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Who's Afraid of Redistribution? An Analysis of the Earned Income Tax Credit

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I. INTRODUCTION

In the 2008 Presidential campaign, the American public was reminded time and again of the differences in the economic policies of the nominees: John McCain would cut taxes,² and Barack Obama would raise them, although only on those earning over \$250,000.³ In the final days of the

1. Associate, Ropes & Gray LLP, Boston, Massachusetts; Harvard Law School, J.D. 2007; jennifer.bird-pollan@ropesgray.com. The author would like to thank Professors Alvin Warren and Daniel Halperin of Harvard Law School for their comments on earlier drafts of this article. The views reflected in this article are the author's alone and do not reflect the views of Ropes & Gray LLP.

2. MCCAIN PRESIDENTIAL CAMPAIGN, JOBS FOR AMERICA: THE MCCAIN ECONOMIC PLAN 13 (2008), <http://www.scribd.com/doc/4296859/John-McCains-Jobs-for-America>. McCain's final plan included cutting the corporate tax rate from 35% to 25% and maintaining the reduced tax rate of 15% on capital gains and dividends. *Id.* McCain did not explicitly promise to reduce tax rates on individuals, although he stated he would "[k]eep [t]ax [r]ates low." *Id.*

3. OBAMA PRESIDENTIAL CAMPAIGN, BARACK OBAMA'S COMPREHENSIVE TAX PLAN 1, 6 (2008), http://www.barackobama.com/pdf/taxes/Factsheet_Tax_Plan_FINAL.pdf (last visited Feb. 7, 2009). Despite the regular refrain that, if elected, Obama would raise taxes, Obama's final plan actually promised to provide an up-to-\$1000 "Making Work Pay" refundable tax credit to many taxpayers, as well as a refundable mortgage interest tax credit. *Id.* at 2. Obama also committed to expanding the reach of the EITC. *Id.*

campaign, the McCain camp accused Obama of proposing “redistribution,” and the Obama camp quickly denied that description.⁴ So why do presidential candidates run so quickly from the r-word? McCain’s senior policy advisor equated redistribution with socialism,⁵ but redistribution, in the form of the federal income tax system, is a central tenet of American democracy. Indeed, the very notion of having a tax system at all – in which amounts are collected from certain members of society in order to benefit other members – fits a classic definition of redistribution.

One central element of the American version of redistribution comes in the form of the Earned Income Tax Credit (the “EITC”). In his campaign platform, Barack Obama vowed to expand the EITC, making it available to more taxpayers than ever before.⁶ Given the outcome of the 2008 election, and President Obama’s seeming commitment to the tenets of redistribution (despite his disavowal of the word) and his express promise to expand the reach of the EITC, as well as the recent changes to the EITC introduced by the American Recovery and Reinvestment Act of 2009 (the “ARRA”),⁷ it seems a perfect time to look at the intent behind, and accomplishments of, the EITC as it currently stands, and the role it can (and will) play in the future of the U.S. federal income tax system.

I begin this article with a review of the history of the EITC and an examination of the form it currently takes. I then turn to a review of some of the difficulties presented by the EITC, and some recurring criticisms it has faced since its inception. In the context of this discussion, I also introduce responses to those criticisms, both within the framework of the EITC as it is currently administered and in the form of possible adjustments that might serve to improve the system.

II. HISTORY OF THE EITC

The EITC was instituted in response to the “Family Assistance Plan” (“FAP”) proposed by President Richard Nixon in 1969,⁸ which was itself an attempt to implement a version of a negative income tax in the U.S. income tax system.⁹ Nixon intended the FAP to be “a new and drastically different

4. Foon Rhee, *McCain Slams Obama on ‘Redistribution of Wealth’*, POL. INTELLIGENCE, Oct. 27, 2008, http://www.boston.com/news/politics/politicalintelligence/2008/10/mccain_slams_ob_3.html.

5. *Id.* “Europeans call it socialism, Americans call it welfare, and Barack Obama calls it change.” *Id.* (quoting McCain Senior Policy Adviser Douglas Holtz-Eakin).

