



The Earned Income Tax Credit (EITC)

Supporting the Working Poor in Creating Long-Term Self-Sufficiency

Summer 2006

EITC BACKGROUND:

The Earned Income Tax Credit (EITC), enacted by Congress in 1975, is a refundable tax credit that increases the income of low- and moderate-income working families through the provision of tax reductions and wage supplements. The program's primary purpose is to aid employed workers in achieving and maintaining their independence from welfare by making work more attractive.

The EITC has been widely praised for its effectiveness in reducing poverty and has been instrumental in closing the poverty gap for the country's working poor. Since low-income families pay little or no taxes, the refunds received represent increases in income, not reductions in taxes owed, providing a greater level of support.¹

During the late 1980s and early 1990s, several expansions of the EITC helped to turn the program into one of the largest and most successful Federal aid programs targeting the working poor.

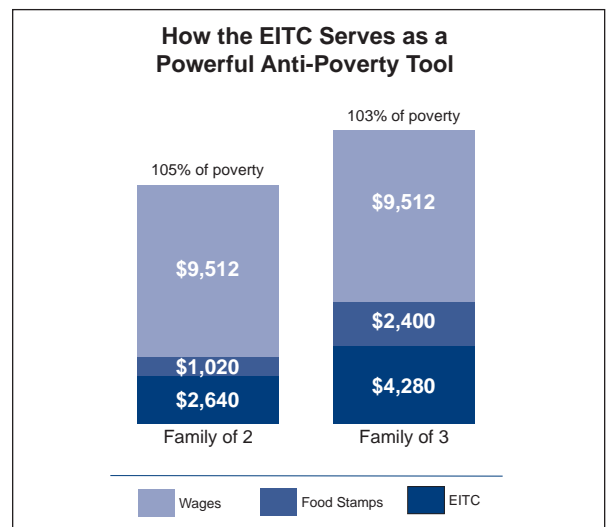
- A 2001 study found that the changes made to the EITC accounted for 61% of the increase in the employment rate for single mothers from 1984 – 1996.² As only those who work are eligible for the EITC and the size of the credit increases with each additional dollar of earnings, the EITC provides an incentive for low-income individuals to work.
- Estimates from 2004 suggest that the EITC provided approximately \$39 billion worth of assistance to more than 21 million low-income working families.³
- Census data from 2003 show that the EITC lifted 4.4 million people out of poverty, including 2.4 million children. Without the EITC, the poverty rate among children would have been nearly one-fourth higher.⁴

- Families use the EITC to pay for basic necessities such as housing, utilities, food and basic household appliances. Research indicates that a large share of families use the refund to repair a car, make necessary renovations to their homes, or for education or job training.⁵

The amount of the EITC is determined by both income and family size. To be eligible in the 2004 tax year, individuals without qualifying children must have earned less than \$11,490; individuals with one child must earn less than \$30,338 and individuals with more than one child must earn less than \$34,458.⁶

For example, a family of four with two children and a full-time, year-round worker earning \$7 an hour has an annual income of about \$13,600, well below the federal poverty line. In 2004, this family would be eligible for a federal EITC of \$4,300 and a child credit of \$395, bringing its annual income close to the poverty line.

The graph below indicates the powerful effect that the EITC can have on family income.



In recognition of its importance, the Federal government has renewed its commitment to promoting the utilization of the EITC and in 2001,



Congress passed legislation to simplify access and increase the benefits to low-income, EITC-eligible tax filers.⁷

Despite these successes, the EITC is not reaching all those who may benefit. An estimated 15-20% of eligible workers fail to claim the credit, typically because they failed to file a tax return.⁸ The fees and costs associated with filing for the EITC are also diminishing the impact the program has. An understanding of the economic benefits of the EITC has helped to spur numerous local and national education campaigns and outreach efforts to encourage eligible families to apply for the tax credit. Although there has been widespread success with these programs, more extensive efforts to promote the EITC would likely serve to increase the number of filers.

