What is the earned income tax credit?

The earned income tax credit subsidizes low-income working families. The credit equals a fixed percentage of earnings from the first dollar of earnings until the credit reaches its maximum. The maximum credit is paid until earnings reach a specified level, after which it declines with each additional dollar of income until no credit is available.

HOW THE EITC WORKS

The earned income tax credit (EITC) provides substantial support to low- and moderate-income working parents, but very little support to workers without qualifying children (often called childless workers). Workers receive a credit equal to a percentage of their earnings up to a maximum credit. Both the credit rate and maximum credit vary by family size, with larger credits available to families with more children. After the credit reaches its maximum, it remains flat until earnings reach the phaseout point. Thereafter, it declines with each additional dollar of income until no credit is available (figure 1).

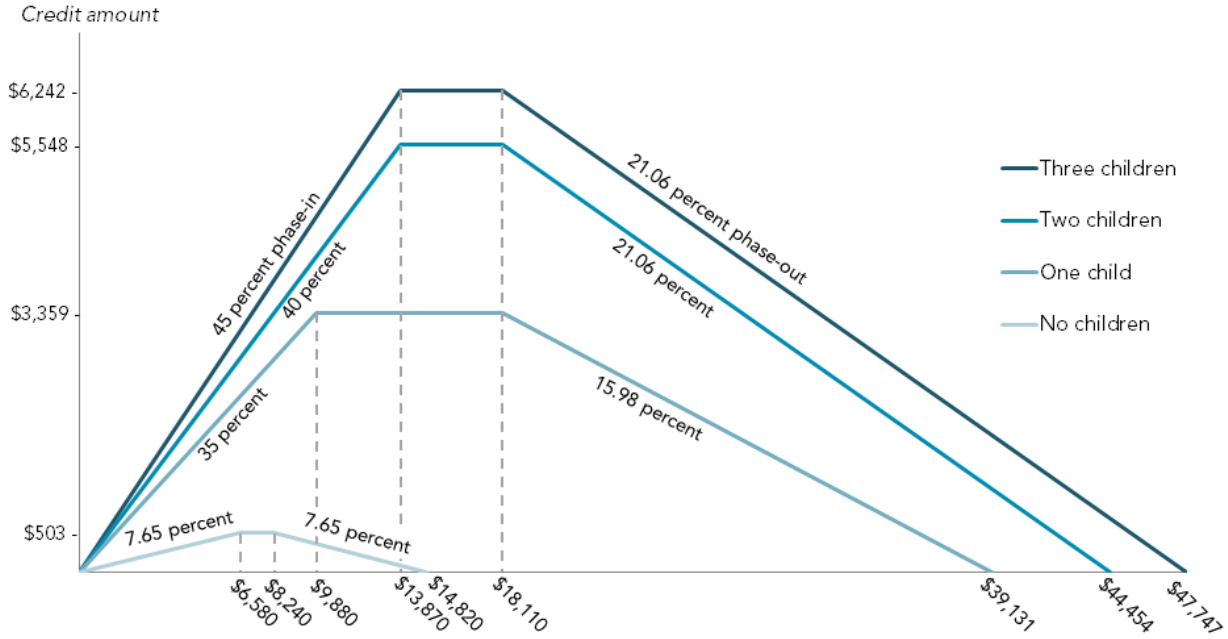
By design, the credit only benefits working families. Families with children receive a much larger credit than workers without qualifying children.[1] In 2015, the maximum credit for families with one child is $3,359, while the maximum credit for families with three or more children is $6,242.

In contrast to the substantial credit for workers with children, childless workers can receive a maximum credit of only $503. Moreover, the credit for childless workers phases out at much lower incomes. Also, childless workers must be at least 25 and not older than 64 to qualify for a subsidy—restrictions that do not apply to workers with children. As a result of these tighter rules, 97 percent of benefits from the credit go to families with children.

[1] A qualifying child must meet requirements based on relationship, age, residency, and tax filing status. See: Qualifying Child Rules.

FIGURE 1

Earned Income Tax Credit
2015



Source: Tax Policy Center, 2015.
Note: Assumes all income comes from earnings. Amounts are for taxpayers filing a single or head-of-household tax return. For married couples filing a joint tax return, the credit begins to phase out at income $5,520 higher than shown.

