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The Earned Income Tax Credit (EITC): An Overview

Christine Scott
Specialist in Social Policy

Margot L. Crandall-Hollick
Analyst in Public Finance

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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 (the credit was, and remains, calculated as a percentage of earned income, with no direct link to Social Security taxes paid by the tax filer), 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 2011 (the latest year for which data are available) received an average EITC of $264, families with one child received an average EITC of $2,199, families with two children received an average EITC of $3,469, and families with three or more children received an average EITC of $3,750.

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 use 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.

The maximum earned income amounts, phase-out income levels, disqualifying investment income level, and maximum credit amounts are adjusted annually to reflect inflation. The actual amount of the credit a tax filer receives is determined by the tax filer's earned income and number of qualifying children using these inflation adjusted parameters.

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; and compliance. Anti-poverty effectiveness concerns have led to the introduction of legislation and the recent Obama Administration proposal for expanding the EITC for childless adults.

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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 27.9 million tax filers receiving $62.9 billion in tax credits for tax year 2011. **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 with relatively low earnings. 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.[1] Eligibility for, and the size of, the EITC is based on earned income; age; residence, citizenship, and identification requirements; and the presence of qualifying children.

Earned Income

Earned income for calculation of the credit 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. All military income earned by a member of the Armed Forces while in a designated combat zone is considered combat pay and is nontaxable income. As a result, a service member with combat zone service during the tax year may, without using the election to include combat pay for credit purposes, have earned income for the EITC.

To be eligible for the EITC, the tax filer must have adjusted gross income (AGI) and earned income below the amount that reduces the EITC to $0[2] and have investment income no greater than $3,800 (in tax year 2013). 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.

[1] Prior to 2011, any person with a child eligible for the credit could elect to receive advance credits through the employer's payroll tax system by filing an eligibility certificate (Form W-5) with his or her employer. The option to claim the EITC in advance was little used, and was discontinued by P.L. 111-226 for tax years beginning after December 31, 2010.

[2] For information on income levels where the EITC is reduced to $0, see **Table 1**.

Age

To be eligible for the credit, a tax filer without a qualifying child must be at least 25 years of age, but not more than 64 years of age, and cannot be claimed as a dependent on another person's tax return. There is no age limitation for tax filers with qualifying children.

Residence, Citizenship, and Identification Requirements

The tax filer must reside in the United States unless in another country because of U.S. military duty.

U.S. citizenship is not a requirement for the credit. To be eligible for the EITC, the taxpayer, spouse (if married), and all qualifying children must meet the identification requirement—have a valid Social Security Number (SSN).

Qualifying Children

The tax filer's child (or children), to be a qualifying child for the credit, must meet three of the five requirements for a qualifying child (as defined for the dependency exemption in 26 U.S.C. §152(c)):[3]

- 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 the age of 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 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.[4]

[3] The two criteria of a qualifying child for the dependency exemption not required for the earned income credit are: (1) that the child has not provided one-half or more of his or her own support; and (2) the special rules (for the dependency exemption) for divorced or separated parents are not applicable.

[4] An eligibility rule that an unmarried filer must meet the requirements for "head of household" tax filer status to be (continued...)

Credit Amount

Claimants receive an EITC in one of three 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; or
- as a combination of reduced taxes and direct payments (refunds).

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. The credit amount will vary based on the number of qualifying children and earned income. This is because the credit rate, maximum amount of qualified income (for computing the credit), the phase-out income level, and the phase-out rate are all based on the tax filer's number of qualifying children and filing status.

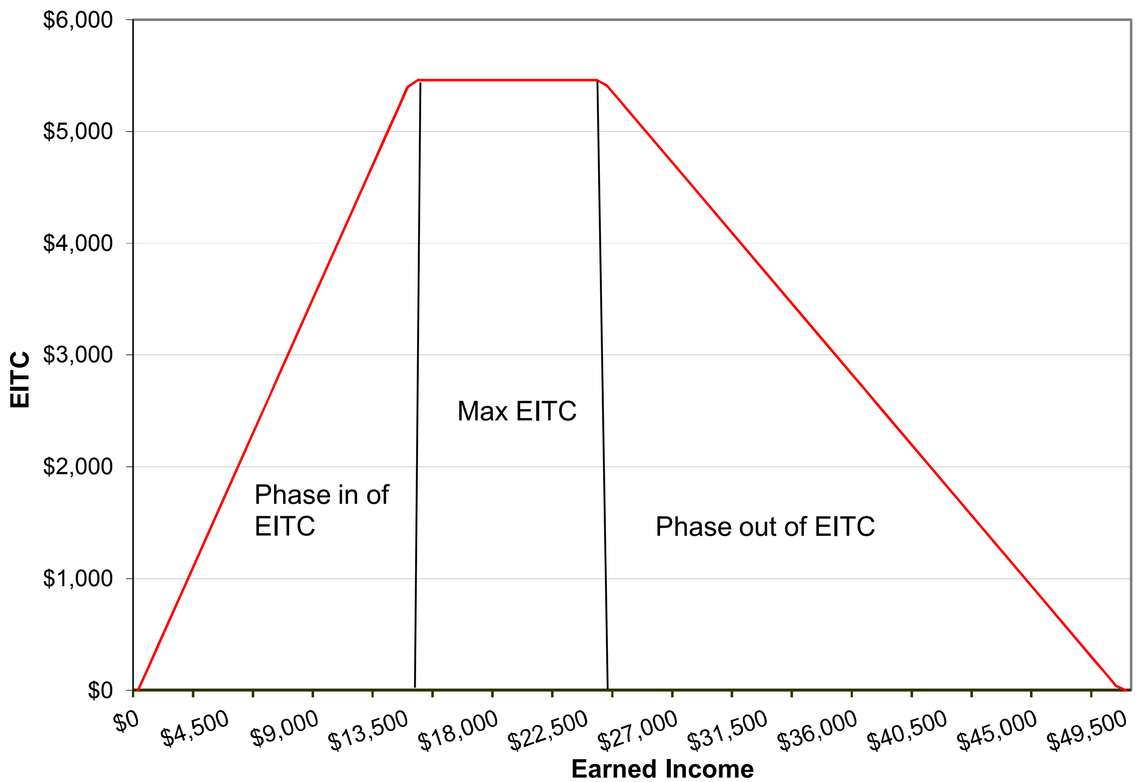
In general, the EITC amount increases with earnings up to a point (the maximum earned income eligible for the credit), then remains unchanged for a certain bracket of income (the plateau), and then (beginning at the phase-out income level) gradually decreases to zero as earnings continue to increase.

