



The Earned Income Tax Credit: An Important Tool in Lifting Families Out of Poverty

The first in a series of fact sheets emphasizing the intergenerational aspects of the issues and proposals that can help to eliminate child poverty.

**fact
sheet**



The Current State of Child Poverty

Children who grow up in poverty are more likely than other children to have problems related to their health, development, school-readiness and achievement, and employability as adults. Generations United is concerned about child poverty because of its impact on all generations. The age-old social compact through which every generation receives resources from its predecessors and passes on material wealth, care and knowledge to the next demonstrates that supporting healthy children supports a healthy country.

There has been a 20% increase in the number of poor young children in working families since 1993.¹ While more poor parents are working, the gains in earnings among the poorest have been outweighed by the decrease in value of cash assistance and food stamps. We must do more to help low-income working parents increase their earnings while providing additional safety nets for them and their children. The Earned Income Tax Credit (EITC) is one important method to help provide such security.

Current Proposals to Expand the EITC

1. **Expand the maximum credit for working families with three or more children by \$500.** In 1998 the poverty rate for children in families with three or more related children was 28.6 percent--more than twice the 12.4 percent poverty rate for children in families with two children.

This new proposal would establish a three-tier EITC payment structure more responsive to these higher poverty rates, for families with one, two, or three or more children. Currently, the only distinction is between families with one or two or more children.

2. **Increase the reward to work while expanding the credit for families with two or more children.** Currently, the maximum credit for families with children begins to decline by 21.06 percent for each dollar earned above \$12,500. This proposal would lower this phase-out rate to 19.06 percent, providing a tax break for 5.4 million low-income families with children.

Child Poverty Rates, 1998

Official Poverty Rate including non-cash benefits (except medical benefits) and Taxes

CHILDREN IN FAMILIES WITH:	OFFICIAL POVERTY RATE	POVERTY RATE INCLUDING NON-CASH BENEFITS AND TAXES
1 child	13.5%	10.3%
2 children	12.4%	8.6%
3 children	22.4%	17.3%
4 children	33.8%	27.5%
Three + children	28.6%	22.8%

Source: CBPP tabulations of Census Data from March 1999 Census Population Survey²

In 1998, the federal EITC was directly responsible for lifting 4.8 million people out of poverty, including 2.6 million children.⁴



3. **Expand the credit for married two-earner couples.** This would provide an average tax break of \$250, partially off-setting the “marriage penalty” that occurs when low-income people marry.

4. **Encourage savings through simplification.** Currently, contributions towards retirement savings (401(k) plans) are counted as income in calculating the EITC, although they do not count as income for other tax purposes. The new proposal would simplify by not counting such savings as income, both reducing errors and encouraging saving.

Examples of how these Changes would increase the EITC

	CURRENT LAW	PROPOSAL	INCREASE
Married; 2 children; 20K earnings	\$2,524	\$2,940	\$416
Individual; 3 children; 15K earnings	\$3,577	\$4,116	\$538
Married; 3 children; 23K earnings	\$1,892	\$2,867	\$975

What is the Earned Income Tax Credit?

The Earned Income Tax Credit (EITC) is one of the most effective anti-poverty initiatives. The EITC is a tax refund available to workers with low incomes. The EITC was enacted in 1975 to offset the impact of increasing payroll taxes on low-income workers. It is called “refundable” because it provides a tax refund to low-income workers even if they earn too little to owe income taxes (although they do pay the FICA taxes that fund Social Security and Medicare). The federal government and eight states offer such a credit.³ In 1998, the federal EITC was directly responsible for lifting 4.8 million people out of poverty, including 2.6 million children.⁴

Census data show that among working families, the EITC lifts substantially more children out of poverty than any other government program or category of programs. A study by Columbia University’s National Center for Children in Poverty found that the EITC

reduces poverty among young children by nearly one-fourth.⁵ Studies have also shown that the EITC has substantial positive effects in encouraging single parents to go to work.⁶

The EITC has had strong bipartisan support throughout most of its history. Presidents Reagan, Bush, and Clinton all proposed EITC expansions and signed expansions into law.

A common concern about the EITC over the years has been its error rate, which has been reduced in recent years, in part through Congressional action. In 1997, legislation was passed linking children to claimants through their Social Security numbers and toughening penalties for those found to be falsely claiming the credit. It is important to note that the Internal Revenue Service and the General Accounting Office show that EITC errors account for less than 5 percent of the total amount the U.S. Treasury loses due to income tax errors.⁷

Who is eligible?

Working people with low incomes are eligible for the EITC, with the largest credits going to families with children. Families with two or more children earning between \$9,500 and \$12,500 can receive a maximum credit of \$3,816, with smaller amounts available to families with incomes up to \$30,580.

Immigrants are eligible if they are legally permitted to work in the United States, have valid Social Security numbers, and identify the United States as their main home. In addition, if they are counting children, their children must have lived in the United States for more than six months out of the year.

College students who work are eligible. Non-taxable scholarships and grants are not considered income in determining eligibility. The EITC may count as income in determining eligibility for scholarships.

Welfare reform affects the EITC because it has increased the number of workers with children entering the low-wage job market. It is poor working families with children who need the EITC the most.



Which children may be counted in determining eligibility for the EITC?