IMPACT OF THE EITC

Research shows that the EITC encourages single people and primary earners in married couples to work (Dickert, Houser, and Sholz 1995; Eissa and Liebman 1996; Meyer and Rosenbaum 2000, 2001). The credit, however, appears to have little effect on the number of hours they work once employed. Although the EITC phaseout could cause people to reduce their hours (because credits are lost for each additional dollar of eanings, which is effectively a surtax on earnings in the phaseout range), there is little empirical evidence of this happening (Meyer 2002).

The one group of people that may reduce hours of work in response to the EITC incentives are the lower-earning spouses in a married couple (Eissa and Hoynes 2006). On balance, though, the increase in work resulting from the EITC dwarfs the decline in participation among second earners in married couples.

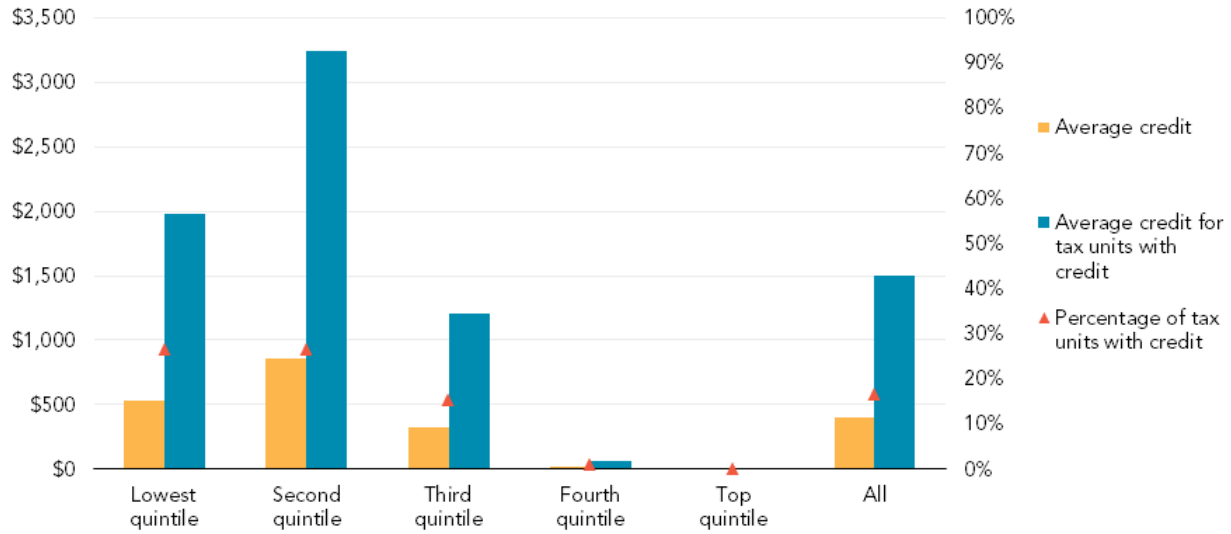
The EITC is the single most effective antipoverty program targeted at working-age households. According to a supplemental poverty measure calculated by the Census Bureau—which unlike the official poverty measure takes into account the effect of

federal income taxes—the EITC lifted 6.2 million people out of poverty in 2013, including 3.2 million chldren (DaSilva 2014; Short 2013).

Benefits from the EITC are concentrated among the lowest earners, with almost all benefits going to families in the bottom three quintiles of the distribution (figure 2). (Each quinitle contains 20 percent of the population, ranked by household income.)

