Enhancing Tax Credits for Working Families

Tax Credits for Working Families Lift Millions of People Out of Poverty
The Earned Income Tax Credit (EITC) and the Child Tax Credit (CTC) help lower-income households build financial security. The EITC is our nation’s most effective anti-poverty tool. It is a refundable tax credit available to low- and moderate-income households with household members who work. In the 2018 tax filing season, 25 million tax filers claimed the EITC, receiving an average benefit of $2,488.1 In 2018, a married couple with two children and an income of $40,000 per year qualified for an EITC of $2,415, meaning their EITC benefit was the equivalent of 6% of their annual income.2 Although structured as a wage subsidy, the EITC actually functions as a lump-sum payment received at tax time. The Child Tax Credit (CTC) is another tool that provides tax relief to Americans with children in their household. This tax credit may be worth as much as $2,000 per qualifying child under age 17, but it is not fully refundable like the EITC. Instead, it has a refundable piece, the Additional Child Tax Credit (ACTC)—worth up to $1,400 per qualifying child—that helps lower-income families raising children. Much like the EITC, the ACTC serves as a lump-sum refund for low- and moderate-income households. For decades, the effectiveness of the EITC and CTC has been recognized by Democrats and Republicans alike, and both credits have been expanded as a result of bipartisan tax legislation.3

Several states have implemented their own EITC. To date, 29 states and the District of Columbia have enacted state EITCs that build on the benefits of the federal credit. In most cases, a state EITC is calculated as a percentage of the federal EITC and 16 states, along with Washington, DC, offer EITCs that are at least 15% of the federal one. In all but six cases, the state EITCs are refundable.4 The federal and state tax credits work together to lift even more families out of poverty.

The EITC and CTC have far-reaching positive impacts. Analyses show that together, the EITC and CTC lifted as many as ten million people out of poverty in 2018, including over five million children.5 These tax credits help advance racial equity since they serve a larger proportion of households of color, who tend to be lower-income, than they do White households.6 Research also shows that these tax credits positively influence many aspects of recipients’ lives. Children in families that receive tax-time benefits like the EITC and CTC experience improved outcomes from early childhood through retirement. This means better infant health, improved test scores in school, boosted college enrollment, increased earnings as adults and higher Social Security benefits in retirement.7 Studies show that these benefits may even be larger for children of color, who experience higher rates of poverty than White children.8 Overall, the long-term impact of receiving a boost in income is quantifiable: children in families that earned an extra $3,000, roughly the size of a typical EITC, worked 135 hours more per year once they reached adulthood.9

The VITA Program Helps Low-Income Families Access Tax Credits
The Volunteer Income Tax Assistance (VITA) program provides free tax preparation to lower-income households. While tax credits are powerful tools for fighting poverty, the way families access them can determine their overall impact. Paid tax preparation can be expensive, costing $273 on average.10 Moreover, a majority of paid tax preparers are not required to meet basic competency standards, so tax filers using these services are vulnerable to inaccuracy, predatory behavior and lack of transparency around fees.11 The VITA program is a free, accurate and safe alternative for low- and moderate-income taxpayers. Administered by the IRS, VITA provides households earning less than $54,000 in annual income with free tax preparation.
services, helping them have equitable access to the tax code and its many benefits, including the EITC and CTC. The program has the highest return preparation accuracy rate of any type of preparer, 98%, and serves as a model for such competency standards. VITA volunteers are held to a high standard and are required to complete IRS certification programs each year. Today, there are 3,700 VITA sites around the country that prepared over 1.5 million returns in 2019, generating over $1.8 billion in refunds. VITA grants must be matched by local, state or private dollars, making the program a prime example of a true private-public partnership. In addition to helping households with their taxes, many VITA programs deliver other services such as financial education and savings programs.

Despite Their Success, the EITC and CTC Could Provide More Effective Support

**Tax credits are disbursed only once per year.** While some low- and moderate-income taxpayers prefer receiving their tax refunds in lump sums, research has revealed that spreading their distribution throughout the year can be beneficial. Studies have found that while many lower-income households intend to save part or all of their tax refund, they often need to allocate it instead to paying off debt or bills, or managing financial shocks. As a result, it may be difficult for them to stretch the money out for future, unforeseen expenses. If tax refunds were disbursed in multiple installments, working families would get a boost in income later in the year, instead of just at tax time.