Figure 1 provides a graphic representation of EITC levels, by income level for a married couple with two children in tax year 2014.

(...continued)

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.

Figure 1. EITC Levels by Income, Married Couple with Two Children, Tax Year 2014



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

Up to the maximum earned income amount, the credit equals the earned income times a statutory percentage (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 2014 for a married couple with two children, for each additional $1 of earnings (up to a total earned income of $13,650) the family receives an additional 40 cents in EITC.

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 2014, for a married couple with two children, for each $1 of income above the phase-out level of income ($23,260), the recipient loses 20.16 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.[5]

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 2012, 2013, and 2014 are shown in **Table 1**.

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

The maximum earned income amounts, phase-out income levels, disqualifying investment income level, and maximum credit amounts are adjusted annually to reflect inflation. The actual amount of the credit a tax filer receives is determined by the tax filer's earned income and number of qualifying children using these inflation adjusted parameters.

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[6] 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.

[6] The tables can be found, for tax year 2013 returns, beginning on page 59 of the Form 1040 general instructions, which can be found at http://www.irs.gov/pub/irs-pdf/i1040gi.pdf.

Table 1. EITC Parameters for Tax Years 2012-2014

	2012 ($)	2013 ($)	2014 ($)	Credit Rate	Phase-out Rate
No children				7.65%	7.65%
Maximum earned income amount	6,210	6,370	6,480		
Maximum credit	475	487	496		
Phase-out income level	7,770	7,970	8,110		
Phase-out income level for married filing joint	12,980	13,310	13,540		
Income where EITC = 0	13,980	14,340	14,590		
Income where EITC = 0 for married filing joint	19,190	19,680	20,020		
One child				34.00%	15.98%
Maximum earned income amount	9,320	9,560	9,720		
Maximum credit	3,169	3,250	3,305		
Phase-out income level	17,090	17,530	17,830		
Phase-out income level for married filing joint	22,300	22,870	23,260		
Income where EITC = 0	36,920	37,870	38,511		
Income where EITC = 0 for married filing joint	42,130	43,210	43,941		
Two children				40.00%	21.06%
Maximum earned income amount	13,090	13,430	13,650		
Maximum credit	5,236	5,372	5,460		
Phase-out income level	17,090	17,530	17,830		
Phase-out income level for married filing joint	22,300	22,870	23,260		
Income where EITC = 0	41,952	43,038	43,756		
Income where EITC = 0 for married filing joint	47,162	48,378	49,186		
Three or more children				45.00%	21.06%
Maximum earned income amount	13,090	13,430	13,650		
Maximum credit	5,891	6,044	6,143		
Phase-out income level	17,090	17,530	17,830		
Phase-out income level for married filing joint	22,300	22,870	23,260		
Income where EITC = 0	45,060	46,227	46,997		
Income where EITC = 0 for married filing joint	50,270	51,567	52,427		
Disqualifying investment income level	3,200	3,300	3,350		

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 2014, 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= $13,650 (the maximum earned income amount) *times* 40%

= $5,460 (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 = $13,650 (the maximum earned income amount) *times* 40% or $5,460 (the maximum credit)

minus

($1,740 (the amount by which income exceeds the phase-out income level[$23,260] *times* 21.06%)

or $366

= $5,094

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 actual amount of the credit a tax filer receives is determined by the tax filer's earned income and number of qualifying children using these inflation adjusted parameters.

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 2011, a total of 27.9 million tax filers claimed a total of $62.9 billion in EITC. For tax year 2011, the average EITC was $2,252, and 87.7% of the EITC was received as a refund. **Table 2** provides the total EITC, refunded portion, number of recipients (tax filers), and average credit for 1975 through 2011.