FIGURE 2

Distribution of and Percentage of Tax Units with EITC
2015



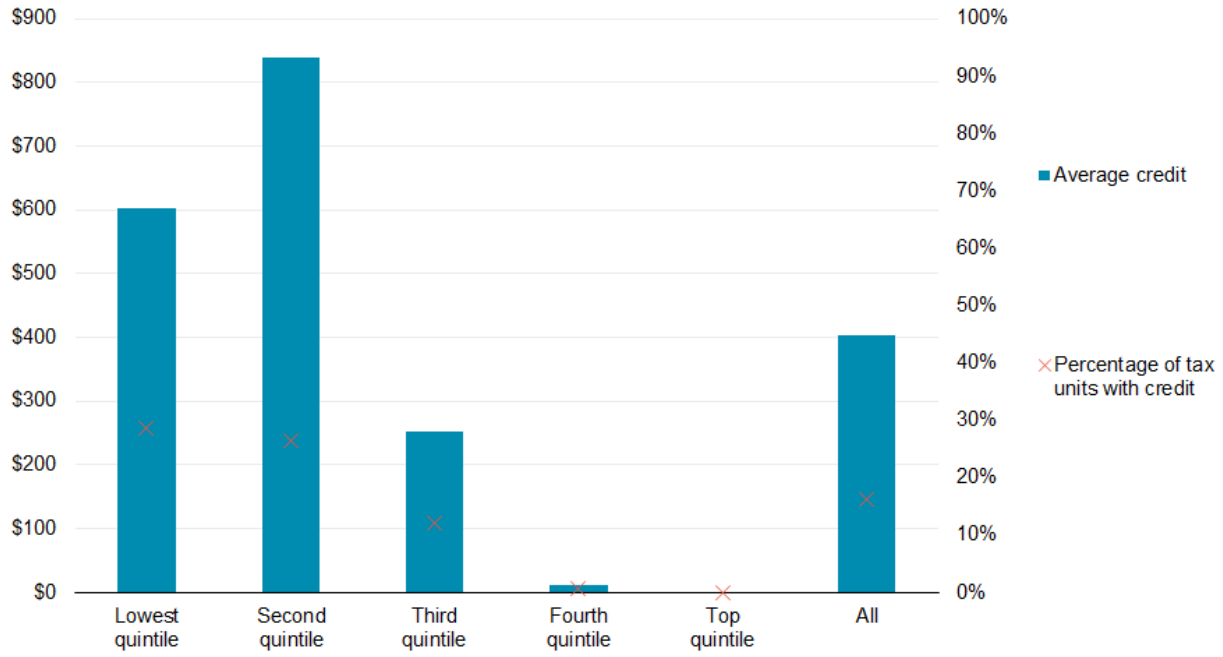
Source: Urban-Brookings Tax Policy Center Microsimulation Model, (version 0515-1).

RECENT CHANGES

As a result of legislation enacted in 2001, the EITC phases out at higher income levels for married couples than for single individuals. That threshold was increased as part of the American Recovery and Reinvestment Act of 2009 (ARRA). The same act increased the maximum EITC for workers with at least three children. The American Taxpayer Relief Act of 2012 made the 2001 EITC changes permanent ($3,000 higher threshold for married couple phaseout, indexed) but extended the ARRA changes ($5,000 higher threshold for married couple phaseout, indexed, and higher credit maximum for workers with at least three children). The Bipartisan Budget Act of 2015 made all of these changes permanent.

FIGURE 3

Share of Tax Units with EITC, and Average Benefits
2018



Source: Urban-Brookings Tax Policy Center Microsimulation Model, (version 0515-1).

PROPOSALS FOR REFORM

President Obama and members of the Republican congressional leadership have proposed EITC amendments to provide a substantial credit for childless workers. These proposals typically involve expanding the eligible age limits for the childless EITC—lowering the age of eligibility from 25 to 21 and increasing the age of eligibility from 64 to 67—increasing the maximum credit, and expanding the income range over which the credit is available. A more far-reaching approach to reform that would still expand benefits to childless workers would be to separate the credit into two pieces—one focused on work and one focused on children. Examples of this type of reform have been proposed by many, including the Bush Tax Reform Panel of 2005, the Bipartisan Policy Center, and Maag (2015b).

ERROR RATES AND THE EITC

The EITC likely delivers more than a quarter (28.5 percent) of all payments in error, according to a recent IRS compliance study. The largest source of error was determining whether a child claimed for the EITC actually qualified (Internal Revenue Service 2014). The child must live with the parent (or other relative) claiming the EITC for more than half of the year in order to qualify. The IRS receives no administrative data that can verify where a child resided for the majority of the year, making it difficult for the agency to monitor compliance. Attempts to use administrative data from other programs to verify child residence have not proven successful (Pergamit et al. 2014).

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