

## A LADDER UP

Why Young And Childless Americans Are Excluded From  
The Earned Income Tax Credit And How We Can Expand It

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## Introduction

Today, the Millennial generation, or those born between 1980 and 2000, lag behind previous generations at the same age in critical measures of economic welfare such as employment, income, and poverty. In fact, a higher percent of Millennials live in poverty today, regardless of education, than the immediate previous generation at a similar point in their lives.<sup>1</sup>

Despite the grim economic reality, one of the largest and most effective antipoverty programs, the Earned Income Tax Credit (EITC), excludes young and childless adults.

Lawmakers must ensure policies like EITC, which has a strong track record of lifting workers out of poverty and moving its beneficiaries from poverty to work, include more young Americans who are facing historic economic strife. Not only does it make sense to support policies that expand economic opportunity for more Americans, but 81 percent of Millennials and 77 percent of the American public support expanding tax credits, like EITC, that help families with low-wage jobs to reduce poverty and increase economic outcomes.<sup>2</sup>

This report outlines how it works, the EITC's track record of success, how it misses young and childless workers, and why and how EITC should be expanded.

Specifically, we believe lawmakers should improve the Earned Income Tax Credit for young, childless workers by taking eight key actions:

1. Lowering the eligibility age for childless workers to 18 years old.
2. Increase the maximum credit for childless workers.
3. Significantly boost the credit's phase-in and phase-out rates, as well as the credit's phase-out range.
4. Utilize EITC to trigger student loan assistance and financial aid.
5. Create an EITC rainy day fund to curb predatory lending and capitalize on upward mobility opportunities.
6. Encourage broader use of EITC as a way for young people to build savings.
7. Make the American Recovery and Reinvestment Act of 2009 EITC enhancements permanent.
8. Expand EITC awareness programs.

### What Is The Earned Income Tax Credit And How Does It Work?

EITC rewards work by allowing low-income workers to keep more of what they earn at tax time. The credit is delivered in lump sum between February and April to low-income individuals who earn income from

## Tax Credit vs. Tax Deduction

**Tax credits and deductions both reduce the amount that you pay in taxes; however, tax credits and deductions reduce an individual's tax obligation in very different ways.**

**A tax deduction reduces a taxpayer's taxable income.**

**For example, a taxpayer with \$30,000 in taxable income pays a 15 percent marginal tax rate, and has \$5,000 in tax deductions. The taxpayer saves \$750 (\$5,000 x 15 percent).**

**In contrast, a tax credit simply reduces the tax amount owed by an individual. For example, if an individual owes \$1,000 in taxes and has \$300 in tax credits then the individual owes the difference between his/her tax liability (\$1,000) and the credit (\$300), which amounts to his/her owing \$700 in taxes.**

wages, salaries, or tips and is refundable which means that the credit can result in a negative tax bill if the tax credit is larger than the tax bill. In contrast, a nonrefundable tax credit cannot reduce the tax burden to less than zero.

The credit increases the more a worker earns until it plateaus and reaches a maximum. Then, the credit begins to decrease as earnings increase until it is no longer available.

People with or without children are eligible for the tax credit. However, those *without* children must be between the ages of 25 and 65 in order to be eligible.

The credit's overall size and phase-in and phase-out rates are determined primarily by three things: 1) the number of children in a family, 2) the family's income, and 3) the tax-filer's marital status.

The size of a family is bucketed into four categories: families with no children, one child, two children, and three or more children. The more children a worker has, the greater the size of the tax credit given the level of income. Additionally, for married couples, the credit phases in and out of the maximum at much higher levels of income.

Below are examples of how children, marital status, and income affects the size of an individual's credit. Note how childless workers are doubly penalized – they are less likely to be eligible, and even if they are, they get a much smaller benefit or none at all.

Assume the primary earner is the only earner in the household, earns a minimum wage of \$15,080 annually,<sup>3</sup> and hopes to take advantage of 2013 values for the Earned Income Tax Credit.

Calculations for examples one through five are made using Center on Budget and Policy Priorities 2013 Federal Earned Income Tax Calculator.<sup>4</sup>

**EXAMPLE 1: 26-year-old, married worker with one child.**

This family is eligible for the maximum credit for one child, earning \$3,250 in EITC. Additionally, since they are married, they can earn the maximum credit even if they earned almost \$8,000 more. If they were single, they could only earn roughly \$2,000 more before the credit started phasing out.

**EXAMPLE 2: 28-year-old single, worker with two children.**

This family is eligible for the maximum credit for two children, earning \$5,372 in EITC, and continues to be eligible for the credit even if they earned about \$2,500 more.

**EXAMPLE 3: 35-year-old, single worker with three children.**

This family is eligible for the maximum credit for three children, earning

## Refundable vs. Nonrefundable Tax Credits

There are two main types of tax credits: nonrefundable and refundable. The difference between them determines the extent to which an individual's liability is reduced.

A nonrefundable tax credit only reduces a taxpayer's tax liability to zero, regardless if the tax credit is larger than the liability. For example, if a nonrefundable tax credit is \$2,000 and the taxpayer's liability is \$1,000, then the taxpayer's obligation will be \$0.

However, a refundable tax credit allows a taxpayer to actually receive a payment from the government if the credit is larger than the liability. For example, if a refundable tax credit is \$2,000 and the taxpayer's liability is \$1,000 then the taxpayer will receive a \$1,000 payment which is the difference between the credit and the liability (\$2,000-\$1,000).

\$6,044 in EITC, and continues to be eligible for the credit even if they earned about \$2,500 more.

**EXAMPLE 4: 27-year-old, single and childless worker.**

This worker is ineligible for EITC because their annual income is above the amount the credit fully phases out.

**EXAMPLE 5: 21-year-old, single and childless worker.**

This worker is ineligible for EITC because they are below the age limit for childless workers and even if they were eligible age-wise, they would not receive EITC because their earning is too high.

### The Earned Income Tax Credit Effectively Boosts Key Socioeconomic Outcomes

The Earned Income Tax Credit was originally conceived in 1974 when President Ford signed into law the Tax Reduction Act of 1975. A Finance Committee report at the time stated the Earned Income Tax Credit aimed to “assist in encouraging people to obtain employment, reducing the unemployment rate, and reducing the welfare rolls.”<sup>5</sup>

Nearly four decades after its inception, the EITC has been effective at meeting each of its stated goals and has been expanded significantly numerous times by presidents from both parties. The credit has proven to reduce poverty, boost take home pay, increase labor force participation, and even reduce income inequality.

