TAX POLICY CENTER
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INVESTING IN WORK BY REFORMING THE EARNED INCOME TAX CREDIT

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SUMMARY & INTRODUCTION

The earned income tax credit (EITC) lifts millions of working families out of poverty, but provides little support to workers without qualifying children. Members from both major political parties have called for reforming this important work incentive program to extend greater benefits to "childless" workers (workers without children or noncustodial parents). But simply expanding the current credit would tend to exacerbate other problems. This paper lays out an alternative approach: a new credit for low- and moderate-income workers that would address the shortcomings in the current system without adding to existing inequities.

Rather than limiting EITC reforms to childless workers, the proposed plan calls for Congress to adopt a new credit based on personal rather than household earnings. It would be less complicated than today's EITC, making compliance easier for individuals and administration easier for the Internal Revenue Service (IRS). It would provide substantial benefits to workers without qualifying children, balancing out the inequity between today's treatment of workers who have children living in their home and those who do not. A worker credit also would mitigate some of the EITC's other problems, including marriage penalties, work disincentives for secondary earners, and the high error rate associated with determining who has qualifying children.

The worker credit would replace the EITC for childless workers, increasing the credit received by those workers. Families with children would be eligible for the new worker credit in addition to a reduced EITC. In most cases, families with one worker would receive total credits similar in size to what they receive now, and families with two workers would receive higher credits.

Numerous research studies have shown that the EITC encourages parents with children to work. Many analysts believe that the credit could be reformed to provide the same work incentives to childless individuals and noncustodial parents. Improving the employment rates of noncustodial parents ought to be a goal of policymakers. Men who are not custodial parents are less likely to be employed than men who are living with their children. Some analysts suggest an increase in work among men could also increase marriage rates, increase child support compliance, and might also reduce crime rates.

President Obama, Representative Paul Ryan (R-WI), and others have proposed ways to reform the EITC, ranging from simple expansions for families without qualifying children to wage subsidies delivered in monthly paychecks to all qualifying workers. Though these plans could provide substantial support to some low-income workers, they either exacerbate problems with today's EITC—creating a possible work disincentive for secondary earners or raising taxes for married couples relative to unmarried individuals—or are complicated to deliver.

A worker credit based on individual earnings would provide benefits akin to an EITC to all workers, would be easier to administer than today's EITC, and would avoid some of the problems introduced by simply expanding the current EITC.

The downside to such a credit is that it would be costly—about $75 billion in 2015. A worker credit designed to fully offset the first $1,500 of payroll taxes (including employee and employer portions) for individuals modeled on the current EITC for families with one child would reduce tax revenues by $868 billion over the 10-year period from 2015 to 2024.

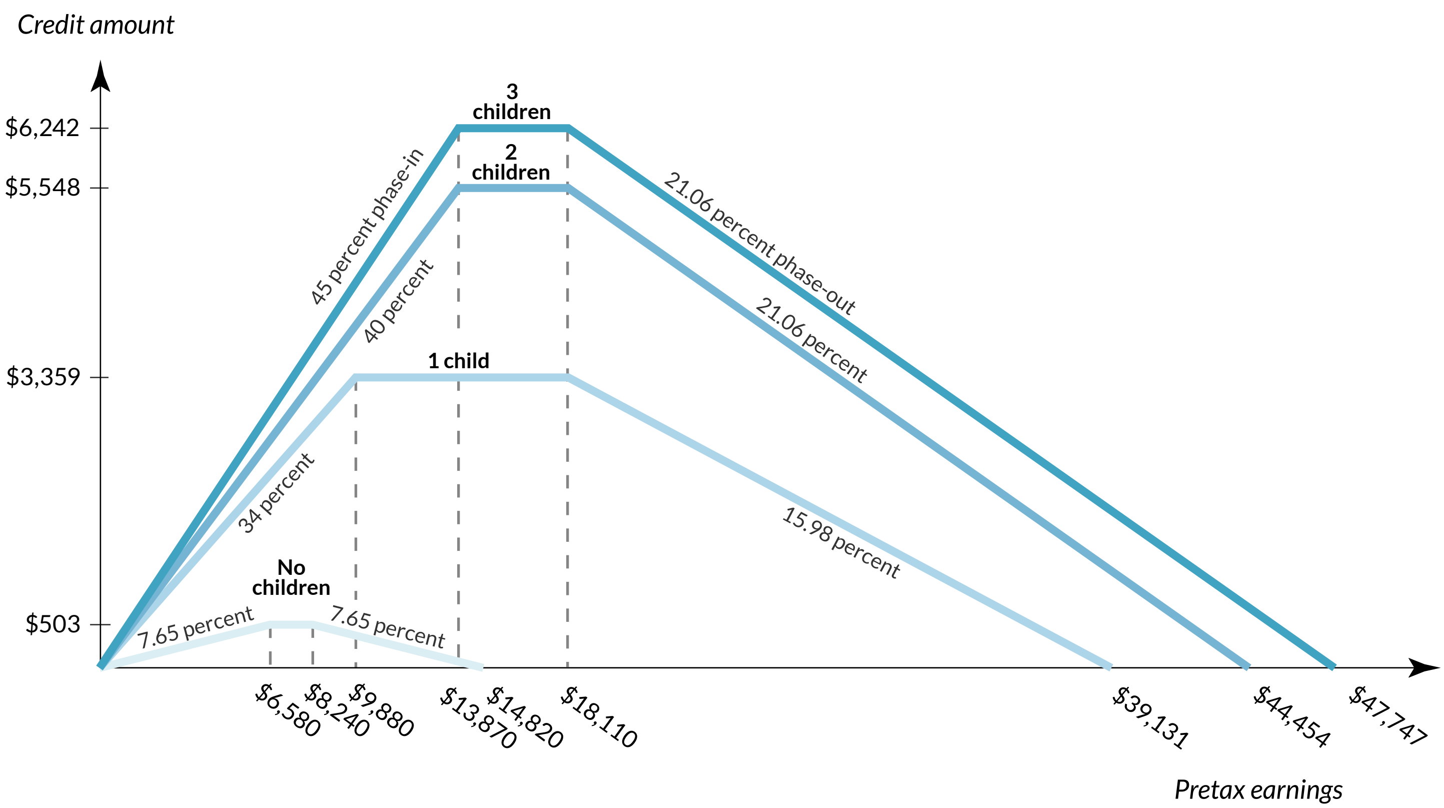
Restricting eligibility would reduce the cost of a worker credit but also lessen some of the benefits. If limited to workers ages 21 to 67, the worker credit would reduce tax revenues by $674 billion over 10 years. These limits would result in many young parents receiving lower credits under this proposal than under current law. Another option would be to phase out the worker credits based on joint earnings and adjusted gross income (AGI) for married couples, following current rules for the EITC. This option would reduce revenues by $629 billion over 10 years and would keep benefits from flowing to high-income couples with one low earner. If the extended phase-outs for married couples were eliminated at the same time, this option would reduce revenues by $605 billion. Either of these cost-reduction options would increase marriage penalties relative to the base proposal.

Another possibility to limit the cost of the proposal would be to pair it with broader tax reform. The options described here could be added to any tax reform plan seeking to rationalize worker and child benefits in the federal income tax system.