**More low- and moderate-income taxpayers need VITA’s services.** Although funding for the VITA program has increased over the last decade, demand for VITA’s services continues to outpace the resources the program is provided with. The high cost of tax preparation, low accuracy rates among paid tax preparers, funding constraints at the IRS and complexities arising from the Tax Cuts and Jobs Act of 2017 (TCJA) have all increased the need for VITA’s free, accurate tax preparation assistance. More funding for VITA, along with basic competency standards for paid tax preparers, are needed to help lower-income families receive the tax credits to which they are entitled.

**More low-income households need access to the EITC and CTC.** While these tax credits lift millions of people out of poverty, some of the nation’s most vulnerable households are locked out of receiving the benefits. For example:

- **The EITC provides little support for workers not raising children in the home.** So-called “childless workers” are the only class of workers taxed further into poverty. A single worker with no qualifying children living right at the poverty line in 2018 qualified for a credit of just $241, boosting their income by less than 2%. Compare this to a single worker with one qualifying child filing as a head of household, whose credit would be $3,461 in 2018. If either worker was younger than 25 or older than 65, then they were ineligible entirely.

- **The lowest-income families receive the least benefit from the CTC.** While the 2017 TCJA doubled the maximum CTC available per child under 17 years of age from $1,000 to $2,000, it limited the refundable portion to $1,400 per child. This means that the lowest-income families receive the least benefit from the credit, since they are less likely to owe taxes and may therefore be limited to just the smaller, refundable portion. The TCJA also expanded the CTC to higher-income households, so that the credit now begins to phase out at $400,000 of income for married couples ($200,000 for single filers), compared to $110,000 for married couples ($75,000 for single filers) before the law took effect. In doing so, the new tax law delivered a boost to high-income earners but effectively left out the most vulnerable families. Under the TCJA, ten million children in the lowest-income working families received a token increase of $75 or less.
• **Many families in Puerto Rico cannot access the CTC and EITC.** Even though Puerto Rico has high rates of poverty, families on the island are only eligible for the CTC if they have three or more children (whereas on the mainland, families with one or two children can access the CTC). Moreover, residents of Puerto Rico are ineligible for the federal EITC, since they do not pay federal income taxes. While policymakers there recently enacted a local EITC, it is modest and provides much less benefit than the federal one.21

• **Restrictions limit immigrant families’ access to the CTC and EITC.** Before the TCJA took effect, immigrant families could qualify for the CTC if their child had an Individual Taxpayer Identification Number (ITIN). Starting with the 2019 tax filing season, however, the TCJA excluded children with ITINs from qualifying for the CTC, requiring instead that they have a Social Security number (SSN). The EITC has always been limited to claimants with SSNs. These restrictions cut off many immigrant families, as well as some children born in the United States to immigrant parents, from accessing these important credits.

**EITC overpayments have led to perceptions of fraud.** The “error rate”22 in claiming the EITC, which falls between 22% and 26%, has led to concerns about recipients committing fraud. In reality, these overclaim errors primarily occur due to the EITC’s complex eligibility rules, which can create confusion among tax filers.23 The lack of basic competency standards among paid tax preparers compounds this problem, increasing the chance of inaccurately filed tax returns and improper claiming of the EITC.24

**Congress Can Strengthen Tax Credits for Working Families**

By taking the following actions, Congress can boost the reach and effectiveness of the EITC and CTC, allowing more lower-income families to build financial security for the long term:

• **Leverage tax refunds to help working families handle financial emergencies.** The bipartisan Refund to Rainy Day Savings Act (S. 1018 and H.R. 2112), introduced by Sens. Cory Booker (D-NJ), Tom Cotton (R-AR), Doug Jones (D-AL) and Todd Young (R-IN), as well as Reps. Bonnie Watson Coleman (D-NJ-12) and French Hill (R-AR-2), would help working families handle financial emergencies that occur throughout the year. As noted below, this legislation would allow tax filers to defer 20% of their tax refund, which would accumulate interest for six months before being deposited into the filer’s direct deposit account. The bill includes a pilot program to match deferred tax refunds for lower-income EITC filers, encouraging the use of the tax credit as an emergency savings tool. Finally, the bill expands the flexibility of the innovative Assets for Independence (AFI) grant program, which encourages earnings, savings and self-sufficiency by offering matching funds to help low-income workers save and build assets.26

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**How the Refund to Rainy Day Savings Act Can Help a Family Build Emergency Savings at Tax-Time**