#### Reduces Poverty

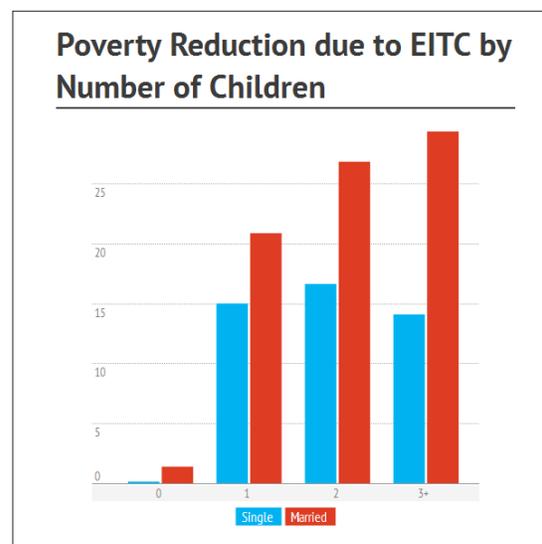
The Earned Income Tax Credit is one of the country’s largest antipoverty programs,<sup>6</sup> second only to Social Security. It effectively reduces poverty and increases employment for low-income Americans. In 2012 alone, more than 27 million people received over \$63 billion in credits,<sup>7</sup> which lifted 6.5 million people out of poverty, including 3.3 million children.<sup>8</sup>

More specifically, the U.S. Census Bureau found that refundable tax credits targeted to the poor—which largely consist of EITC benefits—reduced poverty by three percentage points.<sup>9</sup> Furthermore, additional research suggests that EITC reduces reliance on other poverty programs.<sup>10</sup>

#### Boosts Take Home Pay And Generates Economic Activity

EITC is successful because the tax credit enhances the bottom line for cash strapped workers and becomes a vital component of a recipient’s budget. Recipients have been shown to spend the credit toward existing needs, such as childcare expenses and increasing savings.<sup>11</sup>

For example, a mother from Sunnyside, NY, quoted in a report from the



Source: Congressional Research Service.

Center for American Progress noted that she uses EITC for crucial things like paying her bills and supporting her child.<sup>12</sup>

*"[The Earned Income Tax Credit] has met my basic needs, helped me pay my property tax, get caught up on utilities, buy a winter coat, and allowed me to make a deposit so my son could go to college...the EITC has given me more dignity."*

Since low-income workers with tight budgets will likely put their tax credit right back into the economy, it benefits everyone. Economists estimate that EITC generates \$1.50 to \$2.00 in economic activity for every \$1 that a low-income family receives.<sup>13</sup> A conservative estimate of economic activity generated by EITC in 2012 alone is roughly \$94.5 billion.<sup>14</sup>

Additionally, research finds that those receiving the EITC tend not to be the same group year after year; for example, a study of recipients between 1989 and 2006 showed that 61 percent claimed the credit for only one or two tax years, due to periods of income shock or change in family structure. The EITC helps families overcome these income shocks and promotes upward mobility; thus, allowing many recipients to become net contributors to the tax system in subsequent years. This makes the EITC a fiscally prudent policy because it can pay for itself.<sup>15</sup>

The Center for Budget and Policy Priorities also reported that taxpayers who claim EITC at least once from 1989 to 2006 paid a few hundred billion dollars more in federal income taxes over the period than they received in EITC benefits.<sup>16</sup> Therefore, EITC can pay for itself because workers eventually pay back into the tax code after they have received assistance.

The Earned Income Tax Credit can also encourage financial stability by boosting savings. The median-aged Millennial has zero retirement savings.<sup>17</sup> Also, many have little short-term savings. In a recent national study, roughly half of all Americans age 18 to 34 surveyed reported that they would "probably not" or "certainly not" be able to come up with \$2,000 in 30 days to deal with an unexpected expense, such as a car repair or medical emergency.<sup>18</sup> Even more striking, a new Federal Reserve study found that less than half of households at all age groups would be able to cover an emergency expense of \$400 without borrowing or selling something.<sup>19</sup> But by saving a portion of one's tax refund, Millennials have an opportunity to become more economically secure.

### Increases Labor Force Participation

The substantial size of the credit coupled with the credit's importance in a family's budget makes EITC a powerful work incentive. A study by Harvard University and the National Bureau of Economic Research shows there is a strong correlation between expanding EITC for a particular group and a rising labor force participation rate. EITC expansions from 1984 to 1996 progressively made the credit more salient for female workers with children over workers without children. Accordingly, during that span of time, the labor force participation gap between single females with

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children and without children decreased by 10 percent.

In fact, more than half of the significant rise in labor force participation for single, low-income mothers (the program's largest beneficiaries) is attributed to EITC expansions from 1984 to 1996. Moreover, the tax credit disproportionately benefited the most economically disadvantaged single, low-income mothers, many with low levels of education.<sup>20</sup>

Expanding EITC not only increases the percentage of individuals who work in the labor force, but also a recent study shows it increases the amount they work.

A study led by Harvard professor Raj Chetty found that in areas with high knowledge of the EITC schedule, workers changed their earnings by working more hours or reporting self-employment to receive a larger EITC credit relative to areas with little knowledge of the credit.<sup>21</sup>

### Reduces Income Inequality

Further, EITC's ability to lift up the most economically disadvantaged workers directly combats the trend of rising income inequality. Since the mid-1970s, the national share of income going toward low- and middle-income workers has declined, while the share of income going toward the wealthiest has increased.

By making work pay for low-income workers, research conducted by Harvard University and the National Bureau of Economic Research, showed that the Earned Income Tax Credit has slowed the trend of rising inequality. From 1976 to 1996, the EITC offset 23 percent of the decline in income for the lowest fifth of income earners and 10 percent of the decline in income for the second fifth of income earners.<sup>22</sup>

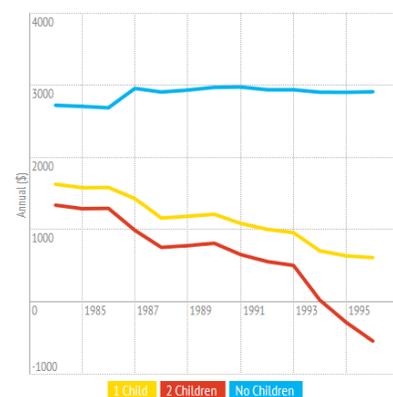
Although the evidence is clear that EITC is one of the country's most effective tools for directly improving the economic well-being of low-income Americans, it is largely unavailable to a large number of young adults.