Table 2. EITC and Recipients 1975-2011

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

Tax Year	Total EITC ($ millions)	Refunded Portion of EITC ($ millions)	Number of Recipients (thousands)	Average EITC ($)
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
2009	59,240	53,985	27,041	2,191
2010	59,562	54,256	27,368	2,176
2011	62,906	55,350	27,912	2,254

Sources: For pre-2003 data, 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, pp.13-41. For 2003 and later data, Internal Revenue Service, *Total File, United States, Individual Income and Tax Data, by State and Size of Adjusted Gross Income, Tax Years 2003 through 2011*, 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 percentage of federal returns claiming the EITC, the total EITC, average EITC, and percentage of the credit refunded by state for tax year 2011 are shown in **Table 3**.

Table 3. EITC Recipients and Amount by State, Tax Year 2011

State	Total Number of Returns	Number of EITC Returns	Percentage of Returns w/EITC	EITC Claimed (Total $)	Average EITC ($)	Percentage of EITC Refunded
Alabama	2,091,528	550,147	26.3%	1,413,774	2,570	89.7%
Alaska	370,819	51,022	13.8%	98,065	1,922	90.5%
Arizona	2,790,467	591,062	21.2%	1,381,176	2,337	89.1%
Arkansas	1,234,459	318,547	25.8%	759,930	2,386	90.0%
California	17,062,133	3,273,578	19.2%	7,251,211	2,215	84.8%
Colorado	2,420,566	372,911	15.4%	757,380	2,031	87.7%
Connecticut	1,747,468	218,030	12.5%	432,218	1,982	87.4%
Delaware	434,239	73,828	17.0%	159,321	2,158	92.3%
District of Columbia	329,718	57,181	17.3%	128,382	2,245	85.1%
Florida	9,695,733	2,126,601	21.9%	4,841,136	2,276	86.4%
Georgia	4,671,692	1,140,859	24.4%	2,833,044	2,483	88.2%
Hawaii	661,948	114,700	17.3%	235,605	2,054	90.4%
Idaho	671,392	140,491	20.9%	302,468	2,153	88.9%
Illinois	6,122,028	1,062,856	17.4%	2,418,298	2,275	86.6%
Indiana	3,018,318	564,116	18.7%	1,242,184	2,202	89.6%
Iowa	1,421,065	215,951	15.2%	437,211	2,025	89.2%
Kansas	1,325,121	223,874	16.9%	478,922	2,139	90.4%
Kentucky	1,876,826	415,891	22.2%	924,565	2,223	89.1%
Louisiana	2,022,779	552,924	27.3%	1,415,334	2,560	89.5%
Maine	633,428	105,893	16.7%	199,851	1,887	86.1%
Maryland	2,837,882	422,019	14.9%	902,588	2,139	86.5%
Massachusetts	3,258,058	408,821	12.5%	782,530	1,914	87.7%
Michigan	4,676,744	861,093	18.4%	1,912,050	2,220	87.1%
Minnesota	2,601,604	355,940	13.7%	695,978	1,955	88.2%
Mississippi	1,286,776	421,934	32.8%	1,106,784	2,623	90.6%
Missouri	2,729,064	539,836	19.8%	1,196,672	2,217	89.5%
Montana	480,902	86,646	18.0%	169,315	1,954	88.5%
Nebraska	868,468	140,207	16.1%	295,609	2,108	89.7%
Nevada	1,297,925	243,606	18.8%	540,001	2,217	88.8%
New Hampshire	678,296	82,739	12.2%	150,292	1,816	86.5%
New Jersey	4,325,769	599,195	13.9%	1,274,398	2,127	86.1%
New Mexico	914,444	222,996	24.4%	502,839	2,255	90.8%
New York	9,387,780	1,789,895	19.1%	3,887,837	2,172	84.7%

State	Total Number of Returns	Number of EITC Returns	Percentage of Returns w/EITC	EITC Claimed (Total $)	Average EITC ($)	Percentage of EITC Refunded
North Carolina	4,295,284	953,786	22.2%	2,200,620	2,307	89.4%
North Dakota	343,814	44,926	13.1%	87,000	1,937	89.8%
Ohio	5,508,810	989,730	18.0%	2,183,483	2,206	89.0%
Oklahoma	1,617,355	358,415	22.2%	821,189	2,291	89.3%
Oregon	1,758,128	291,270	16.6%	570,485	1,959	88.5%
Pennsylvania	6,183,225	945,671	15.3%	1,929,653	2,041	89.5%
Rhode Island	513,134	83,469	16.3%	175,773	2,106	88.2%
South Carolina	2,090,773	512,678	24.5%	1,206,997	2,354	90.1%
South Dakota	411,441	66,464	16.2%	134,299	2,021	90.4%
Tennessee	2,902,907	681,527	23.5%	1,587,753	2,330	87.8%
Texas	11,417,280	2,714,964	23.8%	6,840,529	2,520	87.3%
Utah	1,159,631	203,607	17.6%	451,717	2,219	89.4%
Vermont	320,656	47,051	14.7%	82,990	1,764	85.0%
Virginia	3,801,986	623,145	16.4%	1,334,103	2,141	88.9%
Washington	3,216,985	459,726	14.3%	923,327	2,008	88.9%
West Virginia	791,595	161,595	20.4%	335,500	2,076	91.3%
Wisconsin	2,772,794	399,930	14.4%	812,305	2,031	89.0%
Wyoming	294,713	39,343	13.3%	74,722	1,899	90.1%
Other Areas	1,110,020	33,093	3.0%	73,986	2,236	96.3%
Total	146,455,970	27,955,779	19.1%	62,953,399	2,252	87.7%

