 only)*				45.00	21.06
Maximum earned income amount		12,570	12,570		
Maximum credit		5,657	5,657		
Phase-out income level		16,420	16,420		
Phase-out income level for married filing joint		21,420	21,420		
Income where EITC = 0		43,279	43,279		
Income where EITC = 0 for married filing joint		48,279	48,279		
Disqualifying investment income level	2,950	3,100	3,100		

Source: Table prepared by CRS.

Notes: To reflect the statutory language for calculating the inflation adjusted EITC parameters, the maximum earned income amount and the phase-out income level are rounded to the nearest $10, whereas the disqualifying income level is rounded to the nearest $50. In preparing their tax returns, tax filers will use a table with $50 increments of income to look up their EITC amount.

A formula presentation of the EITC calculation follows (where category reflects EITC factors based on the number of children and filing status as in **Table 1**, and AGI is equal to gross income from all taxable sources such as earned income, dividends, taxable interest, alimony, capital gains, taxable pensions, etc., less statutory adjustments).

EITC =

Lesser of: earned income or maximum earnings amount $_{category}$

times

credit rate$_{category}$

minus

Greater of 0 or [earned income (or AGI whichever is larger) *minus* phase-out income level$_{category}$ *times* phase-out rate$_{category}$]

The following three examples for a married couple with 2 children in tax year 2010, illustrate how the EITC is calculated.

Example 1. For a family receiving less than the maximum allowable credit, with earned income and AGI of $10,000 (which is less than the maximum earned income amount):

EITC = $10,000 *times* 40% = $4,000

Example 2. For a family receiving the maximum allowable with earned income and AGI of $20,000 (which is greater than the maximum earned income amount but less than the phase-out income level):

EITC= $12,590 (the maximum earned income amount) *times* 40%

= $5,036 (the maximum credit)

Example 3. For a family subject to the phase-out of EITC with earned income and AGI of $25,000 (which is greater than the maximum earned income amount and the phase-out income level):

EITC = $12,509 (the maximum earned income amount) *times* 40% or $5,036 (the maximum credit)

minus

($3,540 (the amount by which income exceeds the phase-out income level[$21,460] *times* 21.06%)

or $746

= $4,290

Indexing

With everything else held constant, when inflation increases income, taxes increase. In periods of high inflation, this may result in increases in taxes which many view as a windfall to the government. To reduce the impact of inflation on taxes certain tax provisions, such as the personal exemption amount, are increased each year by the rate of inflation. The Tax Reform Act of 1986 (P.L. 99-514) began indexing of the maximum earned income and the phase-out income levels for the EITC. The structure of the EITC combined with indexing results in the largest annual percentage increases in EITC going to higher income EITC eligible taxpayers. The effect of indexing on the EITC between year 1 and year 2 can be defined for four groups of taxpayers:

- tax filers below the year 1 maximum earned income level will have no increase in the EITC between year 1 and year 2;
- tax filers above the year 1 maximum earned income amounts and below the year 1 phase-out income level will have an increase in EITC equal to the change in the maximum credit amount (the credit rate *times* the change in the maximum earned income);
- tax filers above the year 1 phase-out income amount but below the year 2 phase-out income amount, will have an increase in EITC equal to the change in the maximum credit *plus* the year 1 phase-out reduction in the EITC (the amount by which their year 1 income exceeded the year 1 phase-out income *times* the phase-out rate); and
- tax filers above the year 2 phase-out income level, will have a change in the EITC that is fixed at every income level until the end of the phase-out range. The change is calculated as:

  Change in EITC (above phase-out income level)=
  Change in Maximum Credit
  plus
  Change in Phase-out Income Level *times* Phase-out Rate.

Marginal Tax Rates

Marginal tax rates reflect the additional tax paid for each additional $1 of income earned (or subject to tax). Economic theory suggests that the higher the marginal tax rate, the lower the incentive to work to increase income. The structure of the EITC (phase-in, plateau, and phase-out) creates a wide range of marginal tax rates for EITC recipients based on income. The marginal tax rate for an EITC recipient, excluding interactions with other credits, can be broken down into four ranges that correspond to the structure of the EITC:

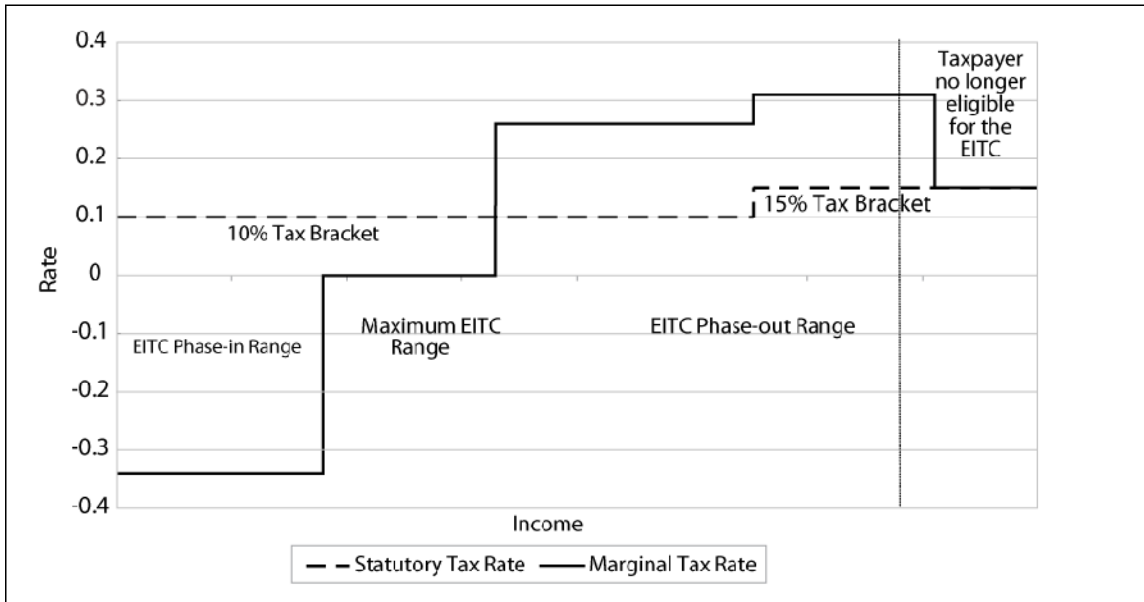
- during the phase-in, when income is below the maximum earned income, the marginal tax rate is negative and equal to the credit rate because for each additional dollar of income the EITC recipient pays no income tax and receives an increase in the EITC equal to the credit rate times the additional income;
- once the income reaches the plateau level, the marginal rate is zero while there is no tax liability and no change in the EITC amount (which is at the maximum);
- during the phase-out of the EITC, for each additional dollar of income the EITC recipient will pay taxes at the marginal tax rate and have a reduction in the EITC

at the phase-out rate creating a marginal tax rate equal to the sum of the two changes. This results in a marginal tax rate that is significantly higher than the statutory tax rate; and

- at the end of the phase-out of the EITC, when the EITC equals zero, the marginal and statutory tax rates for the taxpayer are equal.