6. OBAMA PRESIDENTIAL CAMPAIGN, *supra* note 3, at 2.

7. Pub. L. No. 111-2, 123 Stat. 115.

8. Lawrence Zelenak, *Redesigning the Earned Income Tax Credit as a Family-Size Adjustment to the Minimum Wage*, 57 TAX L. REV. 301, 303 (2004).

9. Robert A. Moffitt, *The Negative Income Tax and the Evolution of U.S. Welfare Policy*, J. ECON. PERSP., Summer 2003, at 119, 122. In contrast to a

approach to the way in which government cares for those in need.”¹⁰ The FAP was effectively a form of welfare, with the caveat that recipients would have to show that they were attempting to find work.¹¹ But even with this caveat, there was no requirement in the FAP that recipients be working or earning any income.¹² Under the plan, all families would be entitled to an annual income of \$500 per person for the first two family members, with \$300 for each additional family member.¹³ In addition, the “work incentive” element of the plan allowed recipients to keep the first \$720 of any earnings, plus half of any additional family income up to \$4000, without losing FAP eligibility.¹⁴ This proposal “would have established in law an unmistakably liberal principle: a federally guaranteed [minimum] income.”¹⁵ However, the political difficulty of these proposals proved insurmountable, and after passing the House, the FAP was defeated in the Senate.¹⁶ Critics saw the plan as a work disincentive, in particular because the FAP’s “guaranteed income” was joined with a high phase-out rate, so that each additional dollar of income earned by the FAP recipient resulted in a loss of 50 cents of FAP subsidy.¹⁷

In response to Nixon’s failed proposal, Senator Russell Long (D-LA) developed an alternative proposal incorporating a requirement that people who receive the credit work and earn income. Long, who was, at the time, chair of the Senate Finance Committee, led the campaign that resulted in the enactment of the EITC as part of the Tax Reduction Act of 1975.¹⁸ The first EITC was only available to taxpayers with earned income and at least one child.¹⁹ The maximum credit in 1975 was \$400.²⁰ In 1986, the EITC was indexed for inflation and made a permanent (as these things go) part of the

traditional income tax, where taxpayers pay some portion of their income to the government, under a negative income tax the government supplements the income of the lowest earning (and non-earning) members of society. *Id.* at 119.

10. President Richard M. Nixon, Welfare-‘Workfare’ Speech (Aug. 8, 1969), in 27 CONG. Q. WKLY. REP. 1517, 1517 (1969).

11. H.R. REP. NO. 91-904, at 20-23 (1970).

12. *Id.*

13. *Id.* at 3.

14. *Id.* at 4.

15. E. J. DIONNE, WHY AMERICANS HATE POLITICS 196 (2d ed. 2004).

16. Statement About House Approval of the Family Assistance Act of 1970, 1 PUB. PAPERS 364 (Apr. 16, 1970), available at <http://www.presidency.ucsb.edu/ws/index.php?pid=2467&st=&st1=>.

17. Zelenak, *supra* note 8, at 303-04. For example, assume a taxpayer was entitled to a FAP subsidy of \$500. If that taxpayer earns an additional \$100 of income, she would lose \$50 of her FAP subsidy. This means, effectively, that working to earn an additional \$100 of income puts this taxpayer only \$50 ahead financially.

18. Marguerite Casey Found., *The Earned Income Tax Credit: Analysis and Proposals for Reform*, 109 TAX NOTES 1669, 1671 (2005).

19. *Id.*

20. *Id.*

tax system.²¹ In 1990, Congress made a larger credit available to families with two or more children, and President Clinton and the 1993 Congress significantly increased the EITC for all recipients. The 1993 changes also allowed childless taxpayers between the ages of 25 and 64 to claim a small EITC.²² Finally, in 2001, Congress attempted to address the “marriage penalty” inherent in the EITC²³ by raising the income ceiling for married taxpayers filing jointly.²⁴ Much of the recent history of the EITC has centered on an attempt to deal with fraud and general noncompliance with regard to claiming the credit.²⁵ I will explore these issues in detail later in the article.²⁶

The latest changes to the EITC were made by the ARRA, as part of the 2009 Stimulus Package. For tax years beginning after December 31, 2008, credit amounts will increase and income ceilings, for purposes of determining EITC eligibility, will be raised. Perhaps most notably, the new law adds a new category of credit recipient: taxpayers with three or more children.