HOW THE EITC WORKS

The EITC provides substantial support to low- and moderate-income working parents, but very little support to workers without qualifying children. 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 phase-out point. At that point, the credit declines with each additional dollar of income until no credit is available (figure 1).

FIGURE 1. EARNED INCOME TAX CREDIT, 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.
Source: Tax Policy Center, 2015.

By design, the credit only benefits workers. Families with children receive a much larger credit than workers without qualifying children. In 2015, the maximum credit for families with one child exceeds $3,300 while the maximum credit for families with three or more children exceeds $6,200.

In contrast to the substantial credit for workers with children, “childless” workers (workers without children or noncustodial parents) can receive a maximum credit of only $503.[1] The credit for childless workers phases out at much lower incomes than the credit for families with children. Also, childless workers must be at least age 25 and not older than 64 to qualify for a subsidy, restrictions that do not apply to workers with children. As a result

[1] In order for a worker to claim a credit for a child, the worker’s child must be younger than 19, or younger than 24 and a full-time student in at least five months of the year, or any age and permanently and totally disabled. The child must also live with the worker in the United States for more than half of the year.

of these more restrictive rules, 97 percent of benefits from the credit go to families with children (Tax Policy Center 2013).

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

The exception to these findings is for secondary earners in married couples. Earnings by a second worker would likely place the combined earnings of the couple in the credit phase-out range, creating a potentially high implicit tax on work. As a result, some potential secondary earners choose to not work (Eissa and Hoynes 2006). But most EITC recipients are single parents for whom the credit is an unambiguous incentive to work. On balance, the increase in labor force participation among single parents dwarfs the small 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 from 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 children (Short 2013; DaSilva 2014).

Box 1. Poverty and the EITC

Official estimates of poverty compare the before-tax cash income of families of various sizes and compositions with a set of thresholds. Many transfer programs use the poverty thresholds to determine program eligibility. The official poverty measure excludes the effect of federal tax and noncash transfer programs on the resources available to the family. Thus, although an EITC adds income to a household, it does not effect the official poverty measure.

In order to understand how the safety net changes resources, the US Census Bureau developed a supplemental poverty measure that better measures the relative well-being of various households (Short 2013). The measure compares resources available to resources needed to determine how well off a household is, accounting for regional differences. Resources needed include basic items such as food and housing, but also expenses such as those associated with working and health needs. Resources available include government transfers, including noncash transfers and tax credits such as the EITC. Official Census publications show that together, the child tax credit (CTC) and the EITC lifted 9.4 million people out of poverty in 2013 (Short 2013). The Center on Budget and Policy Priorities separates the effects of the EITC and CTC and calculates that the EITC was responsible for lifting 6.2 million people out of poverty (DaSilva 2014).

REASONS TO REFORM THE EITC

Analysts criticize the EITC on several counts, saying that it

- provides little or no work incentive for individuals without children,
- discourages some secondary earners from working,
- creates marriage penalties for some couples, and
- delivers more than a quarter of all payments in error.

A worker credit can address each of these criticisms.

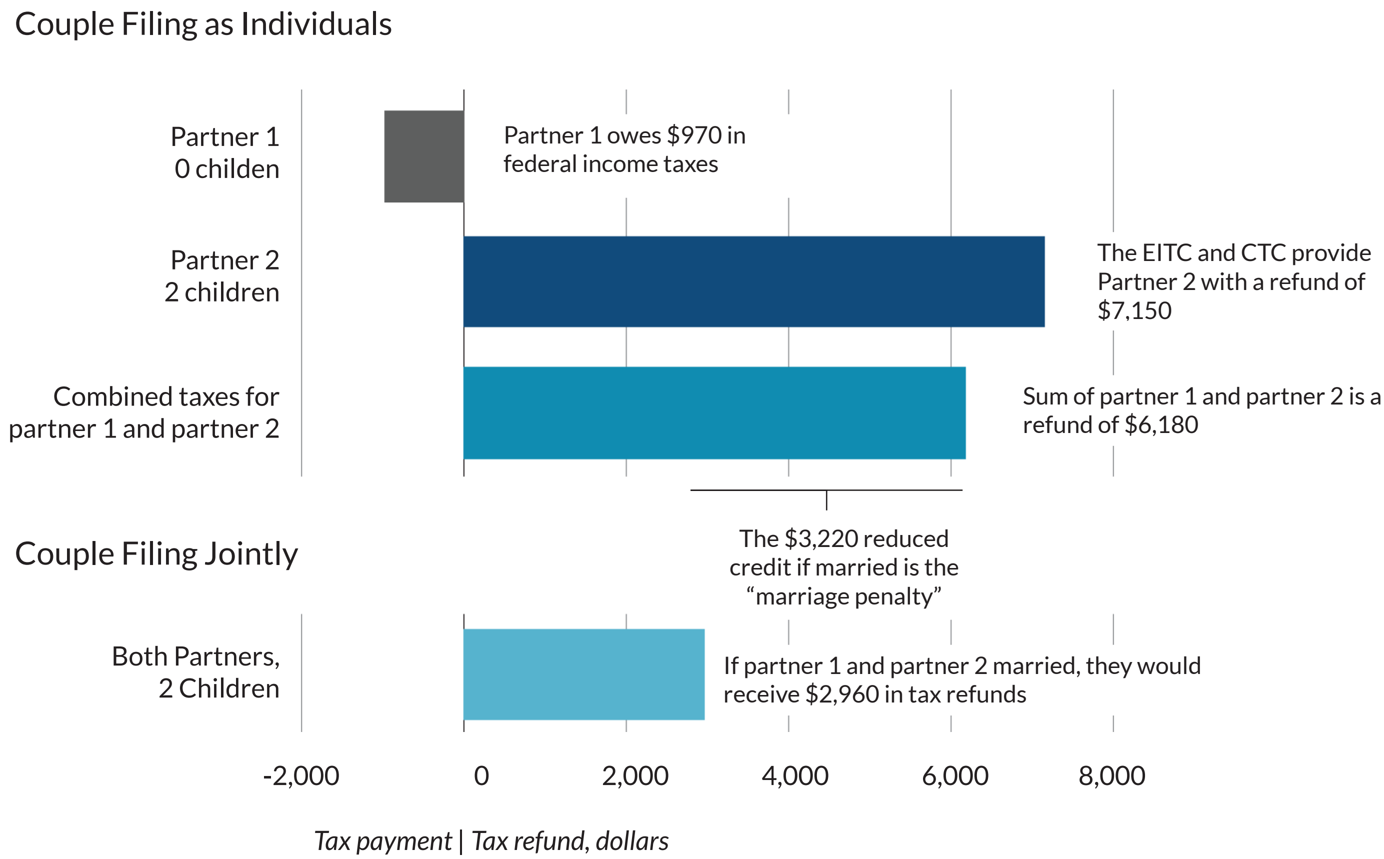
The EITC provides little or no work incentive for individuals without children. The small benefit available from the EITC to workers without qualifying children is unlikely to affect their decision as to whether or not to work. In 2015, a childless, single, full-time worker (2,000 hours per year) earning the federal minimum wage ($7.25 per hour) is eligible for a credit of less than $25. If that worker were married and did not have a working spouse, the EITC would be about $445. Married couples receive no EITC once their earnings reach $20,340, which is equivalent to full-time, full-year work paid at a rate of about $9.78 or two workers working full-time at the federal minimum wage for two-thirds of the year. In states with higher minimum wages, a full-time minimum-wage worker in a married couple would receive a smaller EITC—because these workers are in the EITC's phase-out range—or could be phased out of the credit entirely.

