The Earned Income Tax Credit on Its 40th Anniversary- The Most Successful Anti -Poverty Program in United States History?

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The Earned Income Tax Credit traces its roots to President Richard Nixon's Family Assistance Plan which was proposed to Congress in 1971. In launching the plan, President Nixon said that the nation should, "assure an income foundation throughout every section of America for all parents who cannot adequately support themselves and their children." (Nixon, 1969) In 2015 the earned income tax credit marked its 40th anniversary. The earned income tax credit is now the largest needs based federal welfare program in the United States. (Falk, V., 2014)

INTRODUCTION

As the Earned Income Tax Credit marked its 40th anniversary in 2015, we thought it would be a good time to take an in-depth look at the credit. In this paper we will discuss the history of the Earned Income Tax Credit. Additionally, we will also delve into the attributes and drawbacks of the credit and assess its **impact** on poverty in America. The Earned Income Tax Credit is considered the most successful anti-poverty program in history. However, we found that during the forty years that the Earned Income Tax Credit has been in place, the poverty rate has increased. Additionally, "needs based" welfare spending, as a percentage of the gross domestic product, has increased. In this paper we will assess the impact the Earned Income Tax Credit has had on poverty in America.

HISTORY OF THE EARNED INCOME TAX CREDIT

The Earned Income Tax Credit traces its roots to President Richard Nixon's Family Assistance Plan which was proposed to Congress in 1971. In proposing the plan, President Nixon said that the nation should, "assure an income foundation throughout every section of America for all parents who cannot adequately support themselves and their children." (Nixon, 1969) The plan was designed to help working poor families with children by providing them with a guaranteed minimum annual cash payment. The proposed plan would replace the federal -state welfare program, Aid to Families with Dependent Children. The plan was not passed by either the House of Representatives or the Senate. However, the plan was the first of its kind in that it rewarded the working poor by guaranteeing minimum annual cash payment and thus planted the seeds from which the earned income tax credit grew. (Falk, V., 2014)

In 1972, a proposal called the "*Work Bonus*" was recommended by the Senate Finance Committee. The work bonus was considered to be a *refund* of social security taxes paid by employers and employees on wages paid to "*low annual earners"*. The bonus was to be available only for wages subject to social security taxes. The Senate approved the Work Bonus Plan in 1972, 1973 and 1974 but the House of Representatives did not pass it until 1975 (Falk, V., 2014)

The Earned Income Tax Credit was established in the law as part of the Tax Reduction Act of 1975. This refundable credit was available to tax filers with income below $8,000. A refundable credit is *extremely* valuable to taxpayers in that it can generate a tax refund even if no federal income tax was paid. The earned income credit was equal to 10% of the first $4,000 of any earnings, including earnings not subject to Social Security tax. The maximum credit was $400 and was phased out at a rate of **10%** for adjusted gross income in excess of **$8,000.** (Tax Reduction Act, 1975) The passage of the earned income tax credit was lauded by both Republicans and Democrats (Steurle, 2016).

The Revenue Adjustment Act of 1975, The Tax Reform Act of 1976 and The Tax Reduction and Simplification Act of 1978 all extended the earned income credit by one year. The Revenue Act of 1978 made the Earned Income Tax Credit a permanent part of the law. Additionally, it increased the credit to $500 annually and the eligibility limit to $10,000. The Deficit Reduction Act of 1984 increased the maximum credit to $550 per year. The Tax Reform Act of 1986 increased the annual credit to $800 and indexed it to inflation (United States Congressional Record, 2016).

For the first time under, The Omnibus Reconciliation Act of 1990, the Earned Income Tax Credit was adjusted for family size. Additional credits were provided for families with children less than one year of age. The Omnibus Reconciliation Act of 1993 expanded the Earned Income Tax Credit to childless adults (Falk, V., 2014) When proposing an expansion of the Earned Income Tax Credit, President Clinton commented that the credit "is not liberal or conservative. It should belong to no party. It ought to become part of the American Creed". (Clinton, W., 1993) In 1994 a Tariffs and Trade Law extended Earned Income Tax Credit coverage to military personnel working overseas. (Falk, V., 2014)

Between 1994 and 2014 the Earned Income Tax Credit was expanded and refined. The maximum credit in 2014 was $6,143. Internal Revenue Service, 2016). The maximum credit was available to a taxpayer with three or more eligible children. Throughout the years the Earned Income Tax Credit has been widely supported by both Democrats and Republicans. President Ronald Reagan called the Earned Income Tax Credit . . . "the best antipoverty, the best pro-family, the best job creation measure to ever come out of Congress**" (**Snyder, B., 1995)

FORTY YEARS OF THE EARNED INCOME TAX CREDIT

In 2015 the Earned Income Tax Credit celebrated its 40th anniversary. In 1975, the program's first year, the earned income tax credit was granted to 6.2 million tax filers and the average payment was $201. In 2013 the credit was granted to 28 million tax filers and the average payment was $2,407 (Internal Revenue Service, 2016). Over the 38 years between 1975 and 2013 the number of recipients increased approximately 350% and the average payment increased approximately 1075%. During that same time period 1975 to 2013 the population in the United States increased from 214 million to 317 million an increase of approximately 52% (Population Pyramid, 2016). The total inflation between 1975 and 2013 was 386% (Bureau of Labor Statistics, 2106.) Between 1975 and 2013 the Earned Income Tax Credit has grown at a rate which far exceeds the growth in the population and the inflation rate.