SUCCESSFUL EFFORTS TO INCREASE FILINGS:

Some campaigns have expanded their efforts to include free tax preparation services through the Internal Revenue Services' Volunteer Income Tax Assistance (VITA) program. Most communities have several VITA sites, although there are fewer in rural areas. Other campaigns have developed alternative tax preparation services targeted towards poor, working families. Some efforts have linked asset building and services to outreach and tax preparation services.

OUTREACH PLANNING:

EITC campaigns have traditionally targeted the working poor and have not incorporated asset-building opportunities available to low-income families. Campaigns have since evolved to include such critical information. In the planning stages, it is essential that campaigns adequately research their targeted areas and involve others with a vested interest in the community.

- In **New Orleans, Louisiana**, maps of the targeted neighborhood were developed by a volunteer organization. They identified income concentration, VITA site locations, locations of financial institutions and commercial tax preparation agencies. At a community meeting to discuss mounting an EITC campaign, the maps were used to determine the best location for outreach and affordable tax services. A member of the campaign representing the Federal Reserve Bank also approached financial institutions to join in the partnership. One responded by offering "unbanked" taxpayers the ability to open savings accounts at two free tax preparation sites. The collaboration efforts between volunteers and community organizations and businesses in the planning stages aided the successful development of a comprehensive outreach effort.
- The Center for Economic Progress operates the EITC campaign in **Chicago, Illinois**, in collaboration with the Mayor, city departments, ShoreBank and

other stakeholders. Following the conclusion of the tax season, there is an evaluation of the campaign's performance and planning for the subsequent year begins immediately. This evaluation and pre-planning is instrumental in the appropriate and timely response to any discrepancies or weaknesses in the outreach campaign.

OUTREACH IMPLEMENTATION:

Conducting appropriate marketing and outreach activities is vital to a successful EITC initiative. Accomplished campaigns will know their audience and define effective communication strategies for reaching their target.

- 14,000 flyers, printed in both English and Spanish, were distributed to taxpayers in three targeted areas of **Indianapolis, Indiana**. Articles appeared in Hispanic and neighborhood newsletters, as well as in two of the city's major newspapers. A spokesperson for the IRS appeared on a call-in radio show several times, answering questions about the EITC from the Hispanic population. The Mayor promoted the EITC in several speeches, highlighting the tax credit's value to the working poor. Outreach efforts in numerous mediums and from a variety of sources highlighted the amount of money individuals could save, focusing on the diverse population in the city.

TAX PREPARATION SERVICES:

Many successful campaigns include free or low-cost tax preparation services, either working in partnership with the IRS or recruiting private accountants or employers to provide assistance.

- In **Washington, DC**, CityFirst Bank recruited a local accountant who served the Hispanic community to provide affordable tax preparation services during business hours. Taxpayers were charged a flat fee of \$35 and were referred to CityFirst Bank to establish accounts in which their returns could be deposited directly. If taxpayers insisted upon receiving their refunds earlier, they were referred to the bank's rapid refund loan that provided a simplified interest rate. Such an approach provided lower cost services to EITC eligible individuals in combination with savings opportunities.

ASSET-BUILDING OPPORTUNITIES:

An important element of many successful EITC campaigns is connecting low-income workers to opportunities, such as financial literacy training, debt reduction counseling, credit repair and homeownership counseling, which can encourage filers to use their return to build assets.

- In **Louisville, Kentucky**, banks sent representatives to Volunteer Income Tax Assistance (VITA)⁹ sites to open checking and savings accounts for the direct deposit of

tax refunds. Combined homeownership-financial literacy classes were offered at the sites and individuals were referred to other asset-building opportunities, such as Individual Development Accounts. IDA clients were in turn referred to VITA sites for tax help. Those taxpayers who were flagged with credit problems were referred to a local program, Fresh Start, that offers financial literacy education and credit repair services. A comprehensive approach, such as this, helps taxpayers to get the most out of their EITC.¹⁰

EITC outreach campaigns seem to be reaching the targeted individuals who are eligible, but either for lack of awareness or difficulty in filing, are not taking advantage of the program. It is important to examine the relevant tax data in order to assess whether or not these efforts are having the desired impact.

TRENDS IN EITC UPTAKE 2004:

From a preliminary examination of the 2004 tax data, it would appear that the outreach and educational activities have increased the EITC uptake. However, not all those who are eligible claim their credit and efforts to identify and educate these taxpayers about the program could be intensified.