Figure 2 shows the statutory and marginal tax rates, in tax year 2010, as income increases for a single parent family with one child. The marginal tax rates reflect the combined impact of the statutory tax rate and the EITC phase-out and do not reflect the use of any other tax credits.

Figure 2. Statutory and Marginal Tax Rates, Single-Parent Family with One Child, Tax Year 2010



Source: Figure prepared by CRS.

Participation

The EITC program has grown significantly since its inception in 1975. In 1975, there were 6.2 million recipients for a total of $1.2 billion in EITC, with 72.0% of the EITC received as a refund, and an average EITC of $201. For tax year 2008, a total of 24.8 million tax filers claimed a total of $50.7 billion in EITC. For tax year 2008, the average EITC was $2,047, and 87.4% of the EITC was received as a refund. Estimates of the percentage of EITC eligible families participating in the EITC program (i.e., receiving an EITC) ranged from 80%-86% in a 1993 study[5] using 1990 data to 93%-96% for families with children in a 2001 study[6] by the General Accounting Office using 1999 data.

[5] John Karl Sholz, "The Earned Income Credit: Participation, Compliance, and Antipoverty Effectiveness," *National Tax Journal*, March 1994, vol. 47, no. 1, pp. 63-87.

[6] U.S. General Accounting Office, *Earned Income Tax Credit Participation*, GAO-20-290R, December 14, 2001.

Table 2 provides the total EITC, refunded portion, number of recipients (tax filers), and average credit for 1975 through 2008.

Table 2. EITC and Recipients 1975-2008

Tax Year	Total EITC ($ millions)	Refunded Portion of EITC ($ millions)	Number of Recipients (thousands)	Average EITC ($)
1975	1,250	900	6,215	201
1976	1,295	890	6,473	200
1977	1,127	880	5,627	200
1978	1,048	801	5,192	202
1979	2,052	1,395	7,135	288
1980	1,986	1,370	6,954	286
1981	1,912	1,278	6,717	285
1982	1,775	1,222	6,395	278
1983	1,795	1,289	7,368	224
1984	1,638	1,162	6,376	257
1985	2,088	1,499	7,432	281
1986	2,009	1,479	7,156	281
1987	3,391	2,930	8,738	450
1988	5,896	4,257	11,148	529
1989	6,595	4,636	11,696	564
1990	7,542	5,266	12,542	601
1991	11,105	8,183	13,665	813
1992	13,028	9,959	14,097	924
1993	15,537	12,028	15,117	1,028
1994	21,105	16,598	19,017	1,110
1995	25,956	20,829	19,334	1,342
1996	28,825	23,157	19,464	1,481
1997	30,389	24,396	19,391	1,567
1998	32,340	27,175	20,273	1,595
1999	31,901	27,604	19,259	1,656
2000	32,296	27,803	19,277	1,675
2001	35,784	29,043	19,593	1,704
2002	37,786	33,258	21,574	1,751
2003	39,186	34,508	22,112	1,772
2004	40,024	35,299	22,270	1,797
2005	42,410	37,465	22,752	1,864
2006	44,388	39,072	23,042	1,926
2007	48,540	42,508	24,584	1,974
2008	50,669	44,260	24,756	2,047

Sources: U.S. Congress, House Committee on Ways and Means. 2004 Green Book. Background Material and Data on Programs Within the Jurisdiction of the Committee on Ways and Means, 108th Congress, 2nd session, WMCP 108-6, March 2004, p.13-41. Internal Revenue Service. Total File, United States, Individual Income and Tax Data, by State and Size of Adjusted Gross Income, Tax Years 2003 through 2008. Expanded unpublished version, Table 2.5.

Note: The number of recipients is the number of tax filers claiming the EITC.

Geographic Distribution

The distribution of EITC by state is a function of the relative populations and income levels of the states. In general states with larger populations or a large number of lower income workers will have more EITC recipients. The number of federal returns, the number of returns claiming the EITC, the percent of federal returns claiming the EITC, the total EITC, average EITC, and percent of the credit refunded by state for tax year 2008 are shown in **Table 3**.

Table 3. EITC Recipients and Amount by State, Tax Year 2008

State	Returns	Returns Claiming EITC	Percent of Returns Claiming EITC	EITC Claimed ($ thousands)	Average EITC	Percent Refunded
Alabama	2,076,195	524,097	25.2	1,236,759	2,360	89.7
Alaska	359,709	38,488	10.7	61,815	1,606	88.7
Arizona	2,714,182	487,002	17.9	1,001,197	2,056	89.1
Arkansas	1,223,637	301,909	24.7	655,575	2,171	89.8
California	16,478,215	2,730,012	16.6	5,481,142	2,008	83.8
Colorado	2,340,854	308,255	13.2	563,786	1,829	87.1
Connecticut	1,742,470	190,504	10.9	345,990	1,816	87.4
Delaware	425,490	66,152	15.5	128,227	1,938	90.5
District of Columbia	302,531	50,144	16.6	94,078	1,876	89.6
Florida	8,875,483	1,852,940	20.9	3,825,237	2,064	85.4
Georgia	4,255,054	1,022,957	24.0	2,339,271	2,287	88.4
Hawaii	656,452	97,062	14.8	172,619	1,778	88.9
Idaho	666,723	120,054	18.0	232,570	1,937	87.4
Illinois	6,112,426	954,070	15.6	1,979,163	2,074	86.5
Indiana	3,019,320	504,631	16.7	998,418	1,979	89.8
Iowa	1,415,088	194,022	13.7	358,193	1,846	88.8
Kansas	1,328,944	195,577	14.7	372,693	1,906	90.0
Kentucky	1,869,439	386,058	20.7	768,208	1,990	88.8
Louisiana	1,983,957	516,934	26.1	1,223,396	2,367	89.8
Maine	633,674	94,901	15.0	166,539	1,755	84.4
Maryland	2,776,026	375,444	13.5	722,374	1,924	86.8
Massachusetts	3,197,925	353,061	11.0	622,413	1,763	86.8
Michigan	4,626,365	758,244	16.4	1,526,648	2,013	86.8
Minnesota	2,569,679	308,262	12.0	548,208	1,778	87.1
Mississippi	1,254,942	398,579	31.8	963,186	2,417	90.9
Missouri	2,739,220	489,968	17.9	980,059	2,000	89.5