### The Earned Income Tax Credit Does Not Work For Young, Childless Adults

For young workers with children, EITC is incredibly popular. A study that analyzed EITC usage from 1989 to 2006 for workers with children found that 70 percent of taxpayers that receive EITC are in their 20s and 30s.<sup>23</sup> Almost half of EITC beneficiaries first use EITC while they are in their 20s.<sup>24</sup>

However, if a low-income worker is young and does not have children, the Earned Income Tax Credit is ineffective for two reasons.

### Federal and State Income Taxes for Working, Single Women



Source: Congressional Research Service.

**1. Individuals without children under 25 years old are ineligible for EITC**, which leaves out millions of struggling younger Millennials (18 to 24) that are just starting their careers or are underemployed.

**2. Single, childless households that are eligible for EITC receive meager credits**, which hurts Millennials overall because 33.6 percent do not have children.<sup>25</sup>

### The Case For Expanding EITC For Young Adults

The gaps in the program for young childless workers are based on arguments that are no longer valid. During the last EITC expansion in 1993, the Internal Revenue Service had no way of identifying tax filers as students; thus, Congress set the eligibility age for childless workers to 25 years old in order to avoid giving the Earned Income Tax Credit to college students assumed to be supported by family who only temporarily have low incomes.

As a result, young low-income workers who are not in school and/or are not relying on their parents cannot receive the credit during a vital period of their career development. The IRS today does have the ability to identify the dependent status of students, and they should modernize EITC requirements and extend the credit to younger workers or students working to put themselves through school.

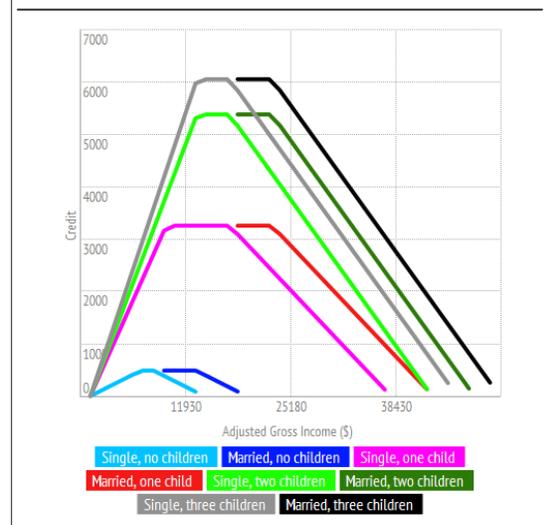
Under the current system, a recent high school graduate entering the workforce would need to work seven years before they are eligible for the tax credit. EITC should be available right out of school because EITC primarily helps workers with little education – 52.6 percent of EITC recipients have a high school degree or less.<sup>26</sup> It is simply unfair that these young workers with little education, who are likely earning low wages, are not eligible for a tax credit that could improve their bottom line because of outdated policies.

Finally, ineligible low-wage workers are not only “missing out” on the benefits of the EITC, but are actually *disadvantaged* by current EITC policy.

EITC has successfully increased the labor supply of workers with children who are eligible for a large credit. Although that is positive for families with children, because it tends to increase their family income, these workers compete with (ineligible) childless workers for jobs. When labor supply increases, wages tend to decrease (unless there is a strong minimum wage in place).

Accordingly, a 2010 study on the wage effects of the EITC, for example, found that a 10 percent increase in the EITC led to a two percent decrease in the hourly wages of high-school educated workers—and a five percent

**Value in 2013 of the Earned Income Tax Credit for Single and Married Workers**



Source: Internal Revenue Service.

decrease in the wages for workers with less than a high school degree.<sup>27</sup>

For families with children, this wage decrease is more than outweighed by the benefit they receive from the EITC. However, ineligible childless workers experience the same pay cut—but do not receive nearly enough in EITC benefits to offset this. Without a more “level playing field” for young and childless workers, Millennials will continue to experience a significant disadvantage in the labor market. For young workers just entering the job market, this disadvantage may come at a time when they most need a “leg up” to establish financial viability.

### The Case For Expanding EITC For Childless Workers

We need to have a more robust EITC for childless workers. Those that argue that childless workers should receive a smaller benefit because raising children simply requires more resources make a logical argument; however, current credit levels for childless workers make the program ineffective for them.

The Congressional Research Service found that the EITC hardly made a dent in reducing poverty for childless workers while successfully reducing poverty by nearly 15 percent or more for families with children.<sup>28</sup>

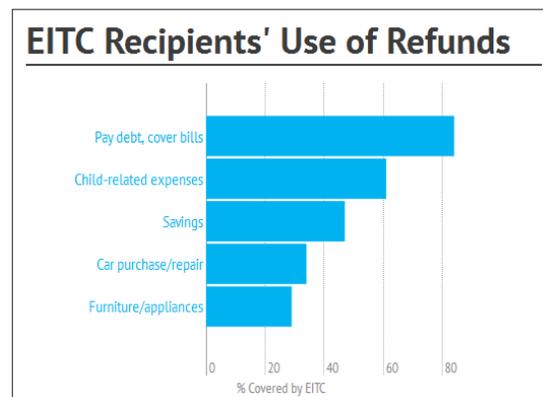
Furthermore, data from a Government Accountability Office (GAO) report found that individuals without children have the lowest eligible participation rates in the program.<sup>29</sup> This is likely because many childless adults do not sign up for EITC because it does not provide meaningful financial support.

For example, the maximum credit for a childless worker is only \$496, which is 11 times less than the maximum credit of \$5,460 for a beneficiary with two children.

Additionally, in 2011, EITC recipients with no children made up a quarter of the filers but only received three percent of the benefits.<sup>30</sup> We should expand benefits to childless workers so that the program is as effective for these workers as it is for workers with children.

In addition to fewer benefits, the credit begins to phase out too early for childless workers. Specifically, the credit begins to phase out at an annual income of \$8,110, which is roughly \$3,600 less than the poverty line<sup>31</sup> and \$7,000 less than the annual income of a minimum-wage worker.<sup>32</sup> As a result, childless workers who are hovering near the poverty line are ineligible for EITC because they make too much to qualify.