The EITC discourages some secondary earners from working. Some evidence suggests that the EITC discourages work for secondary earners, generally subsidizing married mothers to stay at home (Eissa and Hoynes 2004). This occurs when a primary earner qualifies for an EITC based on his or her own earnings. Adding a second earner typically pushes household earnings into the credit's phase-out range or beyond the credit range entirely. In rare cases, if a primary earner has wages in the credit's phase-in range or plateau range, a secondary earner with very low wages can increase or have no effect on the family's EITC. A worker credit based on individual (rather than joint) earnings would be unaffected by a spouse's earnings, removing the disincentive to work for secondary earners in married couples.

The EITC can create substantial marriage penalties for low-income working couples. The EITC can create substantial marriage penalties for low-income working couples. That is, couples may receive a lower credit if they are married than the combined credits they would receive if they remain single. When unmarried people who qualify for the EITC marry, the combined household income often rises into the EITC phase-out range or beyond, reducing or completely eliminating the credit (figure 2 and table 1).[2] The opposite can also be true. Marriage can increase a person's EITC if a parent with no or very low earnings marries a partner with modest earnings. In this case, taxes are lower (or credits are higher) for the couple when they are married than when they are unmarried (figure 3 and table 1).

Although analysts have found little evidence indicating the EITC reduces marriage rates, substantially increasing the EITC for childless workers—as has been proposed in Congress—

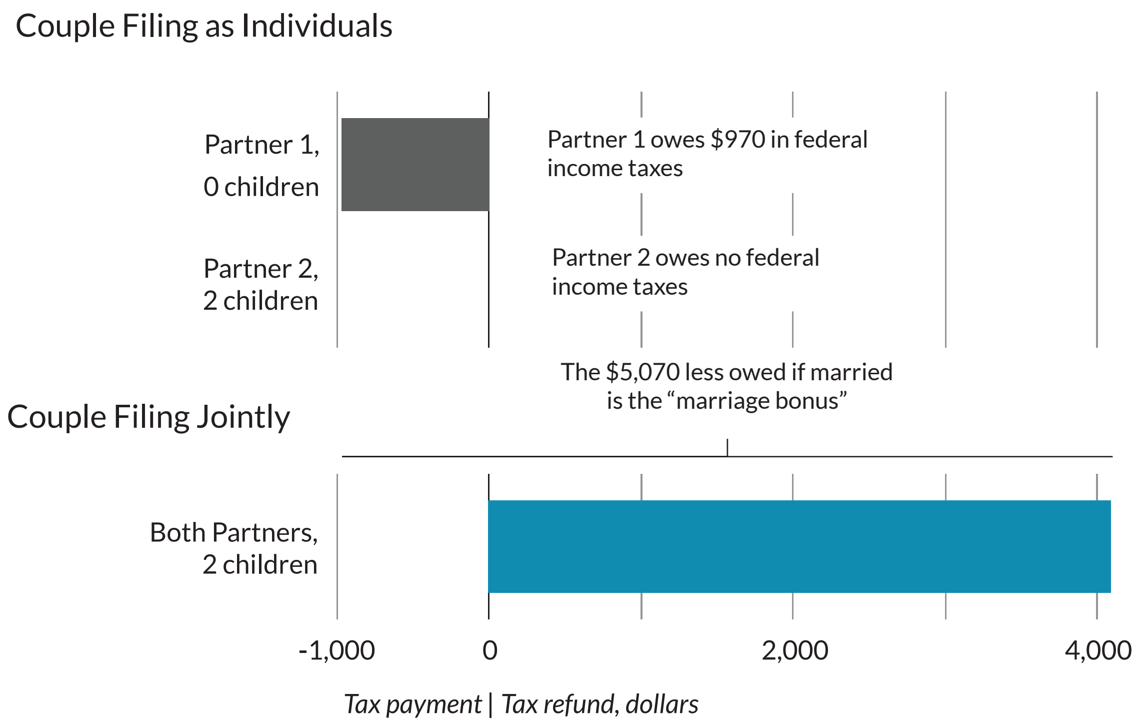
FIGURE 2. SAMPLE MARRIAGE PENALTY FOR COUPLE WITH 2 CHILDREN, 2015



Note: Assumes each partner in couple earns $20,000 and that all income comes from earnings.
Source: Maag, 2015. "Investing in Work by Reforming the Earned Income Tax Credit," Urban-Brookings Tax Policy Center.

[2] Marriage penalties can exceed $8,000, or over 20 percent of pretax income. The worst-case scenario is two unmarried parents with three children who are at the end of the plateau region of the EITC (earnings of $17,830), each claiming the maximum tax credit ($6,143 each, total of $12,286). If they marry, the maximum credit remains the same, but the couple qualifies for one credit now, not two. Their combined income ($35,660) would place them in the phase-out range for the EITC, reducing their credit to $3,531. Moreover, two heads of household—or even a head of household who marries a single filer—with similar incomes owe much less tax before credits than a married couple with the same combined income who file jointly (Congressional Budget Office 1997). An analysis of low-income cohabiting couples showed this was true 40 percent of the time (Acs and Maag 2005).

FIGURE 3. SAMPLE MARRIAGE BONUS FOR COUPLE WITH 2 CHILDREN, 2015



Note: Assumes that partner 1 in couple earns $20,000, partner 2 earns $0 ,and that all income comes from earnings.
Source: Maag, 2015. "Investing in Work by Reforming the Earned Income Tax Credit," Urban-Brookings Tax Policy Center.

would increase marriage penalties. These penalties could be more salient because workers without qualifying children will be much more likely to see the loss of their own childless EITC, rather than the loss of their partner's EITC for workers with children. Even if the EITC does not discourage marriage, reducing or eliminating marriage penalties for low-income families could be warranted on fairness grounds: at present or with an expanded childless EITC, married couples could receive much smaller credits than otherwise similar unmarried pairs.

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 at least six months of the year in order to qualify. Unlike wages (another key factor in determining whether a person qualifies for the EITC), which the IRS can verify relatively easily for most workers, the IRS receives no administrative data that can confirm or deny where a child lived for the majority of the year. This makes the EITC difficult for the IRS to administer.