State	Returns	Returns Claiming EITC	Percent of Returns Claiming EITC	EITC Claimed ($ thousands)	Average EITC	Percent Refunded
Montana	477,153	78,427	16.4	141,891	1,809	87.2
Nebraska	857,622	122,890	14.3	233,344	1,899	89.2
Nevada	1,272,433	196,012	15.4	373,849	1,907	89.3
New Hampshire	668,971	70,926	10.6	119,381	1,683	84.8
New Jersey	4,304,848	535,511	12.4	1,049,299	1,959	85.7
New Mexico	923,431	210,347	22.8	426,626	2,028	90.3
New York	9,203,531	1,622,113	17.6	3,241,226	1,998	82.8
North Carolina	4,180,091	864,536	20.7	1,818,663	2,104	89.5
North Dakota	322,761	40,669	12.6	73,092	1,797	89.2
Ohio	5,562,764	896,168	16.1	1,780,167	1,986	89.1
Oklahoma	1,605,411	329,642	20.5	673,746	2,044	88.8
Oregon	1,753,860	258,435	14.7	463,283	1,793	87.3
Pennsylvania	6,130,055	856,884	14.0	1,611,545	1,881	89.0
Rhode Island	510,709	75,871	14.9	148,347	1,955	87.1
South Carolina	2,047,201	477,905	23.3	1,025,672	2,146	90.6
South Dakota	389,575	60,067	15.4	112,124	1,867	89.8
Tennessee	2,842,898	626,531	22.0	1,307,355	2,087	87.7
Texas	10,792,258	2,417,062	22.4	5,517,268	2,283	86.7
Utah	1,145,303	164,055	14.3	320,501	1,954	88.5
Vermont	320,162	42,141	13.2	68,657	1,629	83.1
Virginia	3,727,792	552,941	14.8	1,076,990	1,948	88.8
Washington	3,185,705	399,088	12.5	725,169	1,817	88.0
West Virginia	785,966	152,595	19.4	287,082	1,881	90.7
Wisconsin	2,767,859	347,667	12.6	642,777	1,849	88.6
Wyoming	274,041	33,807	12.3	59,426	1,758	89.0
Other Areas	1,794,068	28,837	1.6	55,063	1,909	96.7
U.S. Total	**143,490,468**	**24,780,454**	**17.3**	**50,720,307**	**2,047**	**87.2**

Source: Internal Revenue Service, Total File, All States, Individual Income and Tax Data, by State and Size of Adjusted Gross Income, Tax Year 2008, Expanded unpublished version, Table 2. The totals for Table 2 provided by the Internal Revenue Service differ from those of Table 2.5 used elsewhere in this report for several reasons. Table 2 includes "substitutes for returns" in which the Internal Revenue Services constructs tax returns for certain non-filers.

Distribution by Number of Eligible Children and Income

For tax year 2008, returns with two or more eligible children have the highest average EITC ($3,105), and returns with no eligible children have the lowest average EITC ($252). Returns with two or more eligible children claim 61.2% of the EITC and comprise 41.1% of the returns claiming the EITC. The number of eligible children determines the parameters used to calculate the credit and therefore determines the income distribution of returns claiming the EITC. As shown in **Table 4**, for returns with no eligible children 81.5% have an AGI of less than $10,000. However, for returns with two or more children, 46.3% have an AGI of $20,000 or more.

Table 4. Distribution of Returns Claiming the EITC, by Number of Eligible Children and AGI, Tax Year 2008

	No Eligible Children		One Eligible Child	
Adjusted Gross Income Class	**Number of Returns**	**EITC ($ thousands)**	**Number of Returns**	**EITC ($ thousands)**
Less than $10,000	4,263,194	1,228,752	2,359,919	5,012,916
$10,000 less than $15,000	1,233,059	164,814	1,689,339	4,793,649
$15,000 less than $20,000	33,658	927	1,673,079	4,381,111
$20,000 less than $25,000	0	0	1,458,556	2,752,497
$25,000 less than $30,000	0	0	1,251,860	1,404,002
$30,000 or more	0	0	960,403	400,887
Total	5,529,911	1,394,493	9,393,156	18,745,062
Average EITC		$252		$1,996

	Two or More Eligible Children		Total	
Adjusted Gross Income Class	**Number of Returns**	**EITC ($ thousands)**	**Number of Returns**	**EITC ($ thousands)**
Less than $10,000	1,359,584	3,440,278	7,982,696	9,681,948
$10,000 less than $15,000	1,930,646	8,850,342	4,853,044	13,808,803
$15,000 less than $20,000	1,640,155	7,287,133	3,346,891	11,669,171
$20,000 less than $25,000	1,488,002	5,257,612	2,946,559	8,010,109
$25,000 less than $30,000	1,314,441	3,324,509	2,566,301	4,728,511
$30,000 or more	2,100,850	2,369,833	3,061,252	2,770,720
Total	9,833,678	30,529,707	24,756,743	50,669,262
Average EITC		$3,105		$2,047

Source: Table prepared by CRS using Internal Revenue Service Data *Statistics of Income Bulletin*, Table 4 for tax year 2008 returns.

Interaction With Other Tax Provisions

Other Federal Tax Credits

On the tax return, the EITC is calculated after total tax liability and several nonrefundable credits. The nonrefundable tax credits, which are taken against (reduce) tax liability, include credits for education, dependent care, savings, and the child credit. To the extent an EITC eligible family has a tax liability and can utilize one or more of these credits, the refundable portion of the family's EITC is higher. This is because using one or more of the tax credits reduces tax liability before the EITC, but does not affect the calculation of the EITC.

For tax filers in the plateau or phase-out period of the EITC, pre-tax contributions to savings for retirement, education or medical purposes can increase the amount of the EITC by reducing the amount of "earned income" used to calculate the EITC, in addition to reducing tax liability before the EITC if the contributions also qualify for a nonrefundable credit. This is because the earned income for the EITC, like the income subject to tax, does not include these pre-tax contributions as income.

Means Tested Programs

By law, the EITC cannot be taken into account for purposes of determining eligibility or benefits for food stamps, low-income housing, and Medicaid and Social Security Income (SSI). Under Temporary Aid to Needy Families (TANF), the states have the authority to determine if the receipt of an EITC is taken into consideration in determining eligibility or benefits. An EITC refund that is saved may become an asset and could be used in determining TANF eligibility and benefits.

State EITC Provisions

Currently, 23 states and the District of Columbia offer an EITC for state taxes. Of these jurisdictions, three have a nonrefundable EITC, and one is not calculated as a direct percentage of the federal credit.[7] For states with an EITC that is calculated based on the federal EITC, a change in the federal EITC will generally flow through and change the state EITC unless the state takes positive legislative action to alter or prevent the change.

Issues

The structure, impact, and administration of the EITC are reflected in the major policy issues—work incentives, marriage penalty, anti-poverty effectiveness (family size), compliance, and the use of paid tax preparers.

[7] Erica Williams, Nicholas Johnson, and Jon Shure, *State Earned Income Tax Credits: 2010 Legislative Update*, Center on Budget and Policy Priorities, Washington, DC, December 9, 2010, available at http://www.cbpp.org/cms/index.cfm?fa=view&id=2987.

Work Incentives

Although the original purpose of the EITC was to return payroll taxes to low-income workers, in its current form as a cash transfer program it provides assistance to working low income families to meet basic needs. As such it may be viewed as creating an incentive to work, both in participating in the labor force (beginning to work), and increases in work effort (more hours). Economic theory suggests that the phase-in range of the EITC (when income is below the maximum earned income) would create an incentive to begin work, and to work more hours by increasing the marginal return to work after taxes. This is because the EITC increases as work increases and is reflected in the negative marginal tax rate during the phase-in range of the credit.

Conversely, the phase-out range of the EITC would create a disincentive to work more because the more the individual works and earns the greater the individual is penalized (although the after-tax income is higher). The individual not only has to pay taxes at the statutory rate, but the earned income credit is reduced by the phase-out rate. This is reflected in a marginal tax rate for the phase-out period that is higher than the statutory tax rate. In the phase-out range, an individual may attempt to maintain a level EITC by reducing work hours (substituting leisure for work). However, many workers do not have the flexibility (in their jobs) to reduce hours.

