THE CENTURY FOUNDATION

COMMENTARY ECONOMICS

Who the EITC Helps—And Why It Works

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Yesterday's blog post served as an introduction to the history, structure, and intent of the Earned Income Tax Credit (EITC)—our biggest assistance program for the working poor. It's come a long way since its inception during the Ford administration.

Today I'd like to turn to the questions of who receives the EITC, and just how effective the program is at lifting these working Americans out of poverty.

Who Is Eligible?

Eligibility for the EITC is determined primarily by three factors: earnings, qualifying children, and filing status.

As its name suggests, the EITC is contingent upon earned income. To qualify, a tax filer must have earnings—defined as wages, salaries, tips, long-term disability payments, and net earnings from self-employment or farm ownership—that are positive but also below the threshold determined by number of children and filing status. Not included as earnings are things such as Social Security, unemployment benefits, and child support. In 2014, the qualifying earnings thresholds range from $14,590 for a single person with no children to $52,427 for a married family with three children.

To be counted as a qualifying child, a child must (1) be less than age 19 at the end of the year (or age 24, if a full-time student); (2) be related to the tax filer through biology or adoption/foster care (in addition to sons and daughters, this includes, for example, younger siblings, grandchildren, and nieces and nephews); (3) be younger than the filer or filer's spouse; and (4) have resided at least six months of the year with the filer or filer's spouse in the United States. Further, only one tax filing unit can claim each qualifying child. Filers without qualifying children may still receive a credit, but the earnings limitations and maximum credit amounts are much smaller.

Finally, filing status—primarily, single, head of household (the status that applies to single filers with dependent children), or married filing jointly—determines the earnings level at which the credit phases out. People who are married filing separately may not claim the EITC.

In addition to the three main criteria, there are also a handful of subsidiary requirements. First, the filer, as well as her spouse and any qualifying children, must have valid Social Security numbers; the filer must also be a U.S. citizen or resident alien all year. Second, the tax filer must have annual investment income of $3,350 or less. Third, filers without qualifying children must be between the ages of 25 and 65 at the end of the tax year.

To claim the credit, filers with qualifying children who believe they eligible must complete the Schedule EIC supplement to the standard Form 1040/1040A required for income taxes—a process that is simplified considerably by readily available tax filing software. Filers without children can simply file the Form 1040/1040A/1040EZ.

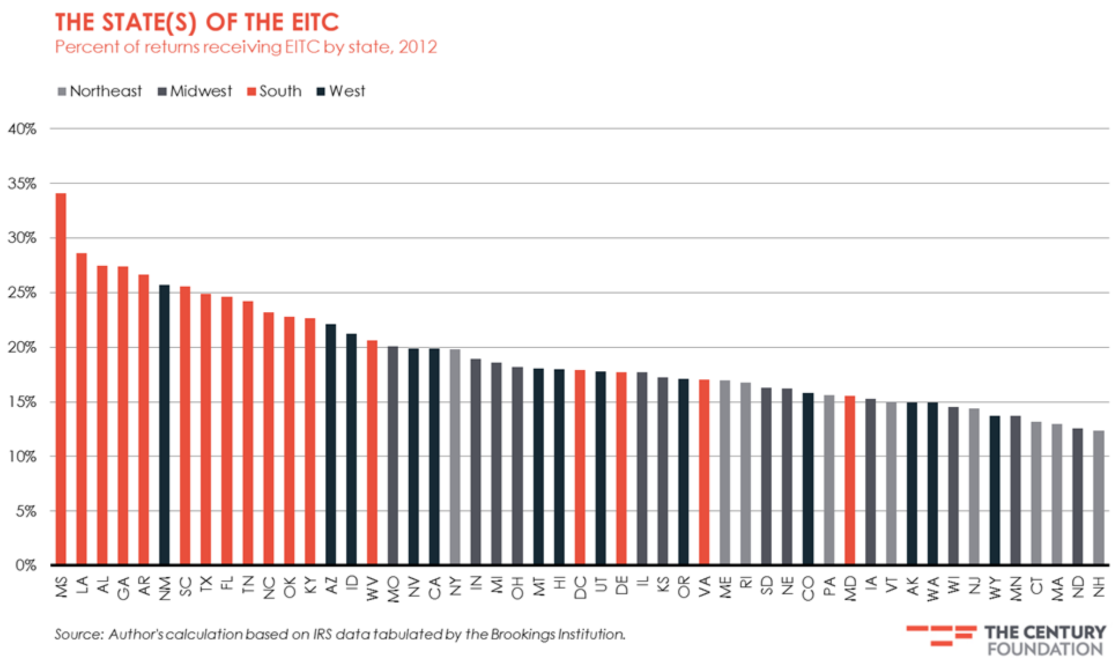
(Note: These are a summary of the eligibility requirements affecting most tax filers; for a complete list, see the official IRS documentation.)