During the 1990's the United States government had a policy shift from traditional welfare based benefit programs to work based benefit programs. This policy shift accounts for the large growth in the earned income tax credit program. Beginning in the mid 1990's the Earned Income Tax Credit (EITC) program became the largest antipoverty program in the United States. (Hotz, V., et al , 2001).

Beginning in the 1990's instead of meeting with a social worker and filing an application for benefits, recipients claimed their benefits by filing a tax return. The Internal Revenue Service thus became the administrator of the largest needs based benefit program in the United States (Hotz, V., et al, 2001)

Although the administrative costs of the program are low according to the IRS less than 1% of total program costs, the costs of false claims are high, according to the IRS, 21 to 25% of total cost. Additionally, over 50% of all recipients use a paid preparer and the average cost of a paid preparer is 12% of the credit payment. Thus between 27% and 32% of federal earned income tax credit payments are going to administration, erroneous claims and paid preparers. In 2013 alone these costs amount to between $17. 8 billion and $21.12 billion (Internal Revenue Service,2016).

Temporary Assistance for Needy Families or TANF is the second largest federal needs based poverty program. In 2013, TANF costs totaled $17.1 billion. Administrative costs of TANF are 7% and the Health and Human Services Department estimates 15% of program costs are paid out in fraudulent benefits. Therefore, in 2015 approximately, 22% of TANF expenditures were paid for administration and fraudulent claims. (Health and Human Services Department, 2015) Thus, the TANF adjunct costs are between 5% and 10% lower than the EITC adjunct costs.

Interestingly, in 1975, **12.3%** of the population in the United States lived below the poverty line but by 2014, the population living below the poverty line had risen to **14.8%.** Additionally, in 1975, **2%** of gross domestic product (GDP) was spent on needs based welfare programs and in 2015 that rate had increased to **2.3% (U S Census Bureau, 2016).)** Clearly, the problem remained unresolved according to the statistics.

THE EARNED INCOME TAX CREDIT TODAY

The following information on the Earned Income Tax Credit was gleaned from the 2013 returns filed with the Internal Revenue Service (Internal Revenue Service, 2016):

- The credit was claimed on **28 million tax returns,** approximately **19%** of all returns
- The credit was not claimed on **120 million tax returns**, approximately **81%** of all returns
- **$66** billion was paid out to recipients
- The average payment was **$2,407**
- **76%** of the recipients were unmarried and **24%** were married.
- **76%** of the recipients had one or more children and **24%** were childless
- **52%** used paid preparers and **48%** were self-prepared
- **94%** were electronically filed and **6%** were filed on paper
- **80%** of eligible filers claim the credit and **20%** do not
- The ratio of costs of administering the program to claims paid is **1% to 99%.**

BENEFITS OF THE EARNED INCOME TAX CREDIT

Over the years research studies have indicated that the earned income tax credit provides a multitude of benefits for both the recipient and society as a whole. The most salient studies are outlined below.

According to the Center on Budget and Policy Priorities, the Earned Income Tax Credit encourages workforce participation. The Center's April 2015 report stated, "The EITC expansions of the 1990's contributed as much to the subsequent increases in work among single mothers and female heads of households as the welfare changes of that period. Women who benefited from those EITC expansions also experienced higher wage growth in subsequent years than otherwise similar women who did not receive the benefits"(Marr, 2015.) Hilary Hoynes a researcher at the University of California states, ". . . the EITC may ultimately be judged one of the most successful labor market innovations in history"(Hoynes, 2014.)

Research studies at the University of California at Davis have found that the Earned Income Tax Credit may improve maternal and infant health. Researchers at the University of California at Davis found that infants born to mothers who had received the largest increases in the earned income tax credit had the greatest improvement in a number of birth metrics. In particular, fewer were premature or of low birth rate. Additionally, the researchers found that the mothers who received the largest increases in the credit were more likely to receive prenatal care and less likely to smoke or drink during pregnancy (Evans, et. al., 2014.)

In a 2012 research study the National Bureau of Economic Research found that increased Earned Income Tax Credit resources <u>reduces</u> the incidence of low birth weight and <u>increases</u> mean birth weight. In particular the study found that for single mothers with less than 12 years of education an increase of $1,000 in Earned Income Tax Credit refunds was associated with a 6.7% to 10.8% reduction in low birth weight (Hoynes, 2012.)