Alternatively, the EITC can be viewed as a wage supplement for lower income workers. The wage supplement increases the hourly wage rate over the phase-in range, the supplement remains steady over the plateau range, and over the phase-out range the wage supplement is reduced, reducing the hourly wage down to the level actually paid by the employer. However, a recent study found that an increase in the EITC resulted in a decrease in hourly wages for workers with less than a college education.[8]

In evaluating the work incentives of the EITC it is important to remember that all of the benefits and costs of work are not reflected in the marginal tax rate. A family receiving TANF cash welfare may be required to work or participate in activities for a stated number of hours to maintain cash benefits. However, if the participation requirement is met by working in a paying job, those earnings may reduce other non-cash benefits such as food stamps or housing allowances, and may require additional cash expenditures for child care, clothing, etc.

Studies on the EITC and labor force participation have concluded that the EITC has a significant positive impact on participation in the labor force, particularly for single mothers.[9] Some studies have concluded that there is a negative impact on work hours at the higher levels of income, but that the impact is not significant.[10]

[8] Andrew Leigh, "Who Benefits from the Earned Income Tax Credit? Incidence among Recipients, Coworkers and Firms", B.E. Journal of Economic Analysis & Policy, Vol. 10, No. 1.

[9] Bruce D. Meyer and Dan T. Rosenbaum, "Making Single Mothers Work: Recent Tax and Welfare Policy and Its Effects," *National Tax Journal*, vol. 53 (December 2000), pp. 1027-1043. Robert Moffitt, *Welfare Programs and Labor Supply*, National Bureau of Economic Research, Working Paper 9168, September 2002.

[10] Stacy Dickert, Scott Houser, and John Karl Scholz, "The Earned Income Tax Credit and Transfer Programs: A Study of Labor Market and Program Participation," *Tax Policy and the Economy*, James M. Poterba ,ed. (National Bureau of Economic Research and the MIT Press,1995), pp. 1-50. V. Joseph Hotz and John Karl Sholz, *The Earned Income Credit*, National Bureau of Economic Research, Working Paper 8078, January 2001.

Marriage Penalty

The structure of the EITC may, depending on the relative income levels of both parties, impose a "marriage penalty"[11] on single low-income parents if they choose to marry. For example, in tax year 2010 two single parents, each with one child and earned income of $15,000 would receive an EITC of $3,050 each for a total of $6,100. If they marry, their combined income is $30,000, and with two children, the EITC is $3,237. The EITC marriage penalty for the couple is $2,863.

Empirical research has concluded that the structure of the EITC, through the phase-out and the marriage penalty, has a negative impact on the labor market participation of nonworking spouses in two-parent families at higher income levels (levels of income in the plateau or phase-out range of the EITC).[12]

Anti-Poverty Effectiveness (Family Size)

The current measurements of poverty do not include the EITC. However, one way to measure the effectiveness of the EITC in providing assistance to families with children (as an anti-poverty program) is whether receiving the EITC can lift a family above the federal poverty level (or threshold). Although benefits for most poverty related programs are related to family size, the family size adjustment for the EITC is capped. For tax years 2009 and 2010, the cap is at three children, whereas for other tax years, the cap is at two children. As a result, families with more children than the cap may be closer to, or below, the poverty threshold. An example for tax year 2009 (which does reflect the temporary change in the EITC and refundable child tax credit for tax years 2009 and 2010) is shown in **Table 5**.

Certain childless adults, even if the adult receives the EITC, also may have a net income after tax that is close to the poverty threshold. In tax year 2009, a childless adult working full-time (2,000 hours a year) at the minimum wage would earn approximately $13,680.[13] That adult would receive an EITC of $0. When combined with a tax liability before credits of $433, and payroll taxes of $1,047, the adult has an after tax income of $12,200. This is 109.3% of the poverty threshold (for one adult) of $11,161.

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[11] The "marriage penalty" is the difference between the tax liability for a married couple (filing a joint tax return) and the sum of the tax liabilities for each person if they each filed using the single filing status.

[12] Nada Eissa and Hillary Williamson Hoynes, "The Earned Income Tax Credit and the Labor Supply of Married Couples," National Bureau of Economic Research, Working Paper 6856, 1998. V. Joseph Hotz and John Karl Sholz, "In-Work Benefits in the United States: The Earned Income Credit," *The Economic Journal*, vol. 106, no. 434 (January 1996), pp. 156-169.

[13] This assumes an average wage over the 2,000 hours of $6.84—based on 7 months of the calendar year at the minimum wage of $6.55 and 5 months of the calendar year at the minimum wage of $7.25.

Table 5. Impact of Family Size on Net Income after Taxes Relative to Poverty Threshold, Tax Year 2009

	Family 1. Two Adults, Two Children ($)	Family 2. Two Adults, Three Children ($)	Family 3. Two Adults, Four Children ($)
Income	25,000	25,000	25,000
Federal tax before credits	0	0	0
Child credit (regular credit limited to tax before credits)	0	0	0
EITC	4,269	4,897	4,897
Additional child credit (refundable portion of credit)	2,000	3,000	4,000
Net tax refund after credits	6,269	7,897	8,897
Payroll tax	1,913	1,913	1,913
Net income after tax	29,357	30,985	31,985
Federal poverty level	21,756	25,603	28,666
Net income after tax as a percentage of poverty level	134.9%	121.0%	111.6%

Source: Table prepared by CRS.

Compliance

Compliance with the EITC provisions has been an issue for the program since 1990, when the Internal Revenue Service (IRS), as part of the Taxpayer Compliance Measurement Program (TCMP), released a study on 1985 tax year returns with the EITC. The study concluded that there was an over-claim rate of 39.1%. This over-claim rate however, did not reflect any later efforts by the IRS to collect on the over payments. Later studies by the IRS have resulted in lower over-claim rates. The 1997 and 1999 tax return studies[14] estimated that the unrecovered over-claim rates were 23.8% to 25.6%, and 27.0% to 31.7%. These studies presented the rates as upper and lower bound-estimates because a number of individuals contacted as part of the study did not respond. The lower bound assumes that the over-claim rate for the nonrespondents is the same as for respondents, while the upper bound assumes that all the nonrespondents are over-claims.

In the 1999 study, 24.9% of over-claims (with errors known) were due to the child claimed not being the tax filer's qualified child. The most common qualifying child error was that the child did not meet the residency test, six months or one year depending on relationship. The second most common was the child not meeting the relationship test, particularly in the case of foster children where the child did not live with the tax filers for the full year or was not cared for as the tax filer's own child.

After errors in claiming an unqualified child, errors in income reporting accounted for 21.4% of the over-claims. Most frequent income reporting errors were underreporting of earned income and

[14] Internal Revenue Service, Department of the Treasury, "Compliance Estimates for Earned income Tax Credit Claimed on 1999 Returns," February 28, 2002, p. 18.

modified adjusted gross income. Another 17.2% of known errors were for a qualifying child also being the qualifying child of another tax filer.