The combination of meager credits and an early phase out for workers at or near the poverty line makes EITC ineffective for young childless workers.<sup>33</sup> In fact, as a result of an inadequate EITC, young,



Source: *The Role of Earned Income Tax Credit in the Budgets of Low – Income Households* by Ruby Mendenhall.

childless workers are the only group that can be taxed into or deeper into poverty.<sup>34</sup>

For example, a childless, young, single woman in 2013 who earns a near poverty level wage of \$13,000 pays \$2,314 in federal income and payroll taxes and only receives \$101 in EITC benefits. Together, her after-tax income is \$10,787 which is \$700 below the poverty. According to Center on Budget and Policy Priorities, this situation is not uncommon. In 2012, 7 million childless workers were taxed below or further below the poverty line, and of those 7 million workers, 3 million (43 percent) were under the age of 30 and 2.2 million (31 percent) were between the ages 18 and 24.<sup>35</sup>

The regressive tax burden for young, low-income, childless workers is largely a failure in policy. Before a series of EITC expansions between 1984 and 1996, tax burdens for single mothers with and without children were uniformly high. However, because of targeted EITC expansions for workers with children from 1984 to 1996, tax burdens went down almost \$1,900 for single mothers with two children and \$1,000 for single mothers with one child. At the same time, the tax burden for childless women actually increased by nearly \$200.<sup>36</sup>

### The Earned Income Tax Credit Can Address Historic Economic Challenges Facing Young Americans

It's impractical that young childless adults by and large cannot receive EITC because they are facing historic economic challenges such as declining wages, declining workforce participation, rising poverty, and rising income inequality that can be directly addressed by a more salient tax credit.

#### Declining Incomes

Roughly 60 percent of young Americans do not have higher education degrees and could benefit significantly from higher take home pay. According to an analysis by the Economic Policy Institute (EPI), the real average hourly wages of recent high school graduates since 2000 has declined by 10.8 percent.<sup>37</sup>

Recent high school graduates that do not go on to receive a higher education should be the target of a more salient EITC, not only because their wages are declining but because they also tend to receive less pay in general because of their lack of work experience and education.

#### Declining Labor Force Participation

As a result of a deteriorated labor market from the Great Recession, there are nearly 1 million young "missing workers"—workers who don't have a job or are not looking actively for work under the age of 25.<sup>38</sup>

Because the labor force participation rate (LFPR) fell twice as much for young men than for older workers since the Great Recession, a significant portion of young missing workers are likely young men.

## Left Further Behind: LGBT Workers And EITC

A report by Generation Progress called: *Left Behind How LGBT Young People Are Excluded from Economic Prosperity* found that the current EITC continues to leave many LGBT young people in a coverage gap.

Data suggests that LGBT young people have children at a later age than their non-LGBT counterparts—of which almost half will have a child before age 25, meaning they can qualify for the EITC. This means that childless LGBT young workers ages 18 to 24, who experience high rates of poverty, miss out on one of the federal government's largest anti-poverty program. Additionally, the current EITC allows married young couples to receive larger benefits at modestly higher income levels. The average age of marriage for non-LGBT workers is significantly less than their LGBT counterparts meaning they can get the added benefit earlier and for more time.

The combination of age restrictions, requirements around children, and older average age of marriage means that the EITC leaves thousands of LGBT young people without the benefits that their non-LGBT contemporaries enjoy.

A study conducted by Georgetown's Center on Poverty, Inequality, and Public Policy said a contributing factor to the decline in LFPR for men during the 1990s was because EITC expansions during this time was not targeted to them, but rather to low-income women with children.<sup>39</sup>

The same Georgetown study recommends that if we expand EITC and increase the returns to work for those without children, the labor force participation for all workers, but particularly men would increase.

### Rising Rates Of Poverty

In addition, partly as a result of declining incomes and participation in the work force, poverty increased from 2006 to 2012 by 23 percent for young adults ages 18 to 24. By 2012, this cohort comprised of one-fifth of those in poverty—more than any other adult age group.<sup>40</sup>

According to the Center on Budget and Policy Priorities (CBPP), EITC can reduce poverty in two ways by 1) supplementing wages of low-income workers and 2) encouraging work.<sup>41</sup> Thus, if we expand EITC to include more young people, rates of poverty of young Americans could begin to fall as well.

### Recent Targeted EITC Expansions Have Had Dramatic Results And Research Shows An Extension To Young, Childless Workers Would Be Effective

Although it can be hard to believe that simply extending a tax credit to young, childless workers can effectively meet the significant economic challenges facing young adults, previous targeted EITC expansions have had dramatic and swift results for their beneficiaries.

The 1993 EITC expansion under President Clinton is a good example of the quick and dramatic effects of targeted expansions of EITC. Before the expansion in 1993, single mothers with *two or more children* only earned \$490 more in maximum EITC credit than *single child* mothers, thus, there was not a significant difference for work incentives between the two groups.<sup>42</sup>

After the expansion was passed in 1993, the maximum credit with *one child* increased by nine percent and the maximum credit for families with *two children* or more increased by 69 percent—nearly tripling the maximum

## The Earned Income Tax Credit And The Minimum Wage

The Earned Income Tax Credit (EITC) and the minimum wage are both policies that are intended to raise the incomes of low-income Americans. Conservative activists often argue that expanding EITC is far better at achieving the goal of raising earnings for low-income workers than the minimum wage. However, studies show that the minimum wage and EITC should be viewed as complements not as alternatives.

In the absence of a strong minimum wage a portion of the EITC will be captured by employers by lowering wages. A study by Jesse Rothstein from Princeton University shows that wage subsidies, like EITC, which are intended to go directly to the employee are actually partially captured by the employer. All else equal, a EITC recipient only keeps \$0.70 of every EITC dollar they receive and employers receive roughly \$0.72—\$0.30 from EITC eligible workers and \$0.42 from EITC ineligible workers.<sup>i</sup>

Another study by Andrew Leigh in *The B.E. Journal of Economic Analysis & Policy* found that a 10 percent increase in the EITC is associated with a five percent fall in wages of a high school dropouts and a two percent fall in the wages with those only with a high school diploma.<sup>ii</sup>

What this means is that even though EITC increases after-tax income for eligible workers, employers will lower before-tax income of their workers. EITC recipients are compensated by the loss in before-tax income because they receive a tax credit, however, workers ineligible for the credit receive no compensation and are worse off.<sup>iii</sup> A higher minimum wage would prevent the income capture by employers and improve the bottom lines for workers who are currently ineligible for EITC.

Expanding the minimum wage is particularly crucial for young Americans since 71 percent of minimum wage workers are Millennials.<sup>iv</sup> Furthermore, 85 percent of young Americans support raising the minimum wage and 81 percent of young Americans support expanding refundable credits like EITC to combat poverty.<sup>v</sup>

Clearly, there is no silver bullet. If the goal is to raise the earnings of hardworking low-income Americans, we need to expand the Earned Income Tax Credit and increase the minimum wage together.

credit for families with two or more children to \$1,404 in 1996.

