

The Earned Income Tax Credit

Good for Our Families, Communities and Economy



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The Annie E. Casey Foundation



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About the National Community Tax Coalition

The National Community Tax Coalition, LLC (NCTC) works to create a more accessible and equitable tax system for American workers. NCTC is a national network dedicated to strengthening economies, building communities and improving lives through tax assistance and asset building activities that produce financial security, protect families and promote economic justice.

Our national network of organizations provides critical, on-the-ground financial services for working families. NCTC represents more than 52,000 volunteers at 5,700 Community Volunteer Income Tax Assistance (VITA) sites that last year prepared an estimated 1.5 million federal tax returns for low- and moderate-income workers – about half of all returns filed with free tax preparation assistance programs. Community tax preparers offer a high-quality choice – one that’s free, accessible, and well-equipped to help families claim their full tax refund and the tax credits for which they’re eligible.

We actively seek to broaden the reach and impact of community tax preparers and are a leading voice in national discussions about how to help low-wage workers and curb unfair financial practices. We believe that, together, we can strengthen economies, build better communities and improve life for all American families.

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Introduction

To many working households throughout the United States, “EITC” is a powerful and different kind of acronym – one that seems to stand for many things.

For John and Melanie Harrison’s family, it means “greater financial security and independence.”

John is a former warehouse manager who is picking-up temporary jobs as he works toward a master’s degree and more stable employment. His wife, Melanie, stays at their home in Orem, Utah, to care for their six children. A household income of less than \$20,000 in 2010 didn’t stretch very far, and the Harrisons frequently turned to the help of family and friends to keep a roof over their heads and meet other basic needs. But when they filed their federal taxes, the Harrisons¹ found they had several thousand dollars coming to them thanks to something called the EITC – the Earned Income Tax Credit.

The family put this unexpected money toward paying-down some bills, starting a garden to help reduce their grocery expenses, and buying new smoke alarms for their house. The Harrisons also were able to establish some savings for household emergencies and cover swim lessons and soccer-league expenses for their kids. Finally, they could rely a little less on the good graces of friends and relatives and become more self-sufficient.

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Other families realize the EITC’s assistance in still other, equally substantial ways.

“It helps to offset the limited income that hardworking parents get,” said LaWanda Lattismore, whose family qualified for the EITC last year. “It means a new pair of shoes or much-needed medicines.”

The EITC helps struggling households “buy groceries, put clothes on our backs, fill our gas tank up in our car, pay rent and other bills, pay medical bills and help with home repairs,” added Paula Byers, who – like LaWanda – lives in Wilson, North Carolina.

In these and many other concrete, day-to-day ways, the EITC provides valuable support to more than 26 million low- and moderate-income, working families throughout the United States. But for more than 35 years, significant research has demonstrated that this credit represents many benefits to the collective well-being of our entire nation, as well. Among other things, the EITC is:

- Arguably the most effective policy tool for lifting American families out of poverty,
- Associated with greater educational outcomes for kids and health outcomes for families, and
- An important way of strengthening neighborhood businesses and boosting local economies, as well as our country’s economic recovery

This paper delves into these matters further by highlighting some of the many studies that have produced these findings. It concludes with some important policy recommendations for maintaining and improving the strength of the EITC for the families and communities that rely upon it, not to mention our entire nation.



Educational expenses are one way families often use their tax refund with the help of the Earned Income Tax Credit – much as this family intends.

What is the EITC?

The EITC is a tax credit that qualifying families can claim against federal income taxes they owe. Based on a policy proposal by the Nixon administration, it was established during the Ford administration in 1975 and strengthened several times since then by both Republican and Democratic presidents. The credit long has enjoyed bipartisan support for the ways it:

- Provides a work incentive for low- and moderate-income families, as it's available only to those who work,
- Offsets the disproportionately heavy tax responsibilities – from federal to state to local taxes – borne by such families, and
- Represents an economic boost for local communities and business climates