III. BACKGROUND INFORMATION

The EITC is a powerful tool in the U.S. government’s redistributive program. The largest program of its kind, the EITC is administered by the Internal Revenue Service (the “IRS”) through the federal income tax system. In 2003, the EITC benefited 19.6 million families, providing \$34 billion in tax credits (either in the form of an offset to taxes due, or in the form of a cash refund).²⁷ Part of what makes the EITC so unique is its construction as “a complex hybrid of an earnings subsidy, a traditional income-transfer program, and a tax credit program.”²⁸

21. *Id.* at 1672.

22. *Id.*

23. For a discussion of marriage penalties and how they relate to the EITC, see *infra* Part IV.B.

24. Marguerite Casey Found., *supra* note 18, at 1672.

25. See Internal Revenue Service, EITC Due Diligence Compliance Program, <http://www.irs.gov/individuals/article/0,,id=179024,00.html> (last visited Mar. 13, 2009).

26. See *infra* Part IV.D.2.

27. Marguerite Casey Found., *supra* note 18, at 1676.

28. Anne L. Alstott, *The Earned Income Tax Credit and the Limitations of Tax-Based Welfare Reform*, 108 HARV. L. REV. 533, 540 (1995).

A. Mechanics of the EITC

The current EITC is not available to individuals with no earned income. That is to say, the EITC is only available to taxpayers after they have earned their first dollar of income.²⁹ However, the phase-out scheme of the EITC means that not all taxpayers with earned income are eligible to receive the credit, either. In fact, both the phase-in and phase-out rates applicable to a given taxpayer depend on the number of children in the household.³⁰ In 2008, for example, for taxpayers claiming no children, the credit was eliminated at \$12,880 (\$15,880 for married taxpayers filing a joint return). For taxpayers with one qualifying child the credit would be eliminated at \$33,995 (\$36,995 for married taxpayers filing a joint return). For taxpayers with two or more qualifying children, the credit was eliminated at \$38,646 (\$41,646 for married taxpayers filing a joint return).³¹ The phase-in rates vary equally depending on the number of children a taxpayer claims. These figures comprise Table 1.³²

29. INTERNAL REVENUE SERVICE, PUBLICATION 596, EARNED INCOME CREDIT: ARE YOU ELIGIBLE? 9 (2008), available at <http://www.irs.gov/pub/irs-pdf/p596.pdf> (last visited Feb. 10, 2009) [hereinafter IRS PUBLICATION 596].

30. The more children a taxpayer has, the larger her tax credit will be. However, in tax year 2008, the credit does not increase further if a taxpayer has more than two children. *Id.* at 5. Under the ARRA, the new EITC category of three or more children will increase the credit amount for taxpayers with three children, but, again, families with more than three children will not receive a larger credit to account for their larger families. For a longer discussion of this issue, see *infra* Part IV.B.

31. All of these figures come from the Tax Policy Center's webpage. Tax Policy Center, Earned Income Tax Credit Parameters, 1975-2009, http://www.taxpolicycenter.org/taxfacts/Content/PDF/historical_eitc_parameters.pdf (last visited Mar. 13, 2009).

32. *Id.*

TABLE 1

Number of Qualifying Children	Phase-in Rate	Phase-Out Rate	Credit Elimination Point
Single – no children	7.65% over first \$5,720	7.65%	\$12,880
Joint – no children	7.65% over first \$5,720	7.65%	\$15,880
Single – one child	34% over first \$8,580	15.98%	\$33,995
Joint – one child	34% over first \$8,580	15.98%	\$36,995
Single – two or more children	40% over first \$12,060	21.06%	\$38,646
Joint – two or more children	40% over first \$12,060	21.06%	\$41,646

As is illustrated by this table, the largest credit available through the EITC in 2008 was \$4,824. This maximum credit amount was available to married taxpayers filing jointly with two or more qualifying children and an adjusted gross income (“AGI”) of between \$12,060 and \$18,750, or single taxpayers with two or more qualifying children and an AGI of between \$12,060 and \$15,750.³³

33. IRS PUBLICATION 596, *supra