A 2013 research study by Michelle Maxfield of the University of Missouri titled: "The Effects of the Earned Income Tax Credit on Child Achievement and Long Term Educational Attainment" indicated that *increases* in the EITC led to better school performance and higher educational attainment. Maxfield summarized her findings as follows, "This study directly links EITC receipt throughout all ages of childhood to both contemporaneous achievement and long - range educational attainment." The study found an increase of $1,000 in the credit significantly increased math scores. Additionally, the study found that an increase of $1,000 in the credit increased the probability of graduating from high school or receiving a general equivalency degree by the age of 19 by 2.1% (Maxfield, 2013.)

Increases in the Earned Income Tax Credit have also been associated with an increase in a child's future earnings. In 2011, Chetty, Friedman and Rockoff published a research study, "New Evidence on the Long-term Impacts of Tax Credits. In the paper the researchers projected that each dollar of income received through tax credits would increase the real value of a child's future earnings by more than $1 (Chetty, et.al.,2011.)

Research has also shown that the Earned Income Tax Credit lifts recipients out of poverty. Ault and Berger in their 2015 research study, "Poverty and the Earned Income Tax Credit found that "...those who received the credit were 53.3 percentage points more likely to be over the poverty line after taxes compared to those who did not receive the credit. Moreover, an additional $1 in value of the earned income tax credit increases the likelihood of being over the poverty line by.94 percentage points" (Ault, et.al,. 2014.)

The Earned Income Tax Credit may enhance recipient's psychological outlook and provides a feeling of societal inclusion. In their 2015 study, "Dignity and Dreams: What the Earned Income Tax Credit means to Low-Income Families", Skyes, Kriz, Edin and Halpern-Meekin found that the credit provided a plethora of emotional and psychological benefits for recipients. In particular they found." Unlike recipients of other means tested government transfers the credit is seen as a springboard for upward mobility. Thus, by conferring dignity and spurring dreams, the EITC enhances feelings of citizenship and social inclusion" (Sykes, et. al., 2015.)

DRAWBACKS OF THE EARNED INCOME TAX CREDIT

As with all social welfare programs there are problems associated with the Earned Income Tax Credit. The most significant ones are discussed below.

The largest problem related to the Earned Income Tax Credit is the number of ***false and erroneous*** claims that are filed per year. The Treasury Department estimates that for 2012 between **21% and 25%** of the Earned Income Tax Credit filings were erroneous and between $11.6 and $13. 6 billion was paid out ***"improperly"*** (US Treasury 2016.)

Additionally, another problem associated with the Earned Income Tax Credit is that it may present a *disincentive* to marry. This is primarily due to the phase out or reduction of the credit at higher income levels. In a 2007 study "Rewarding Work of Individuals: A Counterintuitive Approach to Reducing Poverty and Strengthening Families", Gordon L. Berlin found that the negative effects of marriage on Earned Income Tax Credit eligibility was ***strongest*** when both spouses earned about the same amount. Berlin concluded that the current structure of the earned income credit, 'creates a disincentive to… marry for many" (Berlin, 2007.)

Ironically, lack of awareness of the credit has also been cited as a significant problem. The Internal Revenue Service estimates that **20%** of people who are eligible to receive the credit are not aware of their eligibility. Research suggests that non participation is highest among minorities and individuals with lower levels of education. (United States Treasury Department, 2016)

Unfortunately, a large portion of the Earned Income tax Credit is paid to tax preparers for their services including the problematic *refund anticipation loans*. The Internal Revenue Service reported that **52%** of Earned Income Tax Credit recipients used paid preparers in 2013. The Marguerite Casey Foundation in their 2015 study entitled "The Earned Income Tax Credit: Analysis and Proposals for Reform, estimated that the average cost of professional tax return preparation and refund anticipation loans is **12%** of a the recipient's Earned Income Tax Credit. The return preparation and loan costs are *staggering* in light of the fact that the Internal Revenue Service provides **free** tax return preparation for low income individuals and that the average-wait time for a refund on an electronically filed return is *only* 10 days. The Internal Revenue Service reported that less than **1%** of recipients took advantage of their free preparation services in 2013 (Casey, 2013.)

Ironically, the Earned Income Tax Credit may discourage savings by *disallowing* the credit to individuals with too much investment income. In 2015 for example, an individual was *ineligible* for the credit if their investment income was $3,400 or higher. Vada Waters Lindsey in her 2010 research paper, "Encouraging Savings Under the Earned Income Tax Credit: A Nudge in the Right Direction" concluded, "one significant flaw of the EITC that suggests modification is warranted is that recipients are not encouraged to save or invest their after tax income resulting from receipt of the EITC. In fact, the EITC discourages such use by denying taxpayers with excessive investment income access to the credit" (Lindsey, 2010).