As a result of the over-claim rates, there have been several legislative changes to improve EITC compliance. Among them are: the requirement that dependents have identification numbers (social security numbers); prohibitions of 2 to 10 years on receiving the EITC after improperly or fraudulently receiving the credit; for tax preparers due diligence requirements (maintaining certain paperwork); and permission for the IRS to match tax filers to the Federal Case Registry of Child Support Orders (maintained by the Department of Health and Human Services).

In addition, some of the EGTRRA changes to the EITC definition of a qualifying child and the tie-breaker rules (rules for when more than one person can claim a child), may help in the future to reduce these problems. However, the general rate of over-claims has not changed significantly since 1990.

To reduce the complexity created by the different definitions of a child, proposals were made by both the U.S. Department of the Treasury and the Joint Committee on Taxation to conform the definition of a child for purposes of the personal exemption, child credit, EITC, dependent care, and head of household filing status. The Working Families Tax Relief Act of 2004 (P.L. 108-311) created a more uniform definition of a child for tax purposes, including the EITC. This new definition became effective with tax year 2005.

In 2003, the IRS announced plans to conduct a pre-certification effort for the tax year 2003 returns, in which tax filers expecting to claim the EITC would need to pre-certify that any child claimed for the EITC met the residency requirement (had resided with the tax filer for at least half of the tax year). This pre-certification effort was converted to a study of returns expected to claim the EITC, and combined with two other compliance studies related to the EITC: (1) a study of filing status; and (2) an automated underreporter (income) study. The Consolidated Appropriations Act of 2004 (P.L. 108-199) required a report to Congress on the qualified child study (the pre-certification of a child for the EITC residency requirement). The three studies were part of the IRS's initiatives on EITC compliance, and were designed to assist the IRS in changing processes to improve compliance for the EITC. A final report on the EITC initiatives related to the three studies was released in December 2008.[15]

The qualifying child certification study was conducted for tax years 2003, 2004, and 2005. The results of the study indicate that in each of the study years, 26%-30% of the returns selected for the study did not certify (eligible children) for the EITC for reasons other that the certification requirement. The IRS states that this reflects the annual turnover in EITC participants. Up to 3%-4% of the returns selected for the study were eligible for the EITC but deterred by the certification requirement and 12%-16% (depending on tax year) of the returns selected for the study were ineligible for the EITC and deterred by the certification requirement.

The filing status study was conducted for tax years 2003 and 2004. The tax year 2003 study looked at taxpayers filing as head of household tax year 2002, who had filed as married filing jointly or separately in at least one of the three previous tax years. Taxpayers who could not document their filing status as single or head of household were deemed married filing separately

[15] The final report of the EITC initiative can be found on the IRS website at http://www.irs.gov/pub/irs-utl/final_eitc_initiatives_report_final_121708.pdf.

and had the EITC denied. In the tax year 2003 study, 22% of the returns selected for the study could not document their filing status and had their EITC claim denied.

The automated underreporter study was conducted for tax years 2002 and 2003 using third-party reporting forms (such as the W-2 or 1099), which are not available for matching to returns during the filing season return processing. Taxpayers selected for the underreporter study were sent notices if the income reported on the return did not match the income reported on third-party forms. For tax year 2002, 72% of the returns selected for the study had adjustments, increasing to 82% of the returns selected for the tax year 2003 study. According to the IRS, the underreporter study for tax year 2003 resulted in tax assessments of $256 million related to the EITC (for example, through reducing or denying the credit), and $262 million in tax assessments for taxes net of other adjustments (for example, additional taxes because of increased income), for a total of $518 million in additional tax assessments for the returns.

Expiring Provisions

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA; P.L. 107-16) made several changes to the EITC that will expire on December 31,2010. Changes to the EITC that will expire include

- changing the definition of earned income for the EITC so that it does not include nontaxable employee compensation;
- eliminating the reduction in the EITC for the alternative minimum tax;
- simplifying the calculation of the credit through use of AGI rather than modified adjusted gross income; and

The American Recovery and Reinvestment Act of 2009 (ARRA; P.L. 111-5) created the category for families with three or more children, with a credit rate of 45%, for tax years 2009 and 2010 only. The ARRA also increased the phase-in amount for married couples filing joint tax returns so that it is $5,000 higher than for unmarried taxpayers in tax year 2009, and $5,010 in tax year 2010. The ARRA changes will expire on December 31, 2010.

Appendix A. Legislative History of the EITC

The idea that became the EITC first arose during congressional consideration of President Nixon's 1971 welfare reform proposal. Nixon's proposal, the Family Assistance Plan, would have helped working poor, two-parent families with children by means of a federal minimum cash guarantee that would have replaced the federal-state welfare program of Aid to Families with Dependent Children (AFDC).

Work Bonus Plan (1972-1974 Proposals)

The EITC was patterned after a proposal, then known as a work bonus for the working poor, recommended by the Senate Finance Committee in April 1972. Though the idea originated as an alternative to the proposed Family Assistance Program, the work bonus provision was advocated as a "refund" of Social Security taxes paid by employers and employees on low annual earnings and was to have been available only for wages subject to Social Security taxation.

The Senate approved the work bonus plan in 1972, 1973, and 1974, but the House did not accept it until 1975.

Enactment of EITC in 1975

The Tax Reduction Act of 1975 (P.L. 94-12) included a provision that established, in Section 32 of the Internal Revenue Code, a refundable credit to tax filers with incomes below $8,000. This "earned income credit" was to equal 10% of the first $4,000 of any earnings (including earnings not subject to Social Security taxation) and thus could not exceed $400 per year. The credit was to be phased out, at a rate of 10%, for an AGI above $8,000.

Extensions of EITC (1975-1977 Laws)

The Revenue Adjustment Act of 1975 (P.L. 94-164), Tax Reform Act of 1976 (P.L. 94-455), and Tax Reduction and Simplification Act of 1977 (P.L. 95-30) each extended the EITC by one year.

Permanent Status for EITC and Rise in Maximum Credit (1978 Law)

The Revenue Act of 1978 (P.L. 95-600) made the EITC permanent and increased the maximum credit to $500 and the eligibility limit to $10,000, provided for EITC payments in advance of the annual tax filing, and simplified eligibility determinations.

Under the 1978 law, the EITC was set at 10% of the first $5,000 of earnings (including net earnings from self-employment). The maximum credit of $500 was received for earnings between $5,000 and $6,000. For each dollar of AGI above $6,000, the EITC was reduced by 12.5 cents, reaching $0 at an AGI of $10,000.

Rise in Maximum Credit (1984 Law)

The Deficit Reduction Act of 1984 (P.L. 98-369) raised the maximum credit by 10%, from $500 to $550 by establishing the EITC at 11% of the first $5,000 of earnings. Earnings between $5,000 and $6,500 qualified for the maximum credit of $550. For each dollar of AGI above $6,500, the law required that the EITC be reduced by 12.22 cents. As a result, the credit was completely phased out when AGI reached $11,000.