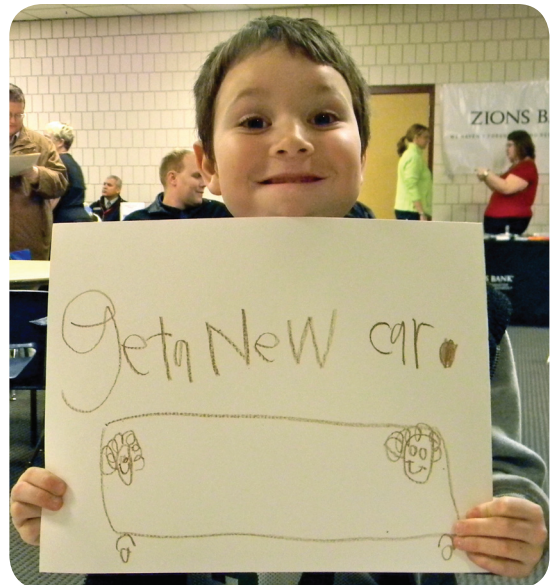
EITC improvements formed a cornerstone of the 1986 Tax Reform Act that President Reagan famously declared “the best anti-poverty, the best pro-family, the best job-creation measure to come out of Congress.”²

President Reagan called the EITC part of “the best anti-poverty, the best pro-family, the best job-creation measure to come out of Congress.”

The key words in Earned Income Tax Credit are “earned income.” A household can qualify for the credit only if it has earnings from the work of at least one family member. The exact amount of the credit available to a qualifying family depends on both earnings and family size. For example, for Tax Year 2011 (taxes filed in 2012), the maximum credit that can be claimed is \$5,751 for a married couple filing jointly, with three or more qualifying children. Such a family, earning between \$12,750 and \$21,800, could claim that top credit amount; the size of the credit would ramp-down as that family earns more, until it phases-out entirely at an income level of \$49,078.

In addition, the EITC is refundable. That means that, if the amount of the credit owed to a taxpayer exceeds his or her tax liability, it not only offsets the tax bill; the taxpayer receives a refund for the balance of the credit amount.

Families use their EITC money in many ways – often, as already noted, to cover pressing, day-to-day bills and pay-down debt. Because their EITC-bolstered tax refund often is the largest single payment they’ll experience all year, many households also strive to set-aside some of it for savings toward specific, long-term goals or to brace for unforeseen needs emergencies. One survey of nearly 200 families in Massachusetts and Illinois found that about 39 percent of families devoted about 15 percent of their EITC refund dollars to savings of some sort.³



A Utah youngster understands the value of his family's tax refund, including any value the Earned Income Tax Credit can add: Replacement of an old family auto.

Overall in 2011, the EITC represented nearly \$59 billion to working, taxpaying households throughout the nation. The average credit came to about \$2,100⁴ – representing substantial help for low- and moderate-income families that work hard and play by the rules, but still struggle to cover their bills and basic, day-to-day expenses. Yet one out of five households eligible for the EITC fail to claim the credit, often be-

cause they don't even know it's available to them.⁵ That's particularly troubling at a time poverty levels are spiking and millions of families are becoming eligible for the credit for the first time.

The EITC: Helping families avoid poverty

U.S. Census Bureau data released in fall 2011 showed the nation's official poverty rate had climbed to 15.1 percent. Altogether, more than 46 million Americans lived in poverty last year – more people than at any point since the Bureau began tracking that figure in 1959.⁶ This reflected an increase of 0.8 percent (about 2.6 million people) from the previous year. The figures ran much higher among particular populations – for example, an official poverty rate of 22 percent among children.

Altogether, experts determined, the credit likely kept more than 6 million people from falling into poverty in 2010, half of them children.

Several important public benefits – factors that are not reflected in these official estimates – work individually and collectively to help prevent families from falling into poverty. The EITC is one of the most powerful of these benefits. Altogether, experts determined, the credit likely kept more than 6 million people from falling into poverty in 2010, half of them children.⁷

Yet such traditionally determined poverty statistics simply measure family incomes against the official poverty line – for example, \$22,113 for a household consisting of two adults and two children in 2010. But this measure is often criticized as being outdated, artificially low and lacking in telling details. In order to paint a more accurate and realistic picture of poverty in America, the Census Bureau went further to assemble a Supplemental Poverty Measure in 2011. This yardstick takes into account such factors as medical and commuting costs, the effects of sev-

eral significant public benefits and such tax credits as the EITC.