Source: Internal Revenue Service, Total File, *All States, Individual Income and Tax Data, by State and Size of Adjusted Gross Income, Tax Year 2010*, 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 Service constructs tax returns for certain non-filers.

Distribution by Number of Eligible Children and Income

For tax year 2011, returns with three or more eligible children have the highest average EITC ($3,750), and returns with no eligible children have the lowest average EITC ($264). Returns with one child claim 35.3% of the EITC and comprise 36.2% of all returns claiming the credit. Returns with two children claim 41.3% of the EITC and comprise 26.9% of all returns claiming the EITC. Returns with three or more children claim 20.5% of the EITC and comprise 12.3% of all 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 68.9% have an AGI of less than

$10,000. However, for returns with two children, 49.6% have an AGI of $20,000 or more, and for returns with three or more children, 59.4% 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 2011

	All EITC Returns		No child EITC		One Child EITC	
	Number of Returns	Amount ($)	Number of Returns	Amount ($)	Number of Returns	Amount ($)
Less Than $10,000	8,219,020	9,967,054	4,741,434	1,459,737	2,349,575	5,460,092
$10,000 less than $15,000	5,890,468	16,014,372	1,912,748	330,279	1,961,593	5,862,058
$15,000 less than $20,000	3,883,866	14,874,684	231,971	30,899	1,625,389	4,664,613
$20,000 less than $25,000	2,965,380	9,887,452	-	-	1,454,723	3,326,615
$25,000 less than $30,000	2,588,844	6,380,470	-	-	1,263,580	1,934,532
$30,000 less than $35,000	2,166,926	3,601,391	-	-	997,578	787,063
$35,000 less than $40,000	1,319,183	1,556,575	-	-	396,972	162,227
$40,000 less than $45,000	687,033	563,720	-	-	44,461	3,929
$45,000 and over	191,006	60,443	-	-	-	-
Total	27,911,726	62,906,161	6,886,153	1,820,915	10,093,871	22,201,129
Average Credit		2,254		264		2,199

	Two Children EITC		Three+ Children EITC	
	Number of Returns	Amount ($)	Number of Returns	Amount ($)
Less Than $10,000	828,892	2,186,917	299,121	860,305
$10,000 less than $15,000	1,523,173	7,222,469	492,953	2,599,568
$15,000 less than $20,000	1,425,709	6,883,162	600,796	3,296,011
$20,000 less than $25,000	1,022,676	4,151,414	487,981	2,409,422
$25,000 less than $30,000	931,190	2,903,870	394,073	1,542,068
$30,000 less than $35,000	784,696	1,699,957	384,653	1,114,371
$35,000 less than $40,000	589,927	734,950	332,284	659,399
$40,000 less than $45,000	347,070	222,441	295,502	337,350
$45,000 and over	44,968	4,930	146,038	55,513
Total	7,498,301	26,010,110	3,433,401	12,874,007
Average Credit ($)		3,469		3,750

Source: Table prepared by CRS using Internal Revenue Service Data *Statistics of Income Bulletin*, Table 2.5 for tax year 2011 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,[7] the EITC cannot be counted as income in determining eligibility, or the amount of benefit, for any federally funded public benefit program including food stamps, low-income housing, Medicaid, Social Security Income (SSI), and Temporary Assistance for Needy Families (TANF). An EITC refund that is saved by the filer does not count against the resource limits of any federally funded public benefit program for 12 months after the refund is received.

State EITC Provisions

Currently, 26 states and the District of Columbia offer an EITC for state taxes.[8] 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 EITC has an impact on several major policy issues—including work incentives, marriage penalties, and poverty reduction. There are also concerns about compliance with this credit. An analysis of each issue is provided below.

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[7] The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (H.R. 4853) included a provision which made tax refund, including those resulting from the EITC, disregarded in the administration of federal programs and federally assisted programs. At the end of 2012, this provision was made permanent by the American Taxpayer Relief Act of 2012 (P.L. 112-240).

[8] Center on Budget and Policy Priorities, *Policy Basics: State Earned Income Tax Credits*, Washington, DC, January 31, 2014, available athttp://www.cbpp.org/cms/?fa=view&id=2505.

Work Incentives

The EITC provides financial incentives to workers based on their earnings. In some cases—especially among taxpayers with children—these incentives can be significant. Given that the value of this credit is tied to work, policymakers may be interested in how the EITC affects the labor force.