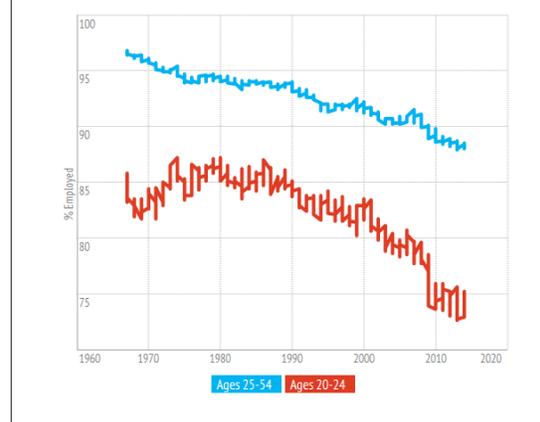
Ultimately, the expansion increased the probability that mothers with two or more children would be in the workforce by 4.3 percent relative to single-child mothers.<sup>43</sup>

After the 1993 expansion went into effect, the participation in poverty programs for single mothers with two or more children decreased annually, while participation in the workforce increased annually. Recently, the EITC expansion in the 2009 Recovery Act increased the credit for families with three or more children and reduced poverty rates for these families by 2.6 percent.<sup>44</sup>

Moreover, research shows that a theoretical EITC expansion to young, childless workers would assist millions. A recent and tempered proposal from the Treasury Department that decreases the age limit to 21 and doubles the maximum credit to \$1,000, would help 3.3 million workers between the ages 21 and 24.<sup>45</sup>

The Georgetown Center on Poverty, Inequality, and Public Policy's proposal to expand EITC would lower the age limit to 21 and increases the maximum credit to childless workers to \$2,726. This proposal would benefit roughly 4.3 million workers between the ages of 21 to 24.<sup>46</sup> The Georgetown Center also believes that expanding EITC would disproportionately expand economic opportunity for less-educated, young men of color, a demographic that face structurally high unemployment rates.<sup>47</sup>

### Labor Force Participation Rate among Young Men



Source: Bureau of Labor Statistics.

### Expanding The Earned Income Tax Credit Has Bipartisan Approval And Is Gaining Momentum

Expanding EITC is not only good public policy, but it is a rare point of agreement from elected officials and thought leaders across the aisle.

President Obama noted in his State of the Union Speech that “[EITC] does not do enough for single workers who do not have kids. So let’s work together to strengthen the credit, reward work, and help more Americans get ahead.”<sup>48</sup>

Glenn Hubbard, former Chair of the Council of Economic Advisers for President George W. Bush argued that expanding EITC was one of the best ways to tackle income inequality and that “increasing the credit for childless workers to an amount closer to that for families with children would augment the direct work incentive and help counter poverty among the working poor.”<sup>49</sup>

Even previous expansions of the Earned Income Tax Credit have

traditionally been supported by both parties. The credit was signed into law by President Ford in 1975 and was expanded in 1986 under President Reagan, 1990 under President H.W. Bush, 1993 under President Clinton, and in 2009 under President Obama.

In fact, President Reagan called the EITC “the best antipoverty, the best pro-family, the best job creation measure to come out of Congress.”<sup>50</sup>

Recently, expanding EITC to include young, childless adults has gained legislative momentum. In the past year and a half, there have been four major bills and two proposals in Congress and from President Obama that expand EITC to young, childless workers.

“The Working Families Tax Relief Act of 2013”/“The Earned Income Tax Credit Improvement and Simplification Act 2013” (S. 836)/ (H.R. 2116) Introduced By Senators Brown (D-OH) And Durbin (D-IL) And Representative Neal (D-MA)

The Brown, Durbin, and Neal proposal makes the improvements to EITC in the Recovery Act permanent.<sup>51</sup> The Recovery Act added a third level of EITC for families with three or more children and allowed this group to be eligible to receive up to \$672 more in tax credits. The bill also lowers the eligibility age for childless workers from 25 to 21, increases the phase-in and out rates to offset payroll taxes<sup>52</sup> from 7.25 percent to 15.3 percent, and triples the maximum credit to roughly \$1,350.<sup>53</sup>

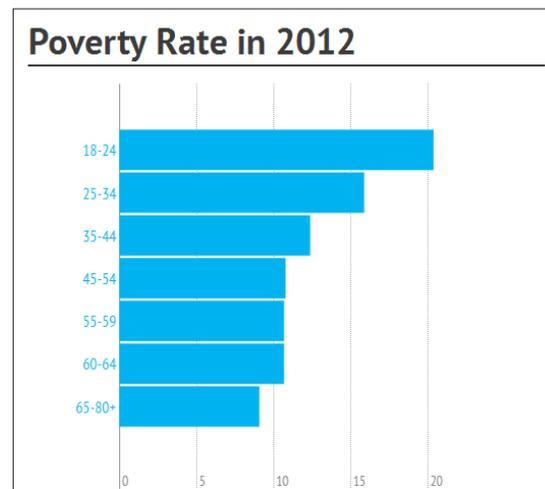
The bill also simplifies the credit by making it easier for parents to understand who claims a child and makes the enhancements in the Child Tax Credit in the Recovery Act permanent.<sup>54</sup>

“Twenty-First Century Worker Tax Cut Act” (S. 2162) Introduced By Senator Murray (D-WA)

The Murray bill, like the Brown, Durbin, and Neal proposal expands EITC by lowering the eligibility age for childless workers from 25 to 21, increases the phase-in and out rate from 7.25 percent to 15.3 percent, and nearly triples the maximum credit from roughly \$500 to roughly \$1,350.<sup>55</sup> Full-time students are barred from the program. A student is considered full-time if they have more than half the normal work load required for their studies.

Murray’s bill also makes EITC more effective by doubling the penalty for tax return preparers who make improper EITC payments and cuts taxes for dual earning households by allowing a 20 percent deduction on a second earner’s income.<sup>56</sup>

Murray proposes paying for the EITC expansion by closing tax loopholes for CEOs and preventing corporations from skirting their tax obligations by putting their profits in tax havens overseas.<sup>57</sup>



Source: Census.