The EITC is primarily a short-term income support

Most families don't claim the EITC for very long stretches. They often "income-out" of eligibility and leave the credit behind when household circumstances change, such as when earnings increase and they can get back on their feet. Among EITC filers studied between 1989 and 2006:

- **42 percent** claimed the credit for only one year at a time,
- **19 percent** retained it for two straight years, and
- Only about **one in five** kept the EITC for five or more consecutive years.

Source: Dowd, Tim and Horowitz, John B. "Income Mobility and the Earned Income Tax Credit: Short-Term Safety Net or Long-Term Income Support." Public Finance Review. Sept. 28, 2011.

This new measure pegged national poverty at a higher, 16 percent rate. Significantly, it also focused a brighter spotlight on the specific, poverty-reduction effects of particular benefits – demonstrating, for example, that the EITC's assistance helped keep the poverty rate from climbing an additional 2 percentage points. As with the traditional poverty rate, the figures for children and minority families ran even higher.⁸

The vagaries of an unstable economy underscore the longstanding significance of the EITC. More families are experiencing job losses, reductions in hours or wages and increasing financial pressures of many other kinds – and struggling households need the help the EITC offers. Yet it's important to note that families generally turn to the EITC only for as long as they need it, treating it as the temporary aid for which it's intended, until they can get back on their feet.

Researchers from the federal Joint Committee on Taxation and Indiana's Ball State University found that 61 percent of families retained the EITC for only brief stretches of time – up to two consecutive years.⁹ Improving financial circumstances or changes in family composition might lead a household to leave EITC eligibility and the credit behind after a short period. And while 20 percent of such families need to return to the credit for assistance after one year, only 2.3 percent reclaim it after five years, the researchers found.

The EITC: Bolstering educational & health outcomes

Knowing all this, it's very little surprise that the EITC has also been associated with stronger educational outcomes among the children of families claiming this credit. After all, plenty of research and literature has connected the dots between the ill effects of poverty on school achievement¹⁰ – and if the EITC helps combat poverty, it should correlate with greater learning among kids.

One recent study demonstrated this by zeroing-in on periods during the 1980s-1990s when EITC amounts increased dramatically for eligible families. This research drew on data from nearly 4,500 kids taking part in the Children of the National Longitudinal Survey of Youth.¹¹

The EITC's help with increasing family income by \$1,000 a year raises children's math and reading test scores a statistically significant amount.

The EITC's help with increasing family income by \$1,000 a year raises children's math and reading test scores by a statistically significant amount, according to this inquiry.¹² In fact, over the study's 1987-1999 sample period, the median EITC amount for qualifying families with two children grew by \$1,670 – a figure associated with even higher average test-score gains.¹³

The effects are larger still for kids in more disadvantaged families, for even younger children and for boys. Researchers suggested that EITC improvements in household income might have boosted test scores, in part, by helping parents purchase books, better child care and/or better health care for their kids, in addition to helping some families move to better neighborhoods. Plus, healthier incomes might have led to improved health for parents – such as reductions in stress and depression – that, in turn, would help them to better-support their children's learning.

In fact, the EITC and positive, physical-health outcomes are linked by several important studies. One of the most recent approached its analysis through the lens of states that have created their own Earned Income Tax Credits to mimic and add to the value of the much larger, federal EITC. On average, researchers found, state EITCs appear to help increase babies' birthweights by 16 grams – an important factor in improving children's well-being in several ways, as low birthweights are associated with a host of poor health outcomes.¹⁴ In addition, this study associated state EITCs with a 5 percent decrease in mothers' smoking; this, too, could help bolster kids' health in a number of ways (including birthweight improvements).