TABLE 1. MARRIAGE PENALTY AND BONUS IN THE EITC, TWO CHILDREN, 2015

Marriage Penalty			
	Spouse 1	**Spouse 2**	**Couple**
Number of children	0	2	2
Filing status	Single	Head of Household	Married
Earnings	$20,000	$20,000	$40,000
Subtract deductions and exemptions	$10,300	$21,250	$28,600
Taxable earnings	$9,700	$0	$11,400
Tax before credits	$970	$0	$1,140
Subtract child tax credit	$0	$2,000	$2,000
Subtract EITC	$0	$5,150	$2,100
Taxes owed	$970	-$7,150	-$2,960
Sum of taxes if single	**-$6,180**		
Sum of taxes if married	**-$2,960**		
Difference	**$3,220**	**lower income after tax if married**	
Marriage Bonus			
	Spouse 1	**Spouse 2**	**Couple**
Number of children	0	2	2
Filing status	Single	Head of Household	Married
Earnings	$20,000	$0	$20,000
Subtract deductions and exemptions	$10,300	$0	$28,200
Taxable earnings	$9,700	$0	$0
Tax before credits	$970	$0	$0
Subtract child tax credit	$0	$0	$2,000
Subtract EITC	$0	$0	$2,100
Taxes owed	$970	$0	-$4,100
Sum of taxes if single	**$970**		
Sum of taxes if married	**-$4,100**		
Difference	**$5,070**	**higher income after tax if married**	

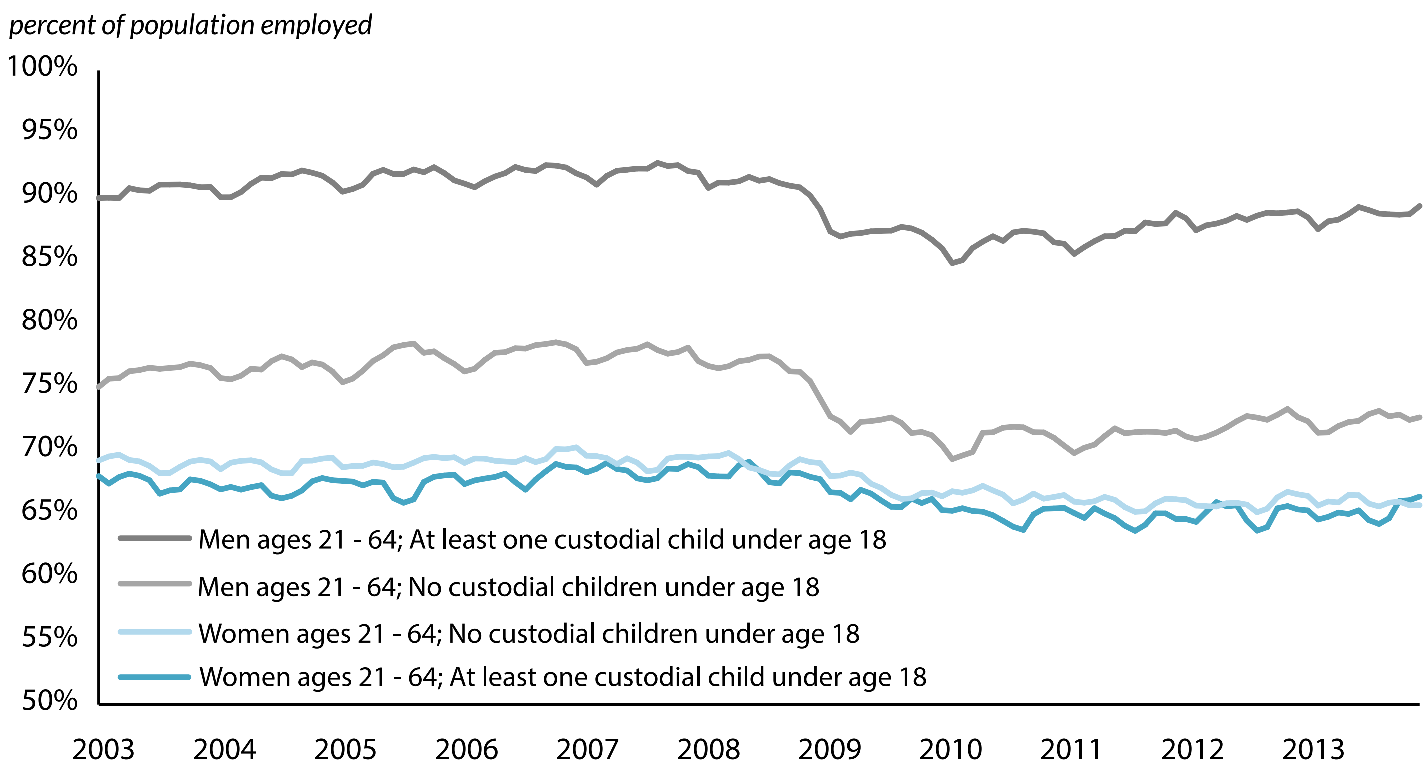
Source: Author's calculations. Assumes all children qualify for EITC and CTC and all income is from earnings.

Two alternatives might reduce compliance problems: (1) develop data that could assist the IRS in determining who is a qualifying child (a path that has proved challenging so far) or (2) base credit eligibility solely on information that may be more readily verified, such as earnings (i.e., remove resident children as a criterion). The worker credit proposed in this paper is an example of the second alternative.

THE CASE FOR EXPANDING THE EITC TO WORKERS WITHOUT QUALIFYING CHILDREN

Why expand the EITC for workers without qualifying children? Working-age men without children living at home are much less likely to be employed than men with children. Over the past decade, only 69 to 79 percent of 21- to 64-year-old men without children at home were employed, compared with 85 to 93 percent of men with children at home (figure 4). Analysts have offered several explanations for these relatively low employment rates, including lower levels of education and higher levels of incarceration (Holzer, Offner, and Sorenson 2005;

FIGURE 4. EMPLOYMENT TO POPULATION RATIOS BY SEX AND PRESENCE OF CHILDREN



Source: Calculations using Current Population Survey. Excludes institutionalized population.

Edelman, Holzer, and Offner 2006). Social scientists are also concerned that men who are unemployed are not considered “marriage material,” and are therefore less likely to live with their children (Greenstone and Looney 2012). Unemployed men are also less likely to make child support payments and remain connected with their noncustodial children. Policies that make work more lucrative for noncustodial parents could encourage them to start working.

Greater economic security may lead to more marriages and could encourage noncustodial parents to pay child support, thus helping them stay more connected with their children (Greenstone and Looney 2012; Cancian, Yang, and Slack 2013; Knox 1996; Graham, Beller, and Hernandez 1994). Boys who grow up without a father living at home have lower educational attainment, are more likely to be incarcerated, and are less likely to be employed than boys who grow up with a father at home, raising the likelihood that the pattern of declining labor force attachment is transmitted from one generation to another (Autor and Wasserman 2013; Black, Dubowitz, and Starr 1999).

The current EITC may indirectly discourage childless individuals from working. Rothstein (2010) found evidence that the EITC depresses wages slightly for low-skilled workers by raising the after-tax wages of workers with children so that they are more willing to work at lower-market wages. Even though the bulk of evidence suggests that the positive work effects associated with the EITC outweigh any negative effects (Meyer 2010), policymakers may still wish to offset the depressed wages of this group by providing a worker credit for workers without qualifying children.

Rising employment rates might also reduce incarceration rates, an effect that would help make childless workers more “marriageable“—something that could also help their noncustodial children (Scholz 2007). Children living in households headed by single mothers are much more likely to live in poverty than those living in households headed by two parents (Haskins 2012). This salutary effect could be reinforced by redesigning worker credits to reduce low-income marriage penalties.

Little empirical research exists on how large an EITC (and what other labor market conditions) would be necessary to address the joint problems of falling employment and marriage rates and increasing incarceration rates. The EITC for workers with one child increased employment among low-skilled single mothers (Grogger 2003). Analysts believe that a similar incentive could increase employment rates among individuals without children at home, given the similarities between the two groups (Edelman et al. 2006; Scholz 2007).