Economic theory suggests that the EITC may have two effects on the labor force: it can encourage non-workers to begin working, and among those already working, it can affect the number of hours they work. For low-income workers eligible for the EITC, the EITC universally increases post-tax earnings, meaning it should theoretically increase labor force participation among eligible non-workers. In contrast, the impact of the EITC on hours worked depends on the taxpayer's earnings, because the marginal value of the EITC, and hence the incentive to work more, changes as earnings rise.

Specifically, the EITC phases in over a certain range of earnings, remains constant over a subsequent earnings range, and then phases out to zero over a final earnings range. For example, in 2014, for an unmarried taxpayer with one child, the EITC

- phases in at 34 cents for every dollar of earnings when the recipients earnings are between $0 and $9,720 (with a maximum credit of $3,305 for earnings of $9,720);
- remains constant at $3,305 for earnings between $9,271 and $17,830, and;
- phases out to zero by 15.98 cents for every additional dollars of earnings between $17,831 and $38,511.[9]

As the EITC phases in, it increases the marginal return to work (i.e., in the example above, over the phase in range, one dollar of earnings pre-EITC, leads to $1.34 of earnings post-EITC), which should theoretically encourage workers to work more hours. Over the earnings range where the credit value is constant, it has neither a positive nor negative effect on post-EITC earnings, and so it theoretically should have little effect on hours worked. As the credit phases out, it decreases the return to work (i.e., in the example above, every additional dollar of pre-EITC earnings, leads to the reduction of post-EITC earnings by 15.98 cents). Hence, for workers whose earnings put them in the phase out range, the EITC should theoretically result in workers working less than they otherwise would. In fact, economists often describe the phase out of the EITC as one component that increases effective marginal tax rates (EMTRs) of low-wage workers. An EMTR is the portion of an additional dollar of earnings that is unavailable to a worker because it is either paid in taxes or offset in reduction in benefits.[10]

Current research indicates that the EITC does have a positive effect on labor force participation (i.e., a non-worker deciding to work), especially among single mothers. Much of the research focuses on how significant legislative expansions of the EITC encouraged previously non-working single mothers to enter the workforce.[11] One study found that the creation of a larger

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[9] See IRS Revenue Procedure 2013-35, http://www.irs.gov/pub/irs-drop/rp-13-35.pdf.

[10] For an overview of EMTRs, see Congressional Budget Office. *Effective Marginal Tax Rates for Low-and Moderate-Income Workers.* November 2012, http://www.cbo.gov/publication/43709.

[11] For example, see Meyer, Bruce D. and Da. T. Rosenbaum "Welfare, the Earned Income Tax Credit, and the Labor Supply of Single Mothers," *Quarterly Journal of Economics*, vol. 116 (3), August 2001, pp. 1063-1114, (continued...)

credit for single mothers with two or more children in the early-1990s resulted in a sharp increase in employment among these workers (in comparison to labor force participation among those with one child, which slightly decreased).[12] Another study found that 34% of the increase in employment among single mothers between 1993 and 1999 was due to legislative expansions of the EITC. [13]

Although there is research that indicates that the EITC has encouraged previously non-working single mothers to enter the workforce, research indicates that the EITC has "had little effect on the number of hours they work."[14] As one study[15] stated,

> ...theory implies that the EITC will decrease hours worked among those already working because most recipients are on the plateau or phase out portion of the credit schedule. However, recent hours worked patterns for EITC eligible individuals do not appear to fit this second prediction. Hours and weeks worked by likely recipient groups have not fallen.

A variety of explanations exist for why the EITC has had little impact on the number of hours recipients work. One explanation is that workers may have little or no control over adjusting their work schedule. Hence, for example even if a worker is aware that their earnings are sufficiently high such that working more hours will reduce the amount of the EITC they receive, they may not be able to reduce the number of hours they work to maximize the value of the EITC. Even if a worker did have flexibility in their work schedule, the complexity of the EITC may make it difficult for the worker to determine the optimal number of hours to work. Specifically, the complexity of this tax benefit in terms of the formulas that go into calculating the credit, what counts as income, interactions with other tax and transfer programs, and the definition of a qualifying child, may make it hard for taxpayers to determine what the optimal range of earnings is to receive the largest EITC. In addition, some experts suggest that instead of responding to the marginal impact work has on their EITC amount (and overall tax liability), taxpayers instead make their decision about how much they will work based on their average tax rate (their total taxes (or refund) divided by their total income). The impact of additional earnings on average tax rates is generally lower than its impact on marginal tax rates, which may account for the limited impact of the EITC on hours worked.

Marriage Penalties

In terms of taxes, a couple is said to be subject to a marriage penalty if their tax liability as a married couple filing a joint return is greater than their combined individual tax liabilities filing

(...continued)

http://harrisschool.uchicago.edu/sites/default/files/MeyerRosenbaumQJE01.pdf.

[12] Bruce D. Meyer, "Labor Supply at the Extensive and Intensive Margins: The EITC, Welfare and Hours Worked" *American Economic Review*, vol. 92, May 2002, pp. 373-379, http://www.ipr.northwestern.edu/publications/docs/workingpapers/2002/IPR-WP-02-04.pdf.