“Qualifying children” include children, stepchildren, grandchildren, and adopted children, as long as they lived with the taxpayer for more than half the year. Foster children, nieces, nephews, or other children can qualify if they lived with and were cared for by the taxpayer all year.

This is important to the 2.5 million grandparent-headed families in the United States.⁸ Qualifying children must be under age 19, or under age 24 if they are full-time students. Children of any age with total and permanent disabilities also qualify. A valid Social Security number is required for any qualifying child. Only one parent, one relative or foster parent may claim a child for EITC purposes.

Why does welfare reform affect the EITC?

Welfare reform affects the EITC because it has increased the number of workers with children entering the low-wage job market. It is poor working families with children who need the EITC the most. There has been a 20% increase in the number of poor young children in working families since 1993.⁹ A record-breaking 1.3 million families with children lived in poverty in 1998 despite being headed by someone who worked full-time, year-round—the highest number in 24 years.¹⁰ The poverty rate for children in families with three or more children is more than double the poverty rate for children in two-child families.¹¹

How do workers get the credit?

Workers can either file for the credit when they submit their annual income tax return or arrange with their employer to receive part of the credit in their paychecks throughout the year. Workers who do not otherwise

have to file a tax return because of their low incomes may file a return to seek the EITC at any time during the year, and may receive a refund for up to three years of unclaimed back EITC payments.

Why is outreach important?

Outreach is important to make sure that all eligible workers take advantage of the EITC. A significant portion of eligible workers do not claim the EITC because they do not know that they are among the groups eligible for the EITC, or they do not know how to apply.¹² There are also some who have very limited incomes, who are not otherwise required to file an income tax return, or who may not understand that they could receive an EITC payment if they file a tax return.

It is important that all workers know about VITA (Volunteer Income Tax Assistance.), a free, IRS-sponsored program to help low-income workers (including anyone eligible for the EITC) fill out their tax forms. Call 1-800-TAX-1040 to find VITA locations.

How can you help with outreach efforts?

The Center on Budget and Policy Priorities has EITC outreach kits, including flyers in many different languages. To receive a kit, contact them at 202/ 408-1080, write 820 First Street, NE Suite 510, Washington, DC 20002 or e-mail eickit@cbpp.org. The IRS has EITC information available at www.irs.ustreas.gov/ind_info/eitc4.html.

This is the first in a series of Generations United fact sheets on proposals that can help to eliminate child poverty in the United States. These fact sheets emphasize the intergenerational aspects of the issues and proposals.

GENERATIONS UNITED (GU) is the national membership organization focused solely on promoting intergenerational strategies, programs, and public policies. GU represents more than 185 national, state, and local organizations and individuals representing more than 70 million Americans and is the only national organization advocating for the mutual well-being of children, youth, and the elderly. Since 1986, Generations United has served as a resource for educating policymakers and the public about the economic, social, and personal imperatives of intergenerational cooperation. GU acts as a catalyst for stimulating collaboration between aging, children, and youth organizations providing a forum to explore areas of common ground while celebrating the richness of each generation.

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- ¹ Children's Defense Fund, "Children in Working Families: 1989-1998" http://www.childrensdefense.org/fairstart_povstat3.html
- ² Robert Greenstein, Center For Budget and Policy Priorities, "Should EITC Benefits Be Enlarged for Families with Three or More Children?" (21, 2000). <<http://www.bcphp.org/3-14-00tax.htm>>.
- ³ Nicholas Johnson, Center on Budget and Policy Priorities, "A Hand Up: How State Earned Income Tax Credits Help Working Families Escape Poverty, 1999 Edition" (December 20, 1999). <<http://www.cbpp.org/11-12-99sfp-sum.htm>>.
- ⁴ Ibid.
- ⁵ National Center for Children in Poverty, press release, "Percentage of Poor Young Children with Working Parents Reaches Highest Levels in Decades as Poverty Rate Falls" (June 17, 1999).
- ⁶ Nada Eissa and Jeffrey B. Liebman, "Labor Supply Response to the Earned Income Tax Credit," *Quarterly Journal of Economics*, 112(2), pp. 637 (May 1996). See also, Gregory Acs, et. al., The Urban Institute, "Does Work Pay? An Analysis of the Work Incentives under TANF" (1998). <<http://newfederalism.urban.org/html/occa9.html>>
- ⁷ Robert Greenstein and Isaac Shapiro, Center on Budget and Policy Priorities, "New Research Findings on the Effects of the Earned Income Credit" (March 16, 1999), citing GAO and IRS reports.
- ⁸ 1998, U.S. Bureau of the Census.
- ⁹ National Center for Children in Poverty, press release, "Percentage of Poor Young Children with Working Parents Reaches Highest Levels in Decades as Poverty Rate Falls" (June 17, 1999).
- ¹⁰ 1999, Bureau of the Census.
- ¹¹ Robert Greenstein, Center on Budget and Policy Priorities, "Should EITC Benefits Be Enlarged for Families with Three or More Children?" (21, 2000). <<http://www.bcphp.org/3-14-00tax.htm>>.
- ¹² Stacy Dickert, Scott Hauser, and John Karl Scholz, "The Earned Income Tax Credit and Transfer Programs: A Study of Labor Market and Participation", in James M. Poterba, ed., *Tax Policy and the Economy*, vol. 9, MIT Press, 1995. It is estimated that nationally 15% of those able do not file for the credit.