One final word on eligibility. If you or someone you know may be eligible for the credit, it's worth understanding two potential misconceptions. First, the EITC does not count as income for purposes of determining eligibility for other federal means-tested safety net programs. So an EITC check will not disqualify you from Medicaid or food stamps. (However, if you save money from the credit for over twelve months, it is possible the savings could be deemed a resource for eligibility purposes.) Second, individuals and families who were eligible for the EITC in prior years but did not claim it have three years to do so retroactively. So, if you think you were eligible for a credit in 2011 but failed to claim it, you have until April 17 of this year to do so.

How Many Americans

What do these eligibility standards translate into in terms of demographics of the recipient population? Based on an analysis of Census data, the Brookings Institution estimates 73 million Americans, of which 32 million are children, reside in EITC-eligible tax units (roughly speaking, families). About a quarter file as singles, a quarter as married, and the remaining half as head of household (unmarried, but providing for more than half the living costs of another person). Median adjusted gross income among the EITC-eligible is $14,100, and slightly more than a third receive food stamps. Compared to Americans overall, the EITC universe is less educated (52 percent have only a high school education or less) and more likely to be minority (19 percent are black and 24 percent are Hispanic). Most commonly, recipients work in low-paying industries such as retail, food services, and health care.

Geographically, EITC receipt is concentrated in the South, particularly the Southeast (which is also where the concentration of poverty is the highest). Leading the way is Mississippi, where 34 percent of filers claim the credit, followed by Louisiana (29 percent), Alabama (28 percent), Georgia (27 percent), and Arkansas (27 percent). Northern states, both in the Northeast and the Midwest, have the lowest claiming rates, with New Hampshire at 12 percent, North Dakota at 13 percent, and Massachusetts, Connecticut, Minnesota, Wyoming, and New Jersey all between 13 and 14 percent. In raw dollars, the most populous states claim the lion's share of credits, with California, Texas, Florida, and New York accounting for $23.6 billion in claims—more than a third of the total nationwide.



Is the EITC Effective?

The effectiveness of the EITC can be evaluated across several dimensions, the two most important of which are reducing poverty and increasing work.

By putting more money directly in the pockets of low-income workers, the EITC—arithmetically and unsurprisingly—makes its recipients less poor. According to the Center on Budget and Policy Priorities (CBPP), the EITC pushed 6.2 million people from below the poverty line to above it in 2013; in addition, it made 21.6 million people less poor than they otherwise would have been. Children in particular have benefited, with 3.2 million of them rising above poverty thanks to the EITC, a reduction in child poverty of 20 percent. Indeed, together with the Child Tax Credit—which offers a 15 percent refund for earnings over $3,000, up to a maximum of $1,000 per qualifying child—the EITC improves living standards for 32 million low-income Americans.

But lots of income transfer programs can reduce poverty; what sets the EITC apart is its role in encouraging employment. A large body of research dating back to the 1990s has found that the EITC incentivizes work. One of the most important early studies, by Nada Eissa and Jeffrey Liebman in 1996, found that the 1980s expansion of the EITC increased labor force participation among single mothers by 2.8 percentage points. In the 1990s—where an even larger expansion of the EITC was paired with welfare reform—the effect was even larger. During this decade, labor force participation among female-headed households—and especially among those headed by single moms—rose dramatically; according to an oft-cited study by Jeffrey Grogger, the EITC could account for as much as a 7.2 percent point increase in employment among this demographic, making it the "single most important policy measure for explaining the decrease in welfare and the rise in work and earnings among female-headed families."

Notably, these findings—and many other like them—apply to the so-called extensive margin of labor supply (whether or not someone chooses to work), rather than the intensive margin (once working, how many hours someone works). In part, the EITC's greater impact on the extensive margin is why it has been successful: the phase-in of the credit induces people who otherwise wouldn't work to get jobs, while the high marginal tax rates associated with the phase-out haven't been a deterrent to clocking more hours.

However, more recent research has found that the reason for the lack of intensive-margin findings is not that they are trivial, but rather that it just takes time for people to learn the idiosyncrasies of tax policy changes and adjust their behavior accordingly. Indeed, once the policy is fully understood, adjustments to work hours may be just as impactful as the decision whether work at all. And here, again, there is more good news: the evidence suggests the EITC increases hours in the phase-in region far more than it reduces hours in the phase-out region, meaning that, if anything, past estimates of the EITC's effectiveness have been understating things. With more employment and more hours come more earnings—which means that not only does the EITC reduce poverty directly, by giving low-income household cash refunds, but it also does so indirectly, by motivating people to lift themselves out of poverty.

That the EITC generates limited work disincentives is important, as such labor market distortions are one of the principal downfalls of safety net programs and tax policy alike. But along with improved employment and earnings come a range of other positive outcomes for low-income families. The EITC has been credited with improving infant health; raising children's test scores; boosting college enrollment; reducing teen birth rates; and increasing earnings in adulthood. And, of course, there is a substantial literature documenting the association between income and many of life's most desirable experiences, including good health, life satisfaction, and happiness (in some cases, in absolute standards; in others, in relative terms). Higher incomes may also lead to higher marriage rates (earnings prospects make potential partners more attractive), lower incarceration rates, and better neighborhoods.

As impressive as the EITC's positive impact is, however, it's far from a perfect program. Tomorrow, in the third and final part of our Tax-Week Series on the EITC, we'll discuss three major ways the credit can be improved.