[13] Jeffrey Grogger, "The Effects of Time Limits, the EITC, and Other Policy Changes on Welfare Use, Work, and Income among Female-Head Families," Review of Economics and Statistics, May 2003, p. 405.

[14] Congressional Budget Office. *Effective Marginal Tax Rates for Low-and Moderate-Income Workers.* November 2012, http://www.cbo.gov/publication/43709, p. 2.

[15] Bruce D. Meyer, "Labor Supply at the Extensive and Intensive Margins: The EITC, Welfare and Hours Worked" *American Economic Review*, vol. 92, May 2002, pp. 373-379, http://www.ipr.northwestern.edu/publications/docs/workingpapers/2002/IPR-WP-02-04.pdf.

as singles, assuming no other change in their circumstances aside from marriage. In the case of the EITC, taxpayers would be subject to a marriage penalty if they receive a smaller EITC as a married couple than their combined EITC as two single taxpayers.

Under the current parameters of the EITC, certain EITC recipients (depending on their earnings) will be subject to a marriage penalty when they marry, and could become ineligible for the EITC entirely. Specifically, the marriage penalty arises in the EITC because (1) the maximum credit for married joint filers is not double the maximum credit for single filers, (2) the income level at which the EITC phases out for married couples is not double the level for singles, and (3) the value of the EITC is affected by the presence and number of children (as well as earnings) and hence marriage may reduce the EITC depending on the number of children each spouse brings to the marriage. For example, in tax year 2013, two single parents, each with one child and earned income of $15,000 would receive an EITC of $3,250 each for a total EITC of $6,500. If they marry, their combined income would be $30,000, and with two children, their EITC would be $3,865.[16] The EITC marriage penalty for this couple would be $2,635. (Note that a marriage bonus—whereby a married couple's EITC is larger than their combined EITC as singles—can also occur. For example, when a single parent with no earnings marries a childless individual with low-earnings, their EITC as a married couple may be larger than their combined EITC as singles.)

Researchers have looked at the impact of the EITC's marriage penalty on two different behaviors among low-income workers—the impact it may have on *labor force participation* among those already married and the impact it may have on unmarried workers *to marry.* With respect to labor force participation, some research suggests that the EITC marriage penalty may act as a work disincentive for secondary earners of EITC-eligible married couples whose earnings place them in the plateau or phase-out range of the credit.[17,18] These couples may decide, for example, that the one spouse's EITC is sufficiently large to allows the other spouse to stay out of the workforce and instead raise children. These couples could determine that having two earners would not only reduce their EITC, but may also increase the cost of other expenses, like child care, ultimately lowering their disposable income.

In terms of the marriage penalties impact on marriage, the actual impact may depend on whether either individual has children prior to marriage as well as each individual's earnings. For example, two single low-income adults, who then marry and have children, may see their EITC increase. In contrast, theoretically a single working mother may be discouraged to marry another working person for fear of a reduced EITC. However, research indicates that the EITC's effects on marriage patterns are small and ambiguous.[19]

[16] See IRS Publication 596, 2013 Earned Income Credit (EIC) Table, http://www.irs.gov/pub/irs-pdf/p596.pdf.

[17] 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 no. 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, http://www.nber.org/papers/w6856.

[18] Nada Eissa and Hilary Williamson Hoynes, "Taxes and the labor market participation of married couples: the earned income tax credit," *Journal of Public Economics*, vol. 88 (2004), p. 1956, http://www9.georgetown.edu/faculty/noe/jpube804.pdf.

[19] Dean Ellwood, "The Impact of the Earned Income Tax Credit and Social Policy Reforms on Work, Marriage, and Living Arrangements," *National Tax Journal*, vol. 53, no. 4 (December 2000), pp. 1063-1106, http://ntj.tax.org/wwtax%5Cntjrec.nsf/53542C9468D27BA085256AFC007F39D9/$FILE/v53n4p21063.pdf.

Poverty Reduction

The EITC is one of the federal government's largest anti-poverty programs[20] reflecting a trend toward reducing poverty through the tax code.[21] However, the official poverty measure is unable to capture the anti-poverty impact of the EITC. The official poverty measure is calculated by comparing an individual's or family's resources, measured as pre-tax cash income (hence excluding the EITC), to a poverty threshold, roughly equal to three times the cost of spending on the U.S. Department of Agriculture's Economy Food Plan. If an individual's or family's resources are less than their applicable threshold, the individual or family is counted as poor.[22]

Although the official poverty measure cannot be used to assess the antipoverty impact of government tax and transfer programs, including the EITC, new experimental poverty measures that include government benefits like the EITC as part of an individual's or family's resources, do provide evidence of the anti-poverty effectiveness of the EITC. The U.S Census Bureau found that when government tax and transfer programs were included in a broader measure of poverty than the official poverty measure, refundable tax credits were estimated to reduce poverty by three percentage points in comparison to a 1.6 percentage point reduction for food assistance (known as SNAP or the Supplemental Nutrition Assistance Program) and 0.2 percentage point reduction as a result of cash welfare (known as SNAP or the Supplemental Nutrition Assistance Program).[23] Although this analysis includes both the EITC and refundable portion of the child tax credit, the EITC is the largest refundable tax credit targeted to the poor and previous research indicates[24] that most of the anti-poverty impact of refundable tax credits can be attributed to the EITC.