DISCUSSION

In 2015 the Earned Income Tax Credit celebrated its 40th anniversary. Over the past 38 years between 1975 and 2013 the number of recipients *increased* approximately **350%** and the average payment *increased* approximately **1075%.** During that same time period 1975 to 2013 the population in the United States *increased* from 216 million to 316 million an increase of approximately **52%.** The total inflation between 1975 and 2013 was **386%.** Between 1975 and 2013 the Earned Income Tax Credit has grown at a rate of approximately three times the population and three and half times inflation. (U S Census Bureau, 2016)

During the 1990's the United States government had a policy shift from traditional welfare based benefit programs to work based benefit programs. This policy shift accounts for the large growth in the Earned Income Tax Credit program. Beginning in the mid 1990's the EITC program became the **largest** *antipoverty* program in the United States and it remains the largest antipoverty program to date. (Internal Revenue Service, 2016)

The Internal Revenue Service thus became the administrator of the largest needs based benefit program in the United States. Although the administrative costs of the program are low, according to the IRS less than **1%** of total program costs, the costs of *false* claims are high, according to the IRS, **21% to 25%** of total costs. Additionally, over **50%** of all recipients used a paid preparer in 2013. The average cost of a paid preparer is **12%** of the credit payment. Thus between **27% and 32%** of federal Earned Income Tax Credit payments are going to administration, erroneous claims and paid preparers. In 2013 alone these costs amounted to between **$17. 8 billion and $21.12 billion. (Casey, 2013)**

Temporary Assistance for Needy Families TANF is the second largest federal needs based program. In 2013, TANF costs totaled **$17.1** billion. Administrative costs of TANF are **7%** and the Health and Human Services Department estimates **15%** of program costs are paid out in *fraudulent* benefits. Therefore, in 2013 approximately**, 22%** of TANF expenditures were paid for administration and fraudulent claims. Thus, the TANF adjunct costs are between **5% and 10%** lower than the EITC adjunct costs. (U S Census Bureau, 2016)

Throughout the years the EITC program has garnered unprecedented support from both Democrats and Republicans. It is routinely heralded as the most successful antipoverty program in United States history. However, we are not sure the numbers support this conclusion. In 1975 **12.3%** of the population in the United States lived below the poverty line and by 2014 that amount had risen to **14.8%** of the United States population who lived below the poverty line. In 1975 2% of Gross Domestic Product (GDP), was spent on needs based welfare programs in and by 2015, **2.3** percent of GDP was spent on such programs.

Over the 40 years since the institution of the Earned Income Tax Credit the percentage of Americans living in poverty has ***increased*** and needs based welfare spending as a percentage of the GDP has ***increased***. As outlined above, research studies tout the benefits of the EITC program. A high profile study concluded that the EITC program has led to increased workforce participation especially among women. However, the researchers attribute the increase equally to the fact that starting in 1996 all federal needs based welfare benefits programs contained strict work requirements (Marr, 2015.)

Other successes attributed to the EITC program include increased maternal and infant health these studies conclude that each dollar of EITC refund correlate to an increase in maternal and infant health indices. I do not think the studies clearly show that EITC funds as opposed to just extra funds in general contribute to health increases (Hoynes, 2014).

The studies do show that the participants in the Earned Income Tax Credit program prefer receiving a tax *refund* over other forms of transfer payments. This is an important strength of the program (Sykes, 2015.)

Research has shown that the Earned Income Tax Credits may have some *negative* impacts on society in that it may provide disincentives to marry and save. Additionally, **20%** of those eligible for the program may not be aware of the program. Unfortunately, the more financially needy the person, the *less* likely they are aware of the program (Halpern-Meeken, 2015.)

CONCLUSION

Over the forty years the earned income tax credit program has been in existence the poverty rate has increased and spending on needs based welfare programs as a percentage of Gross Domestic Product has increased. The costs of *erroneous* claims, paid preparers and administration costs may be as high as **32%** of the total cost of the program. The program may provide <u>disincentives</u> to marry and save. **20%** of eligible people may not know about the program. Unfortunately, the poorer and less educated the person the less likely they are to know about the program (Greene, 2013.)

On the positive side the program may have increased workforce participation especially among single mothers. Furthermore, receipt of the credit has been associated with greater levels of educational attainment and increased maternal and infant health. Perhaps most importantly recipients of the earned income tax credit prefer it to other forms of needs based welfare programs.

To answer the question -is the earned income tax credit the most successful antipoverty program in history? The answer would have to be *no*. Although the program has clearly provided some important benefits to society the poverty rate and spending on needs based welfare programs have increased over the 40 years the program has been in existence and a truly successful antipoverty program should have decreased both of these measures.

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