A NEW PROPOSAL: REFORMING THE EITC AND CREATING A COMPREHENSIVE WORKER CREDIT

A tax credit based on individual workers rather than households could address all the criticisms above and expand benefits to childless workers. The comprehensive worker credit proposed here mimics the structure of the EITC: phasing in, reaching a maximum credit over an extended income range, and then phasing out.[3] For married couples, the proposed credit diverges from the structure of the EITC by applying to individual earnings, rather than a couple's earnings (table 2).

The proposed comprehensive worker credit would

- be calculated based on individual, not joint earnings (similar to payroll taxes, which are based on individual earnings);
- be available to workers of all ages, except those who can be claimed as a dependent on another tax return;
- offset the employer and employee share of payroll taxes during the phase-in range of the credit;
- phase in and out on the same schedule as the EITC for workers with one child;
- coordinate the EITC phase-in ranges for families of all sizes;
- replace the existing EITC for workers without custodial children; and
- reduce the maximum EITC for workers with children by the maximum worker credit.

The most significant difference between a worker credit and the EITC is that rather than subsidizing work and children with one credit, the proposal separates the work and child incentives embedded in the EITC. The worker credit would be available to workers of all ages filing nondependent returns, unlike the current childless EITC, which is only available to workers age 25 to 64. Families with two workers with earnings in the qualifying range would receive two worker credits. Under this plan, the worker credit would become available to 41.7 million tax units who are not eligible for the EITC under current law.

Not surprisingly, the revenue loss associated with eliminating the childless EITC and replacing it with a worker credit that offsets both the employer and employee payroll taxes up to about $1,500 for workers of all ages is significant: $868 billion over the 10-year budget window from 2015 to 2024 (table 3). Part of the cost associated with moving to a worker credit is the need to harmonize the phase-in ranges of the EITC for workers with one child and workers with more than one child to avoid "losers" in the phase-in range of the EITC. The EITC phases in over different income ranges depending on how many children are in a family. Harmonizing the phase-in ranges reduces the number of very low income families

[3] Carasso et al. (2008) analyzed a similar proposal.

who would receive lower credits after the creation of the worker credit. This adjustment is highly progressive, because all benefits go to people in the phase-in range of the EITC. This adjustment would reduce revenues by about $27 billion over the 10-year budget window, which is included in the estimated cost of the proposal.

The proposal does not harmonize the phase-out ranges of the worker credit and the EITC available to workers with at least two children in order to limit the total cost. Because the worker credit phases out on the same (smaller) schedule as the EITC for workers with one child under current law, some workers with two or more children will see modestly reduced benefits under this option as the work portion of their credit phases out faster than under the current EITC.

Given its cost, the implementation of a worker credit would need to be done in tandem with broader tax reform. One such proposal will be discussed in Maag, Nunns, Phung, and Simonsen (forthcoming). The blueprint of a worker credit provided here could be added to any larger tax reform plan aimed at improving and rationalizing worker benefits in the tax code.

A key issue with the worker credit is how it should be phased out. If the worker credit phases in and out based only on individual income, some high-income couples will benefit from the credit if one partner in the couple has low earnings. The basic plan also lacks consideration of whether couples with investment income are eligible for the credit. In 2015, no one with investment income greater than about $3,400 can claim the EITC. Under a worker credit, there would need to be rules for allocating investment income between partners in married couples in order to determine who ought to be eligible for the worker credit.

Winners

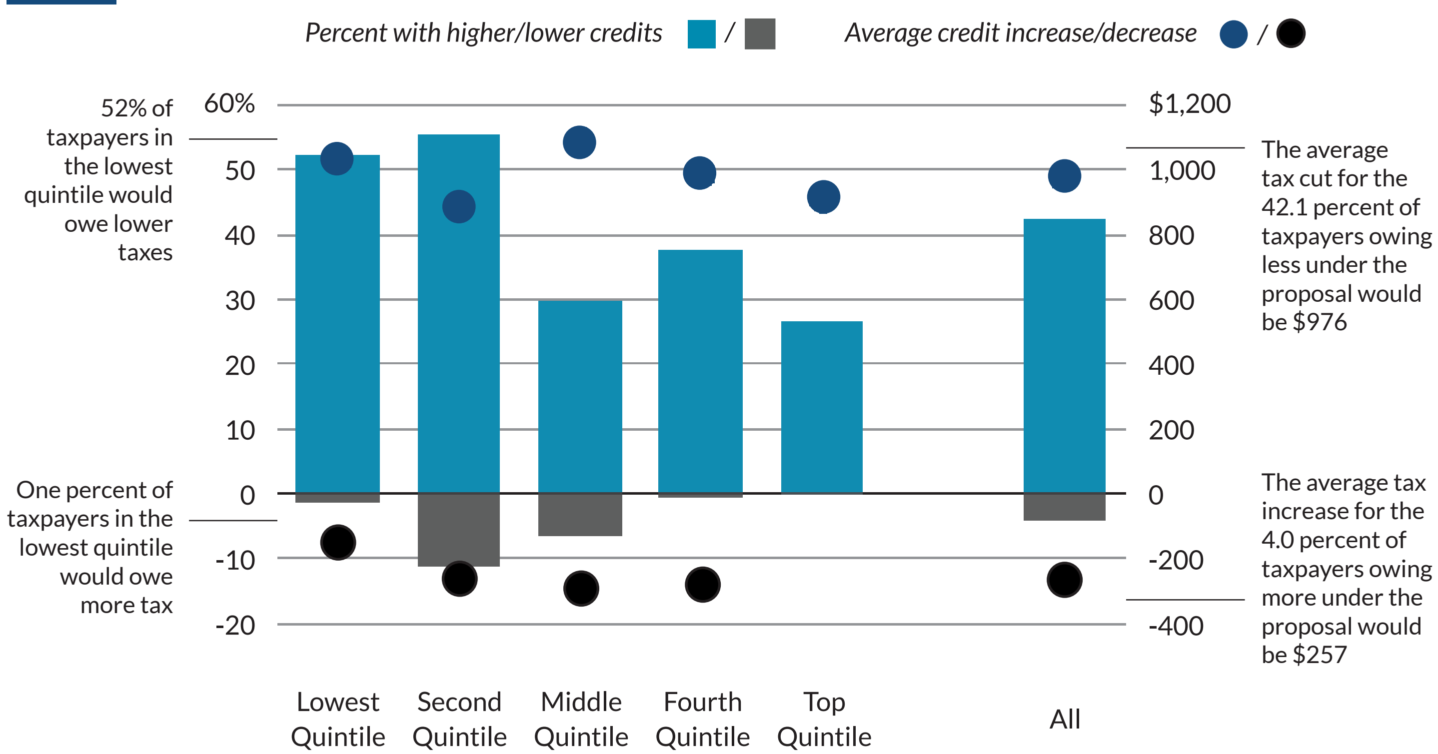
In 2015, this proposal would increase tax credits for

- Childless workers with incomes less than $38,511,
- Married couples with joint income in the plateau or phase-out range of the current EITC with two earners,
- Married couples with at least one earner with earnings in the phase-in range of the EITC under current law,
- Married couples with only one partner with earnings in the credit range and joint income higher than the ending income for the EITC under current law, and
- Single parents with at least two children and earnings in the EITC phase-in range under current law.