<table>
<thead>
<tr>
<th>At Tax Time</th>
<th>Six Months Later</th>
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<tbody>
<tr>
<td>The family will receive $2000</td>
<td>They will receive a Rainy Day payment of more than $750</td>
</tr>
<tr>
<td>TAX REFUND $2000</td>
<td>($500 deferred tax refund + $250 savings match + accrued interest)</td>
</tr>
<tr>
<td>(80% of the standard tax refund)</td>
<td></td>
</tr>
<tr>
<td>The family will receive $2500</td>
<td>They may not have money for an EMERGENCY</td>
</tr>
</tbody>
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**SOURCE:** The Rainy Day EITC, CFED, 2015
• **Strengthen VITA to increase low-income families’ access to tax credits.** VITA was authorized permanently in statute in 2019, affording certainty that the program will continue. However, the level of funding for the VITA program continues to be determined by the annual appropriations process. Congress should take further action to broaden VITA’s reach to lower-income families by increasing its funding. Expanding the program’s federal funding to $30 million (from $18 million in fiscal year 2019) would boost the capacity of existing tax preparation sites and allow more to open. This, in turn, can help more households claim tax credits they are eligible for, including the EITC and CTC, in a safe and efficient manner.

• **Expand the EITC and CTC so that more working families can benefit.** Introduced by Sens. Sherrod Brown (D-OH), Michael Bennet (D-CO), Dick Durbin (D-IL) and Ron Wyden (D-OR), as well as Reps. Dan Kildee (D-MI-5) and Dwight Evans (D-PA-3), the Working Families Tax Relief Act (S. 1138 and H.R. 3157) would expand tax credits for working families. To improve the EITC, the legislation would raise the maximum credit from $529 to $2,074 for childless workers, expand the eligibility age range to 19-67 (from its current range of 25-64), and increase the maximum credit for families with children by 25%. In addition, the Working Families Tax Relief Act would make the CTC fully refundable and establish a new Young Child Tax Credit (YCTC) for households with children under six, which amounts to an extra $1,000 refundable credit. To help families cover expenses incurred throughout the year, the bill would allow households to receive the CTC and YCTC in monthly installments and to draw a $500 advance payment on their EITC, if they so choose. The legislation would also improve access to tax credits for families in Puerto Rico by implementing the same eligibility criteria for the CTC as in the rest of the United States, and doubling Puerto Rico’s current EITC. Finally, the Working Families Tax Relief Act would allow the IRS to regulate paid tax preparers, thereby helping protect lower-income tax filers from unscrupulous behavior and inaccurate tax returns, as well as mitigating errors in claiming the EITC. These expansions to the EITC and CTC would benefit millions of households, including households of color. If enacted, the legislation would boost the incomes of eight million Black households and nine million Latino households, and it would also reduce the Black and Latino poverty rates by 18% and 20%, respectively. Another similar bill introduced in the House, the Economic Mobility Act of 2019, would also expand the EITC to childless workers, make the CTC fully refundable and improve access to these credits in Puerto Rico.

This brief was written by Chad Bolt and updated by Myrto Karaflos.

12 Ibid.
13 Joanna Ain, “VITA Was Put Into Law—But We Still Need $30 Million in Funding for FY2020!”, Prosperity Now, September 2019, [https://prosperitynow.org/blog/vita-was-put-law-we-still-need-30-million-funding-fy2020][12].


Childless workers are still taxed into poverty even though they receive an EITC because the amount of the credit is not high enough to offset the federal income and payroll taxes they owe. "Who Can Claim EITC?" *Internal Revenue Service*, January 4, 2019, [https://apps.irs.gov/app/eitr/2018/](https://apps.irs.gov/app/eitr/2018/).


"Error rate" is the technical term used to describe the rate of overpayments in the EITC. The definition encompasses unintentional errors, as well as fraud in some cases, on the part of tax filers.


In an attempt to prevent overclaims, Congress passed the Protecting Americans from Tax Hikes (PATH) Act of 2015, requiring the IRS to delay refunds involving the EITC and ACTC until February 15. While the aim of this legislation was to give the IRS more time to detect and prevent tax fraud, it could create financial hardship for EITC recipients, many of whom depend on the timely receipt of their tax refund to meet financial obligations. For more information, see Elaine Maag, Stephen Roll and Jane Oliphant, "Delaying Tax Refunds for Earned Income Tax Credit and Additional Child Tax Credit Claimants," *Tax Policy Center*, December 2016, [https://www.urban.org/sites/default/files/publication/86336/2001018-delaying-tax-refunds-for-earned-income-tax-credit-and-additional-child-tax-credit-claimants_0.pdf](https://www.urban.org/sites/default/files/publication/86336/2001018-delaying-tax-refunds-for-earned-income-tax-credit-and-additional-child-tax-credit-claimants_0.pdf).