## “EITC For Childless Workers Act Of 2014” (H.R. 4117) Introduced By Representative Rangel (D-NY)

The Rangel bill is focused on extending EITC to childless workers and has four main provisions. It drops the qualifying age for childless workers from 25 to 21, increases the phase-in and phase-out rates from 7.65 to 23.15 percent, and triples the maximum EITC for childless adults from roughly \$500 to \$1,500.<sup>58</sup>

The bill also significantly increases the range of the credit for childless workers by phasing out at higher amounts of income. For single, childless workers, the amount the credit begins to phase-out increased from \$8,110 to \$16,630 and the amount the credit fully phases-out increased from \$14,590 to \$23,110.<sup>59</sup> For married childless workers, the amount the credit begins to phase-out increased from \$13,540 to \$24,630 and amount the credit fully phases-out increased from \$20,020 to \$31,110.<sup>60</sup>

### President Obama’s Proposal

President Obama made expanding EITC the centerpiece of his FY2015 budget. The President’s proposal also lowers the eligibility age for childless workers from 25 years old to 21 years old and doubles the phase in and out rates from 7.25 percent to 15.3 percent.<sup>61</sup>

The beginning phase-out range for single, childless workers would be increased from \$8,220 to \$11,500 and the amount the credit fully phases-out would be increased from \$14,790 to \$18,070.<sup>62</sup> For married childless workers, the beginning phase-out range would be increased from \$13,720 to \$17,000 and the amount the credit fully phases-out increases from \$20,290 to \$23,570.<sup>63</sup>

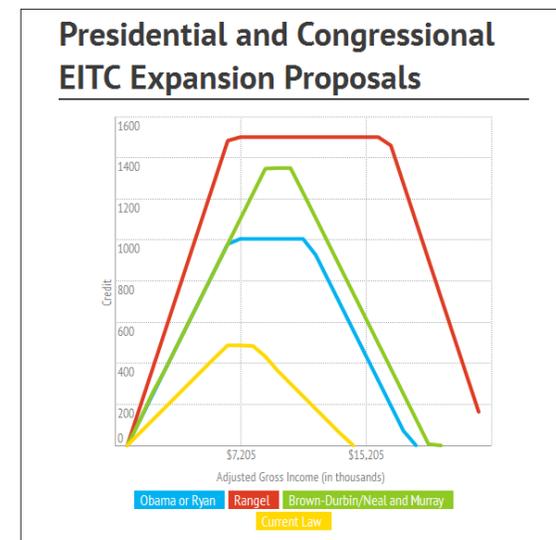
The administration also doubles the maximum credit for childless workers at \$1,000, which is smaller than the Congressional proposals.<sup>64</sup> The Treasury Department estimates the administration’s proposal to expand EITC to young childless workers would assist 3.3 million childless workers.<sup>65</sup>

### Senator Rubio’s (D-FL) Proposal

Senator Rubio’s proposal is short on details, but makes drastic reforms to EITC. His proposal turns EITC into a direct wage supplement, which would apply to single adults the same as it would to married couples and families with children.<sup>66</sup> The credit would also be administered monthly instead of a yearly lump sum.<sup>67</sup> Rubio indicated that he would like his proposal to be budget neutral, which would likely result in cuts in program to recipients with children to make room for childless workers.<sup>68</sup>

### Representative Ryan’s (R-WI) Proposal

Representative Ryan, the Republican House Budget Committee Chairman, proposed an EITC expansion to young and childless workers that is fairly similar to President Obama’s. Like the President’s plan, the Ryan plan also



Source: Author’s calculations of Congressional Bills, IRS.

lowers the age limit from 25 years old to 21 years old, doubles the phase-in rate to 15.3, doubles the maximum credit for single childless workers to \$1,005, and makes the same increases for the beginning and ending phase-out ranges for single and married childless workers.<sup>69</sup>

Where the Ryan plan differs from the President's is how it is funded. President Obama proposed paying for the expansion by closing tax loopholes for hedge fund managers.<sup>70</sup> The Ryan plan is paid for by eliminating other programs that benefit struggling Americans such as the Social Service Block Grant, the Fresh Fruit and Vegetable Program, and an agency squarely focused on economic development – the Economic Development Administration.<sup>71</sup>

### The Way Forward

Our proposal, outlined below, uses the framework of the recent Congressional proposals and adds several measures that further expand the program for young and childless workers, workers who are putting themselves through school, workers paying down student debt or looking to go to school, and workers who need liquidity.

### Lowers The Eligibility Age For Childless Workers To 18 And Allows Eligibility For Full-Time, Independent Students

Our proposal is noticeably different than the conventional Congressional proposals to reform EITC because it lowers the age limit to 18 years old instead of 21 for childless workers and gives access to independent students.

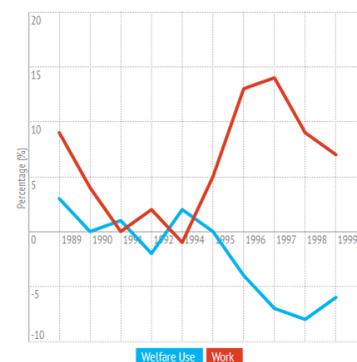
Lowering the eligibility age to 18 for childless workers is crucial for two reasons. First, it makes one of the most effective anti-poverty programs available to young adults ages 18 to 24 who experience poverty at higher rates than any other adult age group.<sup>72</sup>

Second, lowering the childless eligibility age to 18 is vital because a majority of current EITC recipients have a high school degree or less and it will allow the credit to reach its beneficiaries as soon as they need it.<sup>73</sup> These young workers who do not plan to go to college have a clear need for income support—their incomes since year 2000 have dropped by nearly 11 percent,<sup>74</sup> and they have more than twice the labor force participation than of college goers.<sup>75</sup>

Additionally, the population of high school graduates that did not enroll in college is sizeable, and in 2013 alone comprised a little over one-third (1 million people) of the class of 2013. These workers should not have to wait seven years to receive a tax credit that will help them make ends meet.

Furthermore, allowing independent full-time students to access EITC would be beneficial for students working to put themselves through

### EITC's Marginal Effects on Welfare Use & Work for Single Mothers with Two or More Children



Source: *The 1993 EITC Expansion and Low-Skilled Single Mother's Welfare Use Decision* by Hau Chyi.

college. This population particularly needs income support because higher education is more expensive than it has ever been. The cost of tuition has outpaced inflation, shelter, gasoline, and even medical costs.<sup>76</sup>

Rising costs are also signaling the end of the time where students could afford college by working during their summers. In the early 1970's, students could cover the in-state tuition and fees at an average four-year public university by working a full-time minimum wage job for less than 300 hours, or about fulltime for seven and an half weeks.<sup>77</sup> Today, a student would have to log 1,000 hours at a minimum wage job to afford one year of college.<sup>78</sup> The inability to adequately work your way through school as contributed to the growing amount of student debt which has topped over \$1 trillion and is second only to mortgage debt as a source of household debt.