Indexation of EITC and Rise in Maximum Credit (1986 Law)

Effective with tax year 1987, the Tax Reform Act of 1986 (P.L. 99-514) increased the EITC from 11% of the first $5,000 of earnings to 14% of the first $5,714 of earnings. The act also began indexing the credit for inflation. This was done by indexing the maximum earned income eligible for the credit and phase-out income level by using the change in the average Consumer Price Index (CPI) for the 12-month period ending August 31 of each year, from the CPI for the 12-month period ending August 31, 1984. In addition, the starting point of the phase-out income level was increased for 1987 and 1988. The 1986 Act also lowered the phase-out rate from 12.22% to 10% beginning with the 1987 tax year.

The increase in the maximum earned income for the credit and the credit rate raised the EITC, while the reduction in the phase-out rate reduced the marginal tax rate on recipient earnings. The combination of a higher EITC and a lower phase-out rate increased the income eligibility level from $11,000 in 1984 to $14,500 (in 1984 dollars) for 1987. During debate on the Tax Reform Act of 1986, it was said that "the liberalization of the earned income credit will help to assure that low-income citizens are no longer taxed into poverty."[16]

Rise in Maximum Credit and Establishment of Family-Size Adjustment and Supplemental Credits (1990 Law)

Basic EITC

Because the EITC was originally established as a work bonus and advertised as an offset to the Social Security tax, it had not been designed to vary by family size. Thus, the larger the family, the less it met the family's needs. Proposals were introduced in the 101st Congress to vary EITC credit amounts by number of children, up to a maximum of two, three, or four children depending on the bill. These proposals intended to increase the welfare role of the EITC while continuing its provision of payroll tax relief and work bonuses. However, no one proposed that EITC family-size variations be modeled after AFDC, which varied for much larger family sizes.

The EITC expansion enacted in the Omnibus Budget Reconciliation Act (OBRA) of 1990 (P.L. 101-508) took effect in 1991 and was to be completed in 1994. An adjustment for family size was introduced and the credit and phase-out rates for each of the family sizes (one child , two or more children) were increased each year. However, the planned rate increases for 1994 were superseded by a 1993 law. (See below.)

[16] In floor statement of Senator Matsunaga, *Congressional Record*, daily edition, September 26, 1986, p. S13818.

Supplemental Young Child Credit

Numerous proposals were introduced in the 101st Congress to establish refundable tax credits for families with young children. These proposals would have set credit amounts based on earned income and number of qualifying children. Both House and Senate passed such provisions in competing versions of child care legislation. These measures were seen as aiding lower income families in need of child care for preschool children.

Final action in OBRA of 1990 limited additional credits for young children to those under one year of age. Eligible families with such children had an extra 5.0 percentage points added to their credit rate in computing the EITC amount. This extra credit had a maximum amount in 1993 of $388, and was phased out by adding 3.57 percentage points to the family's phase-out rate. Thus, in 1993 families with one or more children under age 1 had a combined credit rate of 23.5% or 24.5%, depending on total number of children, and a combined phase-out rate of 16.78% or 17.50%.

This extra credit was ended effective for tax year 1994 by OBRA of 1993 (P.L. 103-66).

Supplemental Health Insurance Credit

A new refundable credit aimed at helping parents finance health insurance for their children was included in the Senate-passed OBRA of 1990. The House did not include such a provision, but it was accepted by House-Senate conferees. The supplemental health insurance credit applied to earnings up to the maximum amount to which the EITC applied and was then reduced over the same income range used for the EITC phase-out. The rates set for the child health insurance credit and its phase-out were 6.0% and 4.285%, respectively. These percentages were added to those that applied to a family for the basic EITC and, if eligible, the young child credit. The maximum amount of the supplemental health insurance credit in 1993 was $465. The credit could not exceed the health insurance premiums actually paid by a family during the tax year. Unlike the basic EITC, this supplemental credit could not be received in advance of the annual tax filing.

The health insurance credit was ended, effective in 1994, by OBRA of 1993.

Expansion of Credits, Coverage of Childless Adults, and Repeal of Supplemental Credits (1993 Law)

President Clinton began his term in office in 1993 with a pledge to use the EITC to eliminate poverty for families with a member working full-time at the minimum wage in order to "make work pay." Fulfillment of his pledge required a proposal to raise the EITC credit rates, especially for families with two or more children. His proposal was enacted as part of OBRA of 1993 (P.L. 103-66) with little change by Congress. President Clinton also proposed extending the EITC for the first time to low-income working adults with no children to offset tax increases in OBRA of 1993, and Congress adopted this proposal with only minor changes. To offset part of the EITC expansion's cost, and to meet the criticism of the growing complexity of the EITC, Congress also passed the President's proposal to repeal the supplemental credits for young children and for child health insurance premiums as part of OBRA of 1993.

Credit for Families

The EITC parameters for families were significantly changed by OBRA 1993. The credit rates were increased from 23% to 34% in 1996 for a family with one child, and from 25% to 40% for a family with two or more children. The phase-out rate for families with one child was slightly lowered (from 16.43% to 15.98%) and the phase-out rate for families with two or more children was increased from 17.86% to 21.06%.

Extension of EITC to Childless Households

The Clinton Administration proposal enacted in OBRA of 1993 extended the EITC for the first time to workers who have no children. The main rationale for this credit was to offset partly the effect on low-income workers of a gasoline tax increase included in OBRA of 1993. The 1993 law provided, effective in 1994, a credit of 7.65% of the first $4,000 of annual earnings, for a $306 maximum credit. It is phased out at a 7.65% rate, beginning at an income level of $5,000 and ending at $9,000. The maximum earned income and the phase-out income level are adjusted annually for inflation.

This credit applies to adults ages 25 to 64 who are not claimed as dependents on anyone's tax return. The age limits were imposed by Congress to exclude two groups (students under age 25, retirees over age 64) whose incentive to work was not regarded as an important priority.

Coverage of Overseas Military Personnel (1994 Law)

Before 1995, the EITC had always been restricted to families residing in the United States. This rule excluded from EITC otherwise eligible lower income American military families living in foreign countries. A provision in the 1994 legislation to implement the General Agreement on Tariffs and Trade (P.L. 103-465) provides EITC eligibility for qualifying families outside the United States if their foreign residence is because of a U.S. military assignment. This provision became effective in 1995.

This law also included measures to (1) deny the EITC for wages earned by prison inmates; and (2) deny eligibility to anyone who spent part of the tax year as a nonresident alien.

Eligibility Limit Based on Investment Income (1995 Law)

Limitation of EITC eligibility by a filing unit's income has always been based on the greater of AGI or earnings. However, following up on a proposal in President Clinton's FY1996 budget, Congress enacted in 1995 (P.L. 104-7) a new limitation tied to investment income. This provision prohibits EITC claims by tax filers whose annual investment income exceeds $2,350. Investment income is defined to include taxable interest and dividend income, tax-exempt interest income, and net income from rent and royalties not derived in the normal course of the filer's business. This provision took effect in 1996. (It was modified in August 1996 action. See discussion below.)

Revisions of EITC in the Welfare Reform Bill (1996 Law)

Although not proposing specific legislation, the FY1997 congressional budget resolution (H.Con.Res. 178) "assumes reforms of the Earned Income Credit ... to eliminate fraud and abuse within the program, to better target to low-income working families with children, and to coordinate the credit with the $500 per child tax credit that also is assumed in this budget." In follow-up, Congress included EITC savings in the welfare reform measure (H.R. 3734) signed by President Clinton on August 22, 1996 (P.L. 104-193). These provisions are described below.