Analysis of the impact of the EITC on poverty rates of families of different sizes and marital statuses is provided in **Table 5**. Importantly, the poverty rates in **Table 5**—both pre-and post-EITC—do not reflect the official poverty measure. The poverty rates in **Table 5** are calculated by comparing a family's resources to the official poverty threshold. Crucially, for the purposes of this analysis, and unlike the official poverty measure, a family's resources include government benefits (like the Social Security, food assistance, housing assistance, health benefits), net of taxes paid and expenses associated with work, like child care. The EITC is then included in one measure of resources, but excluded in the other. Both measures of resources are then compared with the official poverty threshold to determine if the individual or family is poor. This data illustrates several key aspects of the anti-poverty effectiveness of the EITC based on marital status and number of children.

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[20] CRS Report R41625, *Federal Benefits and Services for People with Low Income: Programs, Policy, and Spending, FY2008-FY2009*, by Karen Spar.

[21] See Len Burman and Elaine Maag, *The War on Poverty Moves to the Tax Code*, Tax Policy Center, January 6, 2014, http://www.urban.org/UploadedPDF/1001711-war-on-poverty-moves-to-tax-code.pdf.

[22] For more information, see CRS Report R41999, *The Impact of Refundable Tax Credits on Poverty Rates*, by Margot L. Crandall-Hollick.

[23] See Table 5a in Kathleen Short, *The Research Supplemental Poverty Measure: 2012*, U.S. Census Bureau, Current Population Reports, November 2013, http://www.census.gov/prod/2013pubs/p60-247.pdf.

[24] CRS Report R41999, *The Impact of Refundable Tax Credits on Poverty Rates*, by Margot L. Crandall-Hollick.

Table 5. The Impact of the EITC on Poverty Rates, 2012

(by marital status and number of related children under the age of 18)

Family Characteristics		Percentage of Families in Poverty Using an Alternative Measure of Income			
Marital Status	**Number of Related Children Under 18 in the Family**	**EITC Excluded from Income**	**EITC Included in Income**	**Percentage Change in Poverty Rates from the EITC**	**Addendum: Percentage of Poor in Extreme Poverty (below 50% of the official federal poverty line)**
Single	0	22.29%	22.26%	-0.14%	47.41%
	1	29.11%	24.74%	-15.02%	44.59%
	2	33.97%	28.31%	-16.65%	41.75%
	3	48.03%	41.26%	-14.10%	41.68%
Married	0	4.44%	4.38%	-1.39%	43.26%
	1	5.27%	4.17%	-20.89%	36.06%
	2	6.10%	4.46%	-26.86%	30.55%
	3	10.04%	7.09%	-29.38%	29.69%

Source: CRS Analysis of the 2013 Current Population Survey.[25]

Notes: This analysis does not reflect income as calculated for the official poverty measure, but instead reflects a more expansive definition of income that includes the value of tax and transfer benefits. In addition, among married families, it is not necessarily the case that both spouses work.

One key aspect of the EITC's impact on poverty reduction illustrated in **Table 5** is that in comparison to workers with children, the EITC has a minimal impact on reducing poverty among childless workers, whether single or married. Poor childless workers tend to have very low incomes, with 43% to 47% in extreme poverty, meaning their incomes are below 50% of the federal poverty line. Although poor childless workers tend to be extremely poor, and poorer than their peers with children, childless workers receive a maximum EITC that is significantly smaller than the credit received by workers with children. Hence, the EITC reduces poverty rates by 0.14% and 1.39% respectively, in comparison to rates for workers with children that are at least fifteen times larger. As a result, recent proposals have called for increasing the EITC for childless recipients.

Senator Marco Rubio has proposed creating an alternative to the EITC, "a federal wage enhancement" that would "apply the same to singles as it would to married couples and families

[25] These figures were calculated by using the CPS Table Calculator available at http://www.census.gov/cps/data/cpstablecreator.html. To access this data under "Data options, "Get Count of: Persons in Poverty Universe (everyone except unrelated individuals under 15)" for the "Latest Year" of "2013" was selected. Under the "Define Your Table," the row variables of "family size," "marital status," and "related children under 18," and the column variable of "poverty status-alternative" were selected. Under "Poverty Thresholds," "Official Poverty Thresholds" was selected, and finally under "Income Definition," the income definition was customized to include all selected sources of income and expenses, except (1) "Economic Recovery Payments," (2) "Public housing and rent subsidies FMR-based estimates," (3) "Work-related expenses excluding childcare." These figures were compared with ones that were identical except for under "Income Definition" the federal earned income credit was de-selected as a source of income. The percentage difference in these two poverty rates is reported in **Table 5**.

with children."[26] In his 2014 State of the Union Address, President Obama expressed support for an expansion of the EITC among childless workers. [27] Senator Sherrod Brown and Representative Richard Neal have both introduced legislation, S. 836 and H.R. 2116, respectively, which would expand the EITC for childless workers in several ways. Specifically, these bills would lower the EITC eligibility age from 25 to 21 and increase both the EITC phase in rate and the maximum value of the credit for childless workers. For example, if enacted, these bills would increase the maximum EITC for childless workers from $487 to $1,350 in 2013.