If the proposal were adopted, we estimate 42 percent of tax units would receive larger combined credits in the first year of the proposal. The average additional benefit, per family, would be about $975. Benefits of the proposal are progressive, with over one-third of new benefits accruing to workers with incomes in the lowest quintile and just under 9 percent of benefits accruing to workers with incomes in the highest quintile (figure 5).

Married couples are most likely to benefit from the proposed worker credit. In 2015, 45 percent of all married couples would receive larger credits. In 4 percent of cases, the combined worker credit plus the remaining EITC is less than they would receive from the EITC under current law. This change is a result of the worker portion of the credit phasing out at lower incomes than the EITC under current law. On average, married couples face lower taxes under the proposal than under current law.

FIGURE 5. IMPACT OF SHIFTING FROM EITC TO A COMPREHENSIVE WORKER CREDIT AND REDUCED EITC



Note: The proposal creates a worker credit equal to 15.3 percent of earnings. Maximum credit equals $1,512. Phase-out begins and ends at same point as phase-out for EITC for families with 1 child. EITC reduced by maximum worker credit. Dependent returns are ineligible for the worker credit. See Table 2 for complete description of credit parameters.
Source: Maag, 2015. "Investing in Work by Reforming the Earned Income Tax Credit," Urban-Brookings Tax Policy Center.

TABLE 2. EARNED INCOME TAX CREDIT AND WORKER CREDIT PARAMETERS, 2015

	Credit rate	Minimum income for maximum credit	Maximum credit	Maximum worker credit plus EITC with one worker	Phase-out rate	Beginning income*	Ending income
Current law EITC							
No children	7.65%	6,580	503		7.65%	8,240	14,820
One child	34.00%	9,880	3,359		15.98%	18,110	39,131
Two children	40.00%	13,870	5,548		21.06%	18,110	44,454
Three + children	45.00%	13,870	6,242		21.06%	18,110	47,747
FY 2014 budget proposal							
No children	15.30%	6,480	991		15.30%	11,500	14,590
Incorporate worker credit into EITC structure							
Worker credit	15.30%	9,880	1,512		7.19%	18,110	39,131
Proposed EITC structure							
One child	18.70%	9,880	1,848	3,359	8.79%	18,110	39,131
Two children	40.87%	9,880	4,038	5,550	15.33%	18,110	44,454
Three + children	47.89%	9,880	4,732	6,244	15.97%	18,110	47,747

*Under current and proposed law, phase-outs are $5,520 higher for married couples, except for the worker credit, which phases out at the same point, regardless of marital status.
Source: http://www.irs.gov/pub/irs-drop/rp-14-61.pdf and Maag, 2015. "Investing in Work by Reforming the Earned Income Tax Credit," Urban-Brookings Tax Policy Center.

Losers

A small portion of workers would owe higher taxes if this proposal were adopted. Taxes would rise for workers with at least two children, one earner, and income in the phase-out range of the credit.

If the proposal were adopted, we estimate that 3.4 percent of all families would receive an average EITC reduction of $270.

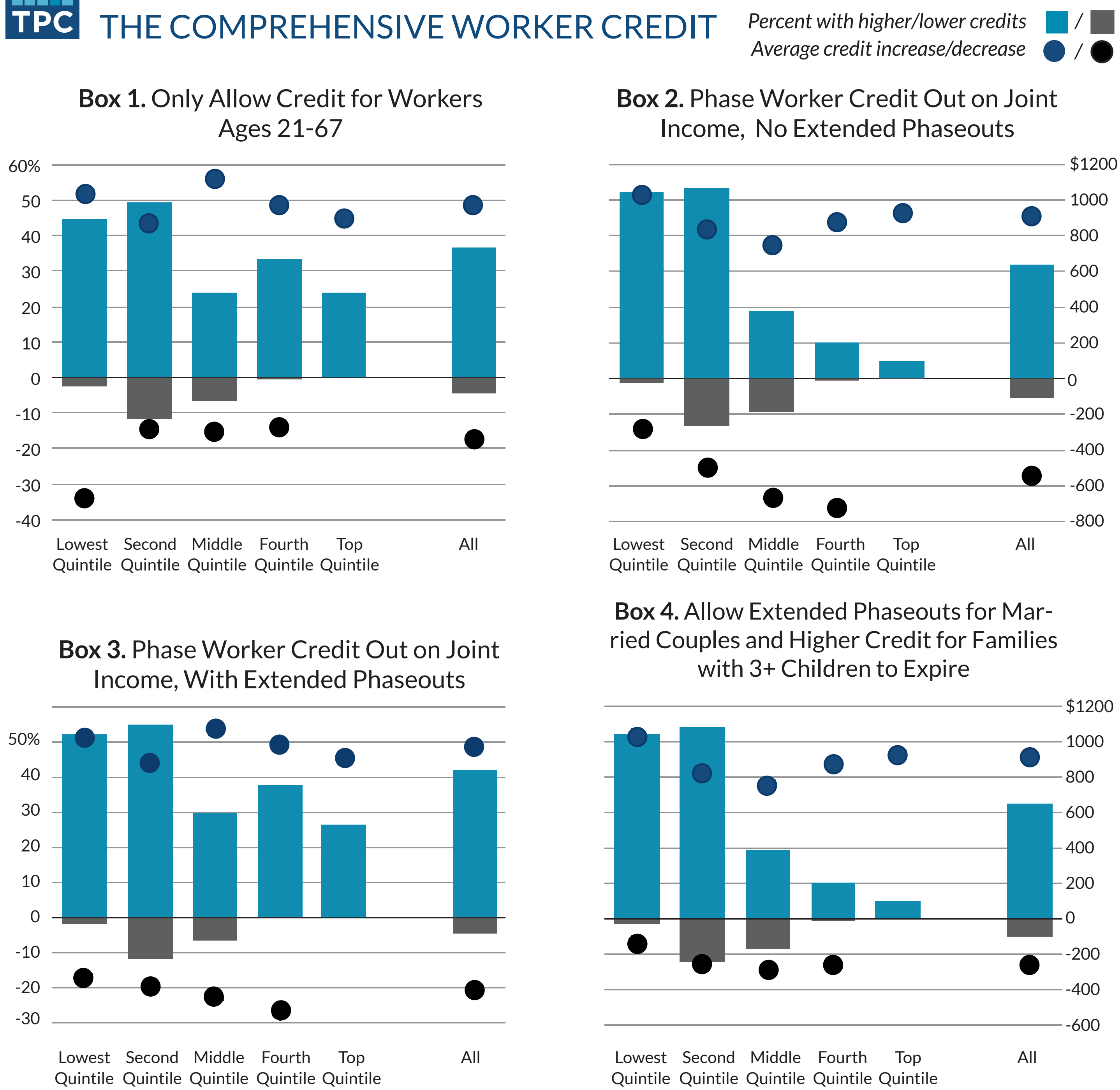
TABLE 3. ESTIMATED COST OF MOVING TO A COMPREHENSIVE WORKER CREDIT AND LOWER COST OPTIONS IN BILLIIONS OF DOLLARS, 2015-2024