Deny EITC to Undocumented Workers

This provision requires tax filers to have valid taxpayer identification numbers (usually Social Security numbers) to be eligible for the EITC. Social Security numbers are issued only to persons who can document their age, identity, and U.S. citizenship or legal alien status. It becomes effective for tax returns due more than 30 days after the enactment date. This measure helps the Internal Revenue Service (IRS) gain compliance from tax filers lacking valid numbers before accepting their EITC claims.

Disqualified Income

Congress acted in March 1995 (see earlier discussion) to exclude from EITC eligibility all filers with "disqualified income," defined as income in excess of $2,350 a year from interest (taxable and tax-exempt), dividends, and net rents and royalties. The welfare reform bill broadened this definition to include net capital gains and net passive income. The maximum allowance for disqualifying income was reduced from $2,350 to $2,200 for 1996 and indexed for inflation in later years.

Broaden Income Used in EITC Phase-out

The EITC is phased out when the greater of earnings or AGI exceeds a certain level ($11,610 in 1996 for families with children). Broadening the definition of income used for EITC phase-out reduces the EITC for persons with income from the sources to be included. Effective for 1996, the welfare reform bill expanded the income used to phase out the EITC by netting out certain losses that are normally taken into account in calculating AGI. These losses are net capital losses, net losses from estates and trusts, net losses from nonbusiness rents and royalties, and half of net business losses.

Allow State Welfare Programs to Count EITC

The 1996 welfare reform bill (Personal Responsibility and Work Opportunity Reconciliation Act, P.L. 104-193) repealed AFDC. And in its place created the Temporary Assistance to Needy Families (TANF) program, a state-run system funded partly by federal block grants. This conversion to state control alters the EITC-welfare relationship. Federal law had required that the EITC be disregarded as income in determining eligibility for AFDC, Food Stamps, Medicaid, Supplemental Security Income (SSI), and housing aid. Lump-sum EITC payments had to be ignored in comparing applicants' assets to program asset limits for the month of receipt and the next month. (The Food Stamp program must ignore lump-sum EITC payments for one year.) Ending AFDC eliminates federal restrictions on states' treatment of the EITC for cash welfare

(TANF) recipients. States may count the EITC as income available to families aided by TANF programs and reduce their welfare accordingly. Lump-sum EITC receipt may be counted by states as assets immediately available to state-aided families, thereby denying them that aid if counting the EITC causes their assets to exceed state asset limits. States adopting such policies may spend less on aid to needy families from their federal grants, in effect substituting the federal EITC for state welfare and lowering the income of those affected.

Denying Credit Based on Prior Claims (1997 Laws)

To improve compliance related to the EITC, the Taxpayer Relief Act of 1997 (P.L. 105-34), denied the EITC to tax filers for a specified period of time if the tax filers had previously made a fraudulent or reckless EITC claim. A tax filer is denied the EITC for two years after it has been determined that the tax filer made a reckless claim, and ten years after a determination that a tax filer has made a fraudulent claim. The Balanced Budget Act of 1997 (P.L. 105-33) provided initial funding for a five-year initiative by the IRS to improve compliance for the EITC.

Reduction of Marriage Penalty and Simplification of the EITC (2001 Law)

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA, P.L. 107-16), to reduce the marriage penalty, increased the phase-out income levels for married couples filing a joint return by $1,000 for tax years 2002 through 2004, $2,000 for tax years 2005 through 2007, and $3,000 beginning in tax year 2008 (indexed for inflation). The bill also simplified the definition of earned income to reflect only compensation included in gross income; based the phase-out of the credit on adjusted gross income instead of expanded (or modified) gross income; and eliminated the reduction in the EITC for the alternative minimum tax.

Uniform Definition of a Child and Combat Pay (2004 Law)

The Working Families Tax Relief Act of 2004 (P.L. 108-311) created a more uniform definition of a child for tax purposes. The EITC, along with other tax provisions used by families (child tax credit, head of household filing status, and dependent care tax provisions) are linked to this more uniform definition of a child under the personal exemption tax provision. The definition of a child and the rules for when more than one party may claim a child for these tax provisions are the same as the rules for the EITC in tax year 2004. In effect, the changes in the tax code for a more uniform definition of a child will not impact eligibility for the EITC. In addition, P.L. 108-311 allowed members of the armed forces to include combat pay for purposes of computing the earned income credit for tax years that ended after October 4, 2004 and before January 1, 2006 (generally tax years 2004 and 2005).

Hurricane Relief (2005 Law)

The Katrina Emergency Relief Act (P.L. 109-73) provided that taxpayers affected by Hurricane Katrina may use their tax year 2004 earned income to compute their 2005 EITC.

Extension of Combat Pay & Hurricane Relief (2005 Law)

The Gulf Opportunity Zone Act of 2005 (P.L. 109-135) extended the option to include combat pay for calculating the credit for another year (tax year 2006, or tax years ending before January 1, 2007).

P.L. 109-135 also extended the option of using 2004 income to compute 2005 EITC to taxpayers affected by Hurricane Rita, and clarified that to use this election, the taxpayer's 2005 income had to be less than the taxpayer's 2004 income.

Extension of Combat Pay (2006 Law)

The Tax Relief and Health Care Act of 2006 (P.L. 109-432) extended the option to include combat pay for calculating the credit through tax year 2007.

Permanent Inclusion of Combat Pay (2008 Law)

The Heroes Earnings Assistance and Relief Tax Act of 2008 (P.L. 110-245) made permanent the option to include combat pay for calculating the credit.

Clarifications to the Definition of a Qualifying Child (2008 Law)

The Fostering Connections to Success and Increasing Adoptions Act of 2008 (P.L. 110-351) clarified the uniform definition of qualifying child for purposes of the dependency exemption, the child credit, the earned income credit, the dependent care credit, and head of household filing status to ensure that such an individual is unmarried and is younger than the taxpayer claiming the individual on his or her tax return. P.L. 110-351 also provided that for purposes of the child credit, a qualifying child must be the dependent of the taxpayer claiming the credit. In addition, P.L. 110-351 provided that if a taxpayer claiming a qualifying child is not the parent of the individual claimed as a qualifying child, the taxpayer must have an adjusted gross income that is higher than either of the child's parents.

Economic Stimulus Changes for Tax Years 2009 and 2010 (2009 Law)

The American Recovery and Relief Act of 2009 (ARRA, P.L. 111-5) created a new credit rate for taxpayers with three or more eligible children. For tax years 2009 and 2010 only, taxpayers with three or more eligible children will use a credit rate of 45% to calculate their EITC.

In addition, the ARRA increased, for married taxpayers filing a joint tax return, the income level at which the EITC begins to phase out. The phase out income level for married taxpayers filing a joint tax return will be $5,000 higher than for unmarried taxpayers in tax year 2009. For tax year 2010 this amount will be $5,010.