- Over twenty million tax returns received the EITC credit, claiming more than \$38 billion dollars. On average, 77% of applicable credits were claimed.
 - Texas, California, Florida and New York had the largest number of EITC returns as well as the greatest amount of money claimed. Given their large populations, this is not surprising.
- However, almost \$11 billion remained unclaimed, estimated to affect almost 6 million filers.
 - Again, Texas, California, Florida and New York had the largest number of eligible filers that did not claim the EITC credit. These states also had the greatest amount of funds unclaimed, highlighting the importance of outreach and educational efforts for states of all sizes.
 - Alaska had the lowest percentage (27%) of claimed EITC credits. All other states had at least 74% of the eligible population claiming the credit.
- The average EITC credit ranged from \$1,515 (in Vermont) to \$2,177 (in Louisiana), with the average return being \$1,750.
 - Five states, Louisiana, Mississippi, Alabama, Texas and Georgia had average returns of over \$2,000.

In 2004, there were more than 21 million EITC returns. Further outreach efforts to increase the number of filers could have large impacts on the amount of money EITC eligible taxpayers receive. Given the known impact that the

program has on reducing poverty, such efforts would only further enhance the impact, bringing more working families out of poverty and into self-sufficiency. The work required to increase the number of filers 5% or 10% is minimal compared to the extraordinary impact the additional billions of dollars can have on the families who receive the credit.

	Number of Returns	Approximate EITC Dollars
2004 EITC Returns	21,075,477	\$39 billion
Increase EITC Returns by 5%	22,129,251	\$41 billion
Increase EITC Returns by 5%	23,183,025	\$43 billion

Merely increasing the number of filers will only have marginal economic impact if families are unable to claim the entire benefit. As more individuals pay for tax preparation and refund anticipation loans, the actual amount of their return diminishes and the effect lessened. Further steps need to be taken to encourage families to file through free services and avoid high-interest short-term loans.

PAID TAX PREPARATION AND REFUND ANTICIPATION LOANS DEPLETING THE EITC IMPACT:

In all states, at least half of 2004 EITC returns were prepared by paid preparers. Nationwide, it is estimated that more than 60% of taxpayers who claim the EITC used a commercial agency.

Paid tax preparers offer quick refund anticipation loans with free cash checking and often exorbitant interest fees. Recently, Jackson Hewitt and Liberty Tax Service joined H&R Block in agreeing to stop charging consumers “administrative” or “application” fees, reducing the costs to consumers by \$30. However, at an average cost of \$300, using paid tax preparers decreased the EITC credit by 17% to \$1,450.¹¹

Refund Anticipation Loans (RALs) are marketed to low-income taxpayers:

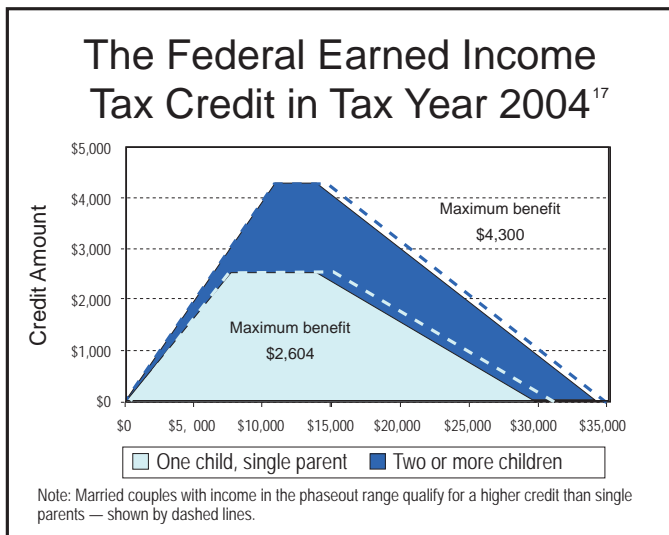
- 78% of RAL applicants in 2004 had incomes of less than \$35,000
- IRS data also show that in 2004, nearly 56% of RAL consumers, 7 million families, were EITC recipients; over 1 in 3 EITC recipients took out a RAL
- Loan fees, administrative/application fees, tax preparation fees and check cashing costs all undermine the effectiveness of the EITC in supporting low-wage workers.¹²