The EITC: Strengthening local economies & business climates

The health of local economies also improves with the help of the EITC, according to research. This is because the credit helps to keep more money in the pockets of those low- and moderate-income, working families who are most likely to spend their money at the local level, patronizing neighborhood stores and other businesses. The resulting effects "ripple throughout the economy," according to the Illinois Retail Merchants Association.¹⁵

In many cases, the businesses affected are those most in need of help in a struggling economy –

employers who already have had to lay-off workers or cut back on their hours or salaries, compounding the challenges to a sustained and successful economic recovery. The EITC ensures that businesses' customer bases have more to spend, thus helping arrest – and begin to reverse – the downward spiral of layoffs and cutbacks. Such job-retention efforts are a critical companion to job-creation efforts.

Packing an economic punch

Over the past decade, several “multiplier effect” studies have measured the effects of the credit in various ways. They’ve demonstrated that every \$1 of EITC realized by local taxpayers generates local economic activity worth:

- **\$1.07** in Nashville
- **\$1.40** in Fresno
- **\$1.58** in San Antonio
- **\$1.67** in Michigan

Sources: Haskell, John N. “The State of the Earned-Income Tax Credit in Nashville.” Vanderbilt University study commissioned by the Nashville Wealth-Building Alliance. Aug. 4, 2006.

Chubb, Amy, and Avalos, Dr. Antonio. “The Economic Impact of the Earned Income Tax Credit (EITC) in the City of Fresno.” Fresno Works for Better Health Advocacy Center and California State University. November, 2007.

Author. “Increased Participation in the EITC in San Antonio.” Texas Perspectives, Inc., prepared for the City of San Antonio and Annie E. Casey Foundation. Feb. 17, 2003.

Sallee, Caroline, and Anderson, Patrick. “Economic Benefits of the Earned Income Tax Credit in Michigan.” Anderson Consulting Group study commissioned by Michigan Association of United Ways and Community Economic Development Association of Michigan. Aug. 13, 2009.

“Economists suggest that every increased dollar received by low- and moderate-income families has a multiplier effect of between 1.5 to 2 times the original amount, in terms of its impact on the local economy and how much money is spent in and around the communities where these families live,” according to a 2008 report by the U.S. Conference of Mayors.¹⁶ If every EITC dollar translates into \$1.50 spent at the local level, the report states, affected communities could be realizing more than \$18 billion worth of

greater economic boosts thanks to the credit – with the potential for more, if the rate of unclaimed credit dollars is reduced.

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To be sure, such “economic multiplier” estimates vary according to a range of factors, relating largely to the differences of local economies’ composition. Whatever an individual study’s “multiplier” findings, the conclusion is the same: The EITC is good for families’ household economies – and that, in turn, is good for the economies of their neighborhoods, municipalities and entire states.

Policy priorities: Keeping the EITC strong for families, communities & economies

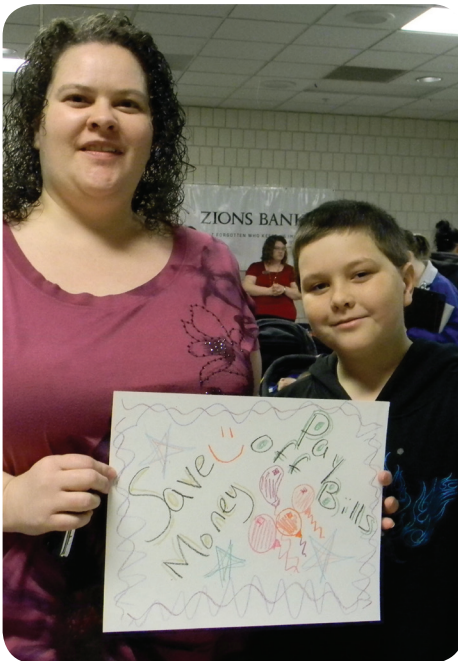
Given the EITC’s enormous merits as demonstrated by research and the experiences of individual families, it’s clear that federal policymakers should protect the credit and strengthen its help for those who need it most. There are several important ways to approach this work in 2012:

Retain critical improvements in the EITC

The American Recovery and Reinvestment Act of 2009 (ARRA) included two significant improvements in the EITC. One created an extra tier of assistance – a higher credit amount – for families with three or more children, reflecting the extra costs they bear. The other change helped to ease one aspect of what’s known as the “marriage penalty” that EITC recipients

often encounter when they marry and file their taxes jointly, only to realize a smaller credit amount than if they'd filed singly and added their individual EITCs together.