Another key aspect of the EITC's impact on poverty rates as illustrated in **Table 5** is that the EITC has a lower anti-poverty impact on single parents than among married parents. The data also indicate, however, that a major factor for this difference may be that poor single parents are generally in much deeper poverty compared with their married peers. Hence, for poor single parents the EITC may be too small to push them over the poverty threshold compared with poor married couples with children.

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.

In more recent years, the IRS has estimated the improper payments rate for the EITC using information from the National Research Program (NRP). Improper payments include payments to the taxpayer in the incorrect amount—both over payments and under payments. The estimates are presented in a range (a minimum and maximum rate of improper payments). Since FY2003, the minimum improper payment rate for the EITC has ranged from 21% to 25%, and the maximum improper payment rate has ranged from 25% to 30%.[28]

Expiring Provisions

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

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[26] U.S. Senator Marco Rubio, "Reclaiming the Land of Opportunity: Conservative Reforms For Combatting Poverty," press release, January 8, 2014, http://www.rubio.senate.gov/public/index.cfm/press-releases?ID=958d06fe-16a3-4e8e-b178-664fc10745bf.

[27] See http://www.whitehouse.gov/the-press-office/2014/01/28/president-barack-obamas-state-union-address.

[28] See Treasury Inspector General for Tax Administration, *The Internal Revenue Service Was Not in Compliance With All Requirements of the Improper Payments Elimination and Recovery Act for Fiscal Year 2012*, 2013-40-024, February 25, 2013, Figure 2, p. 5.

- simplifying the calculation of the credit through use of AGI rather than modified adjusted gross income.

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 were also scheduled to expire on December 31, 2010.

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312) extended the EGTRRA and ARRA provisions for two years (through 2012).

Both the EGTRRA and ARRA provisions were scheduled to expire on December 31, 2012. The American Taxpayer Relief Act of 2012 (ATRA; P.L. 112-240) made permanent the EGTRRA changes and extended the ARRA changes five years (through tax year 2017).

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."[29]

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.)

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[29] 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 the 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 aged 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 eliminated 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 10 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.

Tax Relief Extension (2010 Law)

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312) extended the EGTRRA and ARRA provisions for two years (through 2012).

Tax Relief Extension (2012 Law)

The American Taxpayer Relief Act of 2012 (ATRA; P.L. 112-240) made permanent the EGTRRA changes and extended the ARRA changes five years (through tax year 2017).

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 2014.

Table B-1. EITC Parameters, 1975-2014

	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
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]
2011	34.0	9,100	3,094	15.98	16,690[g]	36,052[g]
2012	34.0	9,320	3,169	15.98	17,090[h]	36,920[h]
2013	34.0	9,560	3,250	15.98	17,530[i]	37,870[i]

	Credit Rate (%)	Maximum Earned Income	Maximum Credit[a]	Phase-Out Rate (%)	Phase-Out Income Level	Income Where EITC=$0
2014	34.0	9,720	3,305	15.98	17,830	38,511[j]
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]
2011	40.0	12,780	5,112	21.06	16,690[g]	40,964[g]
2012	40.0	13.090	5,236	21.06	17,090[h]	41,952[h]
2013	40.0	13,430	5,372	21.06	17,530 [i]	43,038 [i]
2014	40.0	13,650	5,460	21.06	17,830	43,756
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]
2011	45.0	12,780	5,751	21.06	16,690[g]	43,998[g]
2012	45.0	13,090	5,891	21.06	17,090[h]	45,060[h]
2013	45.0	13,430	6,044	21.06	17,530[i]	46,227[i]
2014	45.0	13,650	6,143	21.06	17,830	46,997[j]
For childless adults:						
1994	7.65	4,000	306	7.65	5,000	9,000
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]

	Credit Rate (%)	Maximum Earned Income	Maximum Credit[a]	Phase-Out Rate (%)	Phase-Out Income Level	Income Where EITC=$0
2011	7.65	6,070	464	7.65	7,590[g]	13,660[g]
2012	7.65	6,210	475	7.65	7,770[h]	13,980[h]
2013	7.65	6,370	487	7.65	7,970[i]	14,340[i]
2014	7.65	6,480	496	7.65	8,110	14,590[j]

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.

g. For this tax year, the phase-out income level for a married couple filing a joint tax return is $5,080 higher than shown in the table.

h. For this tax year, the phase-out income level for a married couple filing a joint tax return is $5,210 higher than shown in the table.

i. For this tax year, the phase-out income level for a married couple filing a joint tax return is $5,340 higher than shown in the table.

j. For this tax year, the phase-out income level for a married couple filing a joint tax return is $5,430 higher than shown in the table.

Author Contact Information

Christine Scott
Specialist in Social Policy
cscott@crs.loc.gov, 7-7366

Margot L. Crandall-Hollick
Analyst in Public Finance
mcrandallhollick@crs.loc.gov, 7-7582