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2015-24
Comprehensive Worker Credit*	-75.3	-77.0	-78.9	-82.1	-84.8	-87.6	-90.8	-93.9	-97.1	-100.7	-868.2
Option 1. Limit Comprehensive Worker Credit to workers ages 21 - 67. Everything else in the Comprehensive Worker Credit remains the same as described.	-60.6	-61.3	-62.4	-64.6	-66.3	-68.0	-69.9	-71.8	-73.6	-75.7	-674.2
Option 2. Phase Comprehensive Worker Credit out based on joint earnings for married couples. Eliminate extended phase-outs for married couples.	-50.9	-52.6	-54.3	-58.0	-59.9	-61.8	-64.0	-65.9	-68.1	-70.1	-605.6
Option 3. Same as option 2 but mainting extended phase-outs for married couples.	-53.9	-55.6	-57.3	-59.8	-61.8	-63.8	-66.0	-68.0	-70.1	-72.3	-628.5
Option 4. Comprehensive Worker Credit + Repeal higher credit for workers with at least 3 children and repeal extended phase-outs for married couples.	-73.4	-75.0	-77.0	-82.1	-84.8	-87.6	-90.8	-93.9	-97.1	-100.7	-862.4
Option 5. Increase the EITC for workers with no qualifying children to $1,512. Credit rate = 15.3 percent. Phase the credit out on the same schedule as the EITC for workers with 1 child.	-20.2	-20.6	-21.2	-21.6	-22.0	-22.4	-22.9	-23.3	-23.6	-24.0	-221.7

*Comprehensive Worker Credit: Create a $1,512 worker credit, available to all workers (except those filing dependent returns) with earnings under $39,131; Credit phases in at a rate of15.3 percent; maximum credit = $1,512; credit begins to phase out once earnings reach $18,110. Eliminate EITC for workers with no custodial children; reduce maximum EITC for workers with children by $1,512. EITC for workers with at least two children phases in over same range as EITC for workers with one child under current law. All credit parameters are indexed for inflation. See Table 2 for additional details.

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0613-5).

FIGURE 6. LESS COSTLY ALTERNATIVES TO THE COMPREHENSIVE WORKER CREDIT



Note: The proposal creates a worker credit worth 15.3 percent of earnings. Maximum credit equals $1,512. Phase-out begins and ends at same point as phase-out for EITC for families with 1 child. EITC reduced by maximum The 10-year budget cost for each alternative proposal is as follows. Box 1, only allowing credit for workers age 21 – 67: $674 billion; Box 2 / 3, phasing worker credit out on joint income with no extended phase-out: $606; with extended phase-out: $629 billion; Box 4, allowing extended phase-out for married couples and higher credit for families with 3+ children to expire: $862 billion. worker credit. See Table 2 for complete description of credit parameters.

Source: Maag, 2015. "Investing in Work by Reforming the Earned Income Tax Credit," Urban-Brookings Tax Policy Center.

LESS COSTLY ALTERNATIVES TO THE COMPREHENSIVE WORKER CREDIT

Although members from both political parties have supported proposals to expand the childless EITC, Congress has not seriously considered an EITC reform as extensive and expensive as this proposal. There are a number of ways to reduce the cost of the proposal. I describe five options below. All five alternatives fall short of the comprehensive worker credit, but they are broader than the options proposed by President Obama and Representative Ryan.

Option 1. Make the worker credit only available to workers ages 21 to 67. This option limits eligibility of the comprehensive worker credit to workers ages 21 to 67, the ages adopted by the president's plan. Some policymakers are concerned about creating too large an incentive for young people to work rather than go to school. In addition, policymakers may think of Social Security, not work-based credits, as the appropriate safety net for older people.

However, limiting eligibility to workers who are at least 21 means that young parents ages 20 and under would receive substantially smaller credits under the proposal than under current law. They would receive the reduced EITC for workers with children, but they would lose any benefits siphoned off as part of the worker credit. The Tax Policy Center estimates that 18.5 percent of families with children in the lowest income quintile and 40 percent of families with children in the second income quintile would see their taxes rise if these age limits are adopted for the worker credit (averages for all tax units are shown in figure 6).

Limiting the comprehensive worker credit to workers ages 21 to 67 would reduce revenues over the 10-year budget window from $868 billion to $674 billion (table 3, option 1).

Option 2. Phase out the worker credit based on the higher of joint earnings or AGI, consistent with the phase-out of the EITC under current law; phase out married couples' credits starting at the same income level as unmarried individuals' credits. A worker credit based on individual earnings will deliver benefits to some low-earning individuals who live in high-income families. This happens when a couple with high joint income includes a worker with low earnings. Under current law, such a family does not qualify for the EITC. The Tax Policy Center estimates that 37 percent of tax units in the fourth income quintile and nearly 30 percent of tax units in the top income quintile would receive a worker credit (figure 5) if the credit is not limited by household income. Phasing out the credit based on joint AGI, as is the practice with the current EITC, would greatly reduce these numbers (figure 6, boxes 2 and 3). However, a phase-out based on joint income would add complexity and introduce marriage penalties into the worker credit plan.

Phasing out the credit based on joint income would reduce the proportion of families in the fourth income quintile benefiting from the proposal to just below 10 percent, and to only about 5 percent for families in the highest income quintile. It would also reduce costs of the proposal substantially, from $868 billion to $606 billion over the 10-year budget window (table 3, option 2 and figure 6, box 2).

Option 3. Phase out the worker credit based on joint income as in option 2 and maintain the expanded phase-out for married couples that exists under current law. This option is identical to option 2, except it retains today's higher phase-outs for married couples. If this option were adopted, marriage penalties under the worker credit could be mitigated in the same way they are mitigated under the current EITC, by extending the point at which the worker credit begins to phase out for married couples. This phase-out would reduce cost savings so that the proposal would cost $629 billion over the 10-year budget window (table 3, option 3 and figure 6, box 3).

Option 4. Implement the worker credit but repeal the expanded EITC for families with at least three children and the extended EITC phase-outs for married couples (set to expire after 2017). Two provisions of the EITC are set to expire after 2017: a higher credit for families with at least three children and part of a higher phase-out for married couples.[4] If the larger credit for families with at least three children were eliminated, so that these families qualified for the same EITC as workers with two children (which was the case before 2009), the cost of the proposal would be reduced by $6 billion, from $868 billion to $862 billion (table 4, option 4). Combining this option with repealing the extended phase-outs for married couples would reduce the cost of the proposal to $840 billion (not shown).

Option 5. Increase the childless EITC credit amount, age range, and income range to cover payroll taxes and be more consistent with the one-child EITC. The least expensive option could lay the foundation for the later implementation of a worker credit by expanding the EITC without actually creating a worker credit. This plan is similar to President Obama's proposal but would expand the credit to more childless workers.

[4] Prior to 2002, the EITC phased out at the same point for married couples and individuals. Beginning in 2002, the values of the beginning and ending points of the phase-out range were increased for married taxpayers filing joints. Starting in 2009, the phase-out for married couples began $5,000 higher than individuals, indexed for inflation, as part of subsequent legislation which has been extended. In 2017, the EGTRRA phase-out point for married couples is scheduled to return ($3,000, indexed after 2008). The cost estimate provided here assumes both provisions are eliminated and that the EITC would begin to phase out at the same point for married couples and individuals.