Without these specific EITC improvements, another 490,000 people would have fallen into poverty in 2010, according to the Center on Budget and Policy Priorities; more than half of these would have been children.¹⁷ But without congressional action to retain them, these ARRA measures expire at the end of 2012 – along with important improvements in the Child Tax Credit (helping low- and moderate-income families with kids) and the American Opportunity Tax Credit (increasing college affordability for struggling families). Congress should act to maintain all these important policy priorities.



Reducing bills and increasing savings are two goals that this Utah mom and her son have for their tax refund, including any benefit the Earned Income Tax Credit can bring to bear.

Maintain the EITC as a vital part of any tax-reform efforts

Important tax issues are on the table in 2012, including the scheduled expiration of 2001 and 2003 tax cuts as well as the ARRA matters mentioned above.

National-election campaigns will continue to stoke ongoing tax-policy debate, and some policymakers already have suggested the tax code should be reformed – streamlined, simplified and/or refined in other ways. Certainly, some improvements could be made. But these should be drafted carefully, guided by wise deliberations about the wide range of taxpayers' needs – and the well-being of our entire nation.

One principle that should guide any tax-reform work is this: Low- and moderate-income, working families should be "held harmless" and not asked to pay more than they are today. The EITC has an important role to play in that regard, with its long and strong track record of targeting assistance to low-wage families who work hard and play by the rules, but have little to show for it. Any discussions about improving the tax code thus should prioritize ways of improving EITC assistance for those who need it most.

Increase the size of the EITC for single filers without children

This is one such way to improve the credit. As supportive as the EITC has been for struggling families with children, it does not provide adequate help for single taxpayers who have no kids. In fact, the top credit amount for a single filer is only \$464 in Tax Year 2011 (for a taxpayer earning between \$6,050 and \$7,600). That represents as little as 6.1 percent of their earnings.

As supportive as the EITC has been for struggling families with children, it does not provide adequate help for single taxpayers who have no kids.

Low-wage, single filers need more help than the EITC currently offers them. The size of the credit should be increased for these hardworking taxpayers while maintaining its strength for households with children.

Preserve and improve existing state EITCs – and create new ones

Over the years, about two-dozen states and several local governments – from San Francisco to Maryland’s Montgomery County – have created their own EITCs. These piggyback on and increase the assistance that the much larger, federal-level EITC offers to low- and moderate-income, working families as well as their local communities. But as the nation’s sluggish economy prompts state policymakers to weigh budget-cut proposals, many state EITCs have been put at risk, with dire consequences for struggling households. In Michigan, for example, policymakers slashed the value of the state’s EITC by more than two-thirds, starting in Tax Year 2011 – a move expected to push 14,000 more children into poverty.¹⁸

In these tough times, policymakers should remember the value that state EITCs represent for not only the families who need them, but for the economic vitality of their local communities and entire states. Governors and legislators should work to retain and strengthen existing state EITCs – and create such credits in states lacking them.

Improve EITC access for families who need it, through VITA and other means

It’s important to ensure all eligible families claim and receive their EITCs, improving upon the approximately 80 percent claim rate identified by the IRS. Many states and communities have crafted and are pursuing innovative outreach strategies that serve as models to be replicated elsewhere. Many of these approaches build upon free tax-preparation services such as Volunteer Income Tax Assistance (VITA).

Without VITA help, many families don’t know about the EITC or that they’re eligible for it.

VITA programs help low-income, working families make their way through the complicated tax code, claiming the full amount of any tax refunds for which

they’re qualified. Without VITA help, many families don’t know about the EITC or that they’re eligible for it. In other cases, without VITA, struggling households turn to the help of commercial tax preparers who often charge high fees and eat-into families’ EITC refunds. In fact, community VITA programs saved EITC filers an estimated \$90 million in costs of paid tax return preparation last year.¹⁹

Federal grant help for VITA programs amounts to only \$12 million, nationwide; budget pressures are prompting many states, municipalities and private funding sources to cut back on the grant help they provide to VITA efforts. Policymakers should work to maintain all these important VITA resources – as well as add to them through passage of the federal VITA Act (S. 816 and H.R. 2151).²⁰ This legislation would increase VITA’s federal matching-grant funds for five years as well as establish a national center to focus on program quality, research and best practices. All this work, in turn, would help to substantially bolster EITC outreach for families who need it.