RAL borrowers are also more vulnerable to high cost credit and are likely “unbanked.”¹³ These individuals are also likely to be uneducated, work in service or semi-skilled/skilled jobs, rent instead of own their homes, be female and African American.¹⁴ Considering the purpose of the EITC is to assist workers in achieving and maintaining their financial independence these figures are distressing. This further illustrates the need for education and action beyond simply encouraging eligible tax payers to file for the credit.

Type of Fee	Cost to Taxpayer	Drain on EITC Program
RAL	\$100	\$700 million
App./Admin. Fee	\$32	\$204 million
Tax Prep Fee	\$145	\$1 billion
Check Cashing	\$65	\$205 million
Total	\$317	\$2.1 billion

THE VALUE OF EITC TO LOW-INCOME FAMILIES:

One of the key goals of the EITC is to make work pay. In 2004, the maximum benefit was \$4,300 for a family with two children and \$2,604 for a family with one child. The credit is then phased out gradually.¹⁶



- For families¹⁸ making full-time minimum wage, \$10,700, per year, the federal EITC added \$4,280, 40%, to their annual income.¹⁹
- Families with annual incomes at the poverty line, \$19,000, saw an increase in their incomes of \$3,466 or 18%.²⁰
- In 2004, 96% of EITC recipients had incomes below \$30,000 (approximately 20 million filers); 71% had incomes at or below \$20,000 (approximately 15 million filers).²¹

CONCLUSION:

The EITC has been shown to have powerful anti-poverty effects and is a vital augmentation to welfare. As TANF caseloads continue to decline and the commitment to move recipients to employment grows, the EITC makes work pay for many of those who struggle for self-sufficiency.

Outreach efforts have been successful in increasing filers' awareness of the EITC and the number of eligible families filing for the credit. However, given the number of individuals who both pay for tax preparation and high-interest refund anticipation loans, further action needs to occur. EITC campaigns can stress the availability of free tax preparation services and seek to expand the number of VITA sites. Education efforts should promote a sense that the EITC has been earned by the filer, and discourage them from giving much of it away to high-interest lenders. Efforts should also be made to further develop the assets of those eligible, including the establishment of bank accounts and the utilization of credit repair services, so filers benefit more fully from the EITC.

ENDNOTES:

- 1 Danzinger, S. H. & Haveman R. H. (2001). *Understanding Poverty*.
- 2 Ibid.
- 3 Caliber/ICFI analysis based on ACF data on 2004 tax year.
- 4 Greenstein, R. (8/17/2005). *The Earned Income Tax Credit: Boosting Employment, Aiding the Working Poor*. CBPP.
- 5 Ibid.
- 6 Internal Revenue Service (1/27/05). *New EITC tool helps taxpayers determine eligibility*. IR-2005-11.
- 7 Welfare Peer Technical Assistance Network (Winter 2005). *The EITC: Supporting the working poor in creating long-term self-sufficiency*.
- 8 Berube, A. (February, 2006). *The New Safety Net: How the Tax Code Helped Low-Income Working Families During the Early 2000s*. The Brookings Institute.
- 9 The VITA program is a free, IRS sponsored initiative to help low-income workers complete their tax forms.
- 10 Welfare Peer Technical Assistance Network
- 11 Wu, C. C. (2006). *Another year of losses: High-priced refund anticipation loans continue to take a chunk out of American's tax refunds*.
- 12 Ibid.
- 13 The “unbanked” are those without any sort of deposit accounts at financial institutions.
- 14 Wu.
- 15 Ibid.
- 16 The upper income limit for families with 2 children was \$35,458 in 2004.
- 17 Llobrera, J. & Zahradnik, B. (5/14/04). *A hand up: How state earned income tax credits help working families escape poverty in 2004*. CBPP.
- 18 Married family of 4 with two children.
- 19 Llobrera & Zahradnik.
- 20 Ibid
- 21 Caliber/ICFI.