In his FY2014 and FY2015 budgets, the president called for

- doubling the credit rate for childless workers,
- expanding the eligible age range from 25 to 64 years to 21 to 67 years, and
- increasing the phase-in and phase-out points of the childless EITC.

Option 5 goes beyond the president's proposal by

- increasing the phase-out of the childless EITC so it is the same as the phase-out for the one-child EITC,[5] and
- adopting the president's proposed higher credit rate over a larger income range, so that the childless EITC phases in and out over the same income range as the one-child EITC.

Over the 10-year budget window from 2015 to 2024, the Tax Policy Center estimates that this option would reduce revenues by about $222 billion. Expanding the age limits of eligible workers would cost about $60 billion, and increasing the credit would cost an additional $162 billion. This proposal would not take anything away from current EITC recipients, but would exacerbate marriage penalties for low-wage workers, who might lose all or part of their childless EITC when they marry.

EVALUATING EITC REFORM PROPOSALS

Any change to the EITC for workers without qualifying children—including creation of a worker credit—should be evaluated based on three criteria.

The credit should

- be simple, so the IRS can administer it and eligible workers can understand it;
- be refundable and start with the first dollar of earnings (like the current EITC), so all low-income workers can benefit; and
- not exacerbate existing problems.

The credit should be simple. Keeping the credit simple helps make sure the IRS can administer it and workers can understand and respond to it. Evidence from other parts of the tax system suggests taxpayers are best able to respond to simpler tax rules (Abeler and Jäger 2014; Dynarski and Scott-Clayton 2007).

[5] For an analysis of the president's proposal, see Maag et al. 2014.

The credit should be refundable. Low-income individuals are unable to benefit from nonrefundable credits and deductions. They tend to have little or no federal income tax liability to offset with a credit, making a nonrefundable credit worth very little (and sometimes nothing at all). With refundable credits, if the credit exceeds a worker's tax liability, he or she receives the credit as a refund, making it more effective as an incentive. Refundable credits can also offset payroll taxes owed by low-income workers.

Starting with the first dollar of earnings avoids confusion related to calculating the credit and avoids creating cliffs in the credit, which can unnecessarily complicate the credit while providing little clear benefit.

The credit should not make the EITC's marriage penalties worse. Proposals that simply expand the childless EITC do so at the cost of exacerbating marriage penalties. Under these proposals, not only are low-income workers with children who marry likely to lose their EITC because their joint earnings are beyond the phase-out range of the credit (as they are under current law), but low-income workers without children risk losing their own EITC if they marry someone with modest earnings (something that does not happen under current law very often because the benefit available to workers without children is so small). The net effect of proposals that simply increase the childless EITC (including the proposals put forth by President Obama and Representative Ryan) can be steep marriage penalties.

COMPARING RECENT PROPOSALS

The comprehensive worker credit proposal described here meets all three evaluation criteria. A brief discussion of other proposals follows.

Proposals to expand the EITC generally come in one of a few varieties:[6]

- They increase the maximum benefit for the childless EITC without changing the tax credit for workers with children, leaving the basic rules of the EITC unchanged [e.g., President Obama's 2014 budget proposal and Ryan (2014)];
- They increase the benefits of the childless EITC but tie it to new restrictions, such as requiring recipients to work a minimum number of hours [e.g., Sawhill and Karpilow (2014)]; or
- They change the rules to encourage secondary earners to work, but retain the credit's basic structure for single-parent families [e.g., Murray (2014)].

[6] A recent compilation of Republican plans to increase the EITC can be found in Tax Credits for Working Families (2014).

All these types of proposals can provide substantial benefits to childless workers. Relative to the worker credit proposed here and elsewhere (Bipartisan Policy Center 2010; Carasso et al. 2008; Berlin 2009), however, these types of EITC expansions tend to exacerbate existing problems with the EITC.

Proposals that increase the maximum benefit for the childless EITC. Although a basic expansion lacks the elegance of a worker credit, it might be politically feasible (Kearney and Turner 2013). Tax forms could be modified in relatively straightforward ways, and the IRS could draw on current experience educating taxpayers about the credit and enforcing the law if the childless EITC were simply expanded. Going beyond an expansion of this magnitude will require new IRS administrative mechanisms to be put in place.

Proposals that tie increases to new restrictions. It is tempting to tie an increase in the EITC to some other (desirable) action, such as working full-time, which has been proposed by Sawhill and Karpilow (2014). But doing so can radically increase complexity, particularly if verifying compliance involves information not provided to the IRS via a reliable third-party source. In addition, benefit cliffs can result in which workers receive no benefit if they lose their job at some point in the year, and a large benefit if they maintain that job. It can also create horizontal inequities whereby people earning the same amount of money are entitled to very different EITCs, depending on how many hours they have worked.

Proposals that encourage secondary earners to work. Proposals that tilt benefits toward secondary earners can be administered with existing data. Married taxpayers already report earnings separately, and parents already use those separately reported earnings to calculate their child and dependent care tax credit, which is dependent in part on the earnings of the lower-earning spouse. Proposals in this group tilt benefits toward secondary earners by disregarding some earnings in the calculation of an EITC, reducing the average tax rate on a secondary earner's income. These deductions are designed to offset the work disincentive faced by some secondary earners and offer a good alternative to the other types of expansions. However, if these proposals are not coupled with an increase in the childless EITC, they cannot deliver substantial benefits to childless workers. At the point these plans are paired with a substantial increase in the childless EITC, couples begin to face marriage penalties, as described above.

CONCLUSION

Members of both political parties have advocated using the tax code to strengthen the work incentive for low-income workers, and many of those proposals focus on childless workers.

A worker credit based on individual earnings provides several benefits relative to other expansion options. It is available to all low-wage workers, providing a clear work incentive that extends to workers without children in their custody. Replacing a portion of the current EITC with a worker credit eliminates a large source of EITC eligibility errors. For workers with children, the IRS has trouble verifying where those children live for the majority of the year; in contrast, eligibility for the worker credit can be verified much more readily with third-party earnings data, which the IRS already collects. The residency test for families with children will still be a challenge, but a much smaller credit is attached to that requirement with a separate worker credit than is required today, so fewer dollars will be at risk of being paid errantly. A credit for individual workers would dramatically reduce marriage penalties and create bonuses for many dual- earner couples. Low-income couples would no longer be subject to much higher taxes upon marriage. Finally, a worker credit provides an incentive for all low-income individuals, not just primary earners, to enter the labor force.

The downside to the worker credit proposed here is its cost. To provide a substantial work incentive to all low-wage workers will require a substantial outlay. We estimate that a worker credit offsetting both the employer and employee share of payroll taxes and that operates on the same schedule as the EITC for families with one child will reduce tax revenues by $868 billion over the 10-year budget window from 2015 to 2024. If the credit phased out based on joint earnings and AGI (which is the current practice of the EITC), the cost of the proposal would be reduced to $606 billion over the 10-year budget window, assuming the extended phase-out range for married couples was also eliminated. This alternative approach would keep some marriage penalties associated with the current EITC intact (those on the now smaller EITC for families with children), but it would still achieve the primary goal of providing a substantial work incentive to a much larger group of workers, including those without qualifying children.

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