Appendix B. History of the EITC Parameters

Since its inception in 1975, the EITC has evolved from a small program to refund a portion of social security taxes to the largest anti-poverty entitlement program. The credit has been modified through changes in eligibility and in the values of the parameters used to calculate the credit. **Table B-1** shows the changes to the parameters for the EITC for tax years 1975 through 2010.

Table B-1. EITC Parameters, 1975-2010

	Credit Rate (%)	Maximum Earned Income	Maximum Credit[a]	Phase-Out Rate (%)	Phase-Out Income Level	Income Where EITC=$0
For families with children:						
1975	10.0	4,000	400	10.0	4,000	8,000
1976	10.0	4,000	400	10.0	4,000	8,000
1977	10.0	4,000	400	10.0	4,000	8,000
1978	10.0	4,000	400	10.0	4,000	8,000
1979	10.0	5,000	500	12.5	6,000	10,000
1980	10.0	5,000	500	12.5	6,000	10,000
1981	10.0	5,000	500	12.5	6,000	10,000
1982	10.0	5,000	500	12.5	6,000	10,000
1983	10.0	5,000	500	12.5	6,000	10,000
1984	10.0	5,000	500	12.5	6,000	10,000
1985	10.0	5,000	500	12.22	6,500	11,000
1986	10.0	5,000	500	12.22	6,500	11,000
1987	14.0	6,080	851	10.0	6,920	15,432
1988	14.0	6,240	874	10.0	9,840	18,576
1989	14.0	6,500	910	10.0	10,240	19,340
1990	14.0	6,810	953	10.0	10,730	20,264
For families with one child:						
1991	16.7	7,140	1,192	11.93	11,250[a]	21,250[a]
1992	17.6	7,520	1,324	12.57	11,840[a]	22,370[a]
1993	18.5	7,750	1,434	13.21	12,200[a]	23,050[a]
1994	26.3	7,750	2,038	15.98	11,000	23,750
1995	34.0	6,150	2,094	15.98	11,290	24,396
1996	34.0	6,350	2,152	15.98	11,650	25,100
1997	34.0	6,500	2,210	15.98	11,950	25,800
1998	34.0	6,650	2,271	15.98	12,300	26,500
1999	34.0	6,800	2,312	15.98	12,500	26,950
2000	34.0	6,900	2,353	15.98	12,700	27,450

	Credit Rate (%)	Maximum Earned Income	Maximum Credit[a]	Phase-Out Rate (%)	Phase-Out Income Level	Income Where EITC=$0
2001	34.0	7,100	2,428	15.98	13,100	28,300
2002	34.0	7,350	2,506	15.98	13,550[b]	29,250[b]
2003	34.0	7,490	2,547	15.98	13,730[b]	29,666[b]
2004	34.0	7,660	2,604	15.98	14,040[b]	30,338[b]
2005	34.0	7,830	2,662	15.98	14,370[c]	31,030[c]
2006	34.0	8,080	2,747	15.98	14,810[c]	32,001[c]
2007	34.0	8,390	2,853	15.98	15,390[c]	33,241[c]
2008	34.0	8,580	2,917	15.98	15,740[d]	33,995[d]
2009	34.0	8,950	3,043	15.98	16,420[e]	35,463[e]
2010	34.0	8,970	3,050	15.98	16,450[f]	35,535[f]
For families with two or more children:						
1991	17.3	7,140	1,235	12.36	11,250[a]	23,122[a]
1992	18.4	7,520	1,384	13.14	11,840[a]	22,370[a]
1993	19.5	7,750	1,511	13.93	12,200[a]	23,050[a]
1994	30.0	8,425	2,528	17.86	11,000	25,300
1995	36.0	8,600	3,110	20.22	11,290	26,673
1996	40.0	8,890	3,556	21.06	11,650	28,495
1997	40.0	9,100	3,656	21.06	11,950	29,290
1998	40.0	9,350	3,756	21.06	12,300	30,095
1999	40.0	9,500	3,816	21.06	12,500	30,580
2000	40.0	9,700	3,888	21.06	12,700	31,152
2001	40.0	10,000	4,008	21.06	13,100	32,121
2002	40.0	10,350	4,140	21.06	13,550[b]	33,150[b]
2003	40.0	10,510	4,204	21.06	13,730[b]	33,666[b]
2004	40.0	10,750	4,300	21.06	14,040[b]	34,458[b]
2005	40.0	11,000	4,400	21.06	14,370[c]	35,263[c]
2006	40.0	11,340	4,536	21.06	14,810[c]	36,348[c]
2007	40.0	11,790	4,716	21.06	15,390[c]	37,783[c]
2008	40.0	12,060	4,824	21.06	15,740[d]	38,646[d]
2009	40.0	12,570	5,028	21.06	16,420[e]	40,295[e]
2010	40.0	12,590	5,036	21.06	16,450[f]	40,363[f]
For families with three or more children:						
2009	45.0	12,570	5,657	21.06	16,420[e]	43,279[e]
2010	45.0	12,590	5,666	21.06	16,450[f]	43,352[f]
For childless adults:						
1994	7.65	4,000	306	7.65	5,000	9,000

	Credit Rate (%)	Maximum Earned Income	Maximum Credit[a]	Phase-Out Rate (%)	Phase-Out Income Level	Income Where EITC=$0
1995	7.65	4,100	314	7.65	5,130	9,230
1996	7.65	4,200	323	7.65	5,300	9,500
1997	7.65	4,300	332	7.65	5,450	9,750
1998	7.65	4,450	341	7.65	5,600	10,050
1999	7.65	4,500	347	7.65	5,700	10,200
2000	7.65	4,600	353	7.65	5,800	10,400
2001	7.65	4,750	364	7.65	5,950[b]	10,750[b]
2002	7.65	4,900	376	7.65	6,100[b]	11,100[b]
2003	7.65	4,990	382	7.65	6,240[b]	11,230[b]
2004	7.65	5,100	390	7.65	6,390[b]	11,490[b]
2005	7.65	5,220	399	7.65	6,530[c]	11,750[c]
2006	7.65	5,380	412	7.65	6,740[c]	12,120[c]
2007	7.65	5,590	428	7.65	7,000[c]	12,590[c]
2008	7.65	5,720	438	7.65	7,160[d]	12,880[d]
2009	7.65	5,970	457	7.65	7,470[e]	13,440[e]
2010	7.65	5,980	457	7.65	7,480[f]	13,460[f]

Source: Table prepared by the Congressional Research Service.

a. The credit maximums for 1991-1993 do not include the two supplemental credits that were available to some EITC recipients in those years. The young child supplement added 5 percentage points to a family's credit rate; the child health insurance supplement added up to 6 points.

b. For this tax year the phase-out income level for a married couple filing a joint tax return is $1,000 higher than shown in the table.

c. For this tax year the phase-out income level for a married couple filing a joint tax return is $2,000 higher than shown in the table.

d. For this tax year, the phase-out income level for a married couple filing a joint tax return is $3,000 higher than shown in the table.

e. For this tax year, the phase-out income level for a married couple filing a joint tax return is $5,000 higher than shown in the table.

f. For this tax year, the phase-out income level for a married couple filing a joint tax return is $5,010 higher than shown in the table.

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