Thus, by lowering the eligibility age for childless workers to 18 and ensuring full-time students could access EITC, the tax credit could capture a higher level of the working student population thereby making college more attainable and reducing the burden of student loans for these workers.

#### Significantly Boosts The Credit's Phase-In And Phase-Out Rates As Well As The Credit's Phase-Out Range

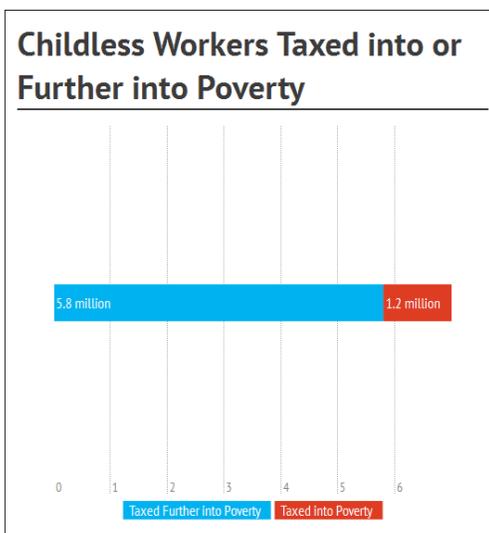
Currently, the credit's phase-in rate is 7.65 percent for childless workers, however, payroll taxes account for 15.3 percent of a worker's income.<sup>79</sup> Thus, to fully offset payroll taxes for childless workers, our proposal doubles the credit's phase-in and phase-out rates to 15.3 percent. Additionally, the beginning of the phase-out range is raised to \$11,500 from \$8,220 and the amount the credit fully phases out increases to \$18,070 from \$14,790.

Ultimately, raising the phase in range by fully offsetting payroll taxes, EITC could accomplish its stated mission of reducing poverty and increasing workforce participation for childless workers.

#### Drastically Increases The Maximum Credit For Childless Workers

A major issue with the way the tax credit is currently structured is that it is not large enough to make a significant impact for young and childless workers. Our proposal fixes this problem by nearly tripling the maximum credit for childless workers from \$500 to roughly \$1,500.

Further, making the credit more salient for childless workers will likely increase participation in the EITC for this group. Also, as demonstrated by the 1993 EITC expansion for families with two children, increasing EITC's maximum credit for childless workers will likely have the same effect of significantly increasing labor force participation and reduce the use of poverty assistance programs for childless workers.



Source: Center on Budget and Policy Priorities.

In addition, increasing the maximum credit and reducing the age eligibility will be particularly beneficial for young adults, ages 18 to 24, with disabilities because a little more than one-quarter of them are in poverty.<sup>80</sup>

### Utilizes EITC As A Trigger For Student Loan Assistance

Expanding EITC would also be a good opportunity to streamline enrollment in student loan assistance programs because research shows that most taxpayers file for EITC during periods of income shock and family changes,<sup>81</sup> which are similar events that cause student loan borrowers to miss their payments or default on their loans.<sup>82</sup>

Accordingly, a strategic arrangement between the Internal Revenue Service (IRS), which handles EITC distribution, and the Department of Education, which manages student loan assistance programs, can help quickly identify and assist borrowers that may likely struggle with their student loans.

This arrangement could precisely help EITC eligible student loan borrowers in two ways:

1. Proactively help borrowers that will likely struggle with their student loans.
2. Identify and rehab student loans that have defaulted.

### Scenario 1: EITC And Student Loan Assistance

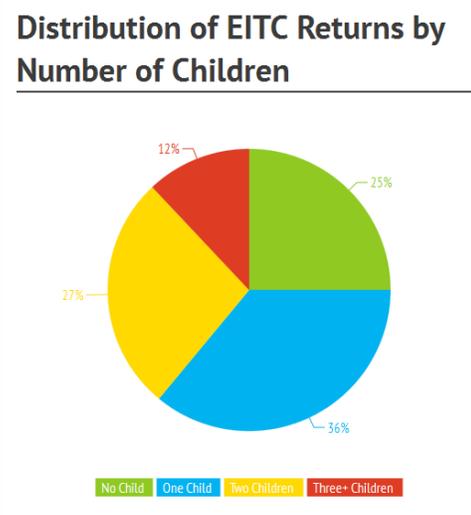
Since similar situations cause a tax filer to utilize EITC and struggle with their student loans, EITC-eligible student loan borrowers should automatically be presented with various options like Pay As You Earn (PAYE) to reduce their student loan burden.

Specifically, we propose that the IRS match interest statements, which show if a taxpayer is paying a student loan, with EITC eligible taxpayers. This will yield a list of taxpayers that have a likelihood to struggle with their student loans. This list should be passed off to the Department of Education, which can reach out and enroll borrowers in programs that can optimize their monthly payment like Pay-As-You-Earn (PAYE).

Moreover, this arrangement will help the administration effectively enroll more borrowers into their assistance programs which have had low uptake.<sup>83</sup>

### Scenario 2: EITC And Student Loan Default

Currently, if a student loan borrower is in default, any tax credits that this borrower is eligible for will be garnished to pay down their debt. The practice of garnishing EITC directly conflicts with the credit's mission of reducing poverty and a more productive practice would be to get this borrower assistance.



Source: Congressional Research Service.

Thus, we propose that the IRS match data of tax filers eligible for EITC to tax filers scheduled to have their refund garnished. The match would create a list of low-income student loan borrowers in default. This list could then be passed on to the Department of Education, where the Department can reach out to borrowers and place them into student loan rehabilitation programs and eventually programs like PAYE.

### Uses EITC To Streamline Max Pell Grant Eligibility

Currently, students applying for federal aid that are receiving or have received certain means-tested federal benefits are automatically eligible for the maximum Pell Grant. These means-tested benefits include supplement security income, supplemental or special supplemental nutrition assistance, and free and reduced price lunch. The Secretary of Education has the ability to designate other federal means-tested programs and could expand this treatment to include EITC. Doing so would simplify the process of applying for federal student aid to low-income Americans. This treatment should be automatic, without the need to apply for aid at all, but this would require a change to the tax code to allow the IRS to share data directly with the Department of Education.