Notes

- 1 Names of families receiving the EITC have been changed in this report, to respect their privacy.
- 2 Donosky, Lea. "Sweeping Tax Overhaul Now the Law." *The Chicago Tribune*. Oct. 23, 1986.
- 3 Mendenhall, Ruby, University of Illinois, et al. "The Role of Earned Income Tax Credit in the Budgets of Low-Income Families." *National Poverty Center*. June, 2010.
- 4 Author. "2011 Tax Year Fast Facts: Earned Income Tax Credit." *Internal Revenue Service*. Autumn, 2011.
- 5 *Ibid.*
- 6 DeNavas-Walt, Carmen; Proctor, Bernadette D.; Smith, Jessica C. "Income, Poverty and Health Insurance Coverage in the United States: 2010." *U.S. Census Bureau*. September, 2011.
- 7 Sherman, Arloc. "Poverty and Financial Distress Would Have Been Substantially Worse in 2010 Without Government Action, New Census Data Show." *Center on Budget & Policy Priorities*. Nov. 7, 2011.
- 8 Short, Kathleen. "The Research Supplemental Poverty Measure: 2010." *U.S. Census Bureau*. November, 2011.
- 9 Dowd, Tim and Horowitz, John B. "Income Mobility and the Earned Income Tax Credit: Short-Term Safety Net or Long-Term Income Support." *Public Finance Review*. Sept. 28, 2011.
- 10 Duncan, Greg and Magnuson, Katherine. "The Long Reach of Early Childhood Poverty." *Pathways*. Winter, 2011.
- 11 Dahl, Gordon, and Lochner, Lance. "The Impact of Family Income on Child Achievement: Evidence from the Earned Income Tax Credit." *University of California, San Diego; University of Western Ontario; and NBER*. June 15, 2011.
- 12 6 percent of a standard deviation. *Ibid.*
- 13 10 percent of a standard deviation. The dollar figures cited here are figured in year 2000 dollars. *Ibid.*
- 14 Strull, Kate; Rekopf, David; and Xuan, Ziming. "Effects of Prenatal Poverty on Infant Health: State Earned Income Tax Credits and Birth Weight." *American Sociological Review*. August, 2010.
- 15 From remarks by Rob Karr, Senior Vice President for Government and Member Relations, *Illinois Retail Merchant Association*. Chicago bill-signing ceremony for Illinois legislation increasing the state EITC (Senate Bill 400, 97th Illinois General Assembly). Jan. 10, 2012.
- 16 Author. "Dollarwise Best Practices: Earned Income Tax Credit, 2nd Edition." *U.S. Conference of Mayors*. 2008.
- 17 Sherman, Arloc. "Poverty and Financial Distress Would Have Been Substantially Worse in 2010 Without Government Action, New Census Data Show." *Center on Budget & Policy Priorities*. Nov. 7, 2011.
- 18 Author. Michigan entry for "50-State Resource Map," posted online at <http://www.taxcreditsforworkingfamilies.org/state/michigan>. *Tax Credits for Working Families*. 2011.
- 19 NCTC calculation based on two figures: 489,262 tax returns with EITCs prepared by Community VITA programs in 2011 filing season (per figures provided by IRS Stakeholder Partnerships, Education and Communications, December 2011) and an \$189 average fee charged by a paid tax preparer for a return with an EITC filing (per Wu, Chi Chi, *National Consumer Law Center*, and Fox, Jean Ann, *Consumer Federation of America*. "End of the Rapid Rip-Off: An Epilogue for Quickie Tax Loans." February 2011.)
- 20 Legislation filed in 112th Congress. For more information on the VITA Act, visit <http://tax-coalition.org/policy-resources/vita-funding>.



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