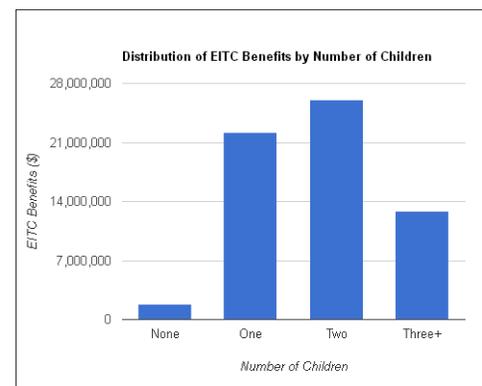
### Creates An EITC Rainy Day Fund To Curb Predatory Lending And Capitalize On Upward Mobility Opportunities

Another opportunity to enhance EITC for young Americans is to create an “Early Refund” option or less formally, a rainy day fund, as suggested by the Center for American Progress report *Harnessing the EITC and Other Tax Credits as Tools for Financial Empowerment and Economic Mobility*.<sup>84</sup> Young Americans are more prone to income shocks or family changes and it leaves many low-income young adults to turn to predatory lenders like payday lenders. In fact, nearly nine percent of young Americans ages 25 to 29—more than any age group—borrow from payday lenders.<sup>85</sup>

Under the rainy day fund, workers could access one-third of their projected EITC and no more than \$500 (which is more than the average predatory loan) halfway through the year, July 1. Furthermore, this arrangement allows EITC to preserve its use as a savings tool since two-thirds of a worker’s EITC would still be available early next year in a lump sum.

The rainy day fund would also only be possible under an EITC expansion for childless adults because the credit is currently not large enough for childless workers to receive one-third of their EITC in advance. Thus, without a childless EITC expansion, the Early Refund option would be limited only to workers with children.

Finally, since the goal of the rainy day fund is to assist workers with unexpected expenses or help pay for opportunities to advance economically like going to school or making a payment toward your



Source: Congressional Research Service.

mortgage, the success of the program would be measured by the decline in the share of workers using predatory lenders rather than the participation rate.

### Encourages The Use Of The Earned Income Tax Credit As A Savings Vehicle

The Earned Income Tax Credit is likely the largest single deposit that many families receive all year. Less frequent payments like bonuses and tax refunds are often treated differently than regular income. A number of studies have shown that low-income tax filers can and will save a portion of their refund when given incentives to do so.<sup>86</sup> Unfortunately, the current Saver's Credit that is designed to encourage savings by low- and moderate-income families fails to help EITC recipients build financial stability because the credit is nonrefundable, so potential savers see no financial benefit, and contributions can only be made to a retirement account with restricted purposes.<sup>87</sup>

Two steps can make it easier and more rewarding for working families to save a portion of their Earned Income Tax Credit for the future. The first is to match a percentage of families' contributions to some form of savings account. For low-income earners, matching savings through refundable tax credits offers a true financial incentive, unlike tax deductions or nonrefundable credits.<sup>88</sup> Last year, Representative Serrano (D-NY) proposed the Financial Security Credit Act to reward savings in savings accounts, CDs, and college and retirement savings vehicles with a 50-percent match on the first \$1,000 saved by low- and moderate-income families, provided that funds remained in the account for eight months.<sup>89</sup>

Even without matching tax filers' savings, policymakers can make it easier for families to save a portion of their refund. Tax filers are able to split refunds into multiple accounts, such as a checking account and a savings account, but splitting only works if filers have a preexisting savings account. Making it possible to open an account on the tax form would help tax filers get over this hurdle rather than facing a "leaky bucket," where funds intended for savings end up in the checking account and being spent instead.<sup>90</sup>

### Makes The 2009 Recovery Act Improvements Permanent

EITC was temporarily expanded in 2009 as part of the American Recovery and Reinvestment Act or popularly known as the "Recovery Act." The Act created a category for families with three or more children and increased the maximum 2009 credit for this group from \$5,028 to \$5,657.<sup>91</sup> Additionally, the phase-out level for married couples increased from \$3,000 to \$5,000 and indexed that amount to inflation.<sup>92</sup>

These improvements are set to expire in 2017, but our proposal makes these improvements permanent since they have successfully improved the financial situation of their beneficiaries.<sup>93</sup>

**According to the Center on Budget and Policy Priorities (CBPP), the Earned Income Tax Credit can reduce poverty in two ways by supplementing wages of low-income workers and encouraging work. Thus, if we expand the Earned Income Tax Credit to include more young people, rates of poverty of young Americans could begin to fall as well.**

## Expands EITC Awareness Programs

As suggested by the Center for American Progress, policymakers should work with the IRS to increase program expansion awareness and participation among young Americans who maybe filing taxes independently for the first time under the outlined expansions.<sup>94</sup> Further, policymakers should continue to support the Volunteer Income Tax Assistance (VITA) Program where experts prepare taxes for middle and low-income families free of charge. The purpose of EITC is to boost take home pay for low-income workers but nearly \$900 million of EITC refunds were taken out in the form of refund anticipation and tax preparation fees, thus, services like VITA are critical in ensuring that EITC refunds are eroded by various fees.

## Conclusion

Young Americans are facing historic economic challenges, and one of our country's main goals should be implementing policies to meet those challenges and ensure that America's next generation inherits an economy that works for everyone, not just the privileged few. The first step that we can take toward meeting that goal is expanding one of the country's most effective programs, the Earned Income Tax Credit. EITC rewards hard work and levels the playing field by putting money in the pockets of workers who need it the most.

First, from a policy perspective, it is common sense to expand EITC to include young, childless workers because it would help mitigate key socioeconomic challenges facing Millennials such as high rates of poverty, rising income inequality, declining labor force participation, and falling incomes.

Second, EITC expansions targeted to specific groups have worked in the past. The Clinton expansion targeted to women with two or more children dramatically and swiftly increased their labor force participation and decreased their use of poverty programs.

Third, during a period of deep polarization in Congress, expanding EITC to young childless workers is a rare point of agreement. Similar EITC expansion proposals have been promoted by the President and Congressional leaders from across the aisle and EITC has previously been expanded under Democrat and Republican administrations.

Ultimately, expanding EITC for young, childless workers is a common sense, bipartisan policy that levels the economic playing field for young Americans who work hard, and it will help the Millennial generation rebuild a much needed path toward economic stability.

**Expanding EITC would also be a good opportunity to streamline enrollment in student loan assistance programs because research shows that most taxpayers file for EITC during periods of income shock and family changes, which are similar events that cause student loan borrowers to miss their payments or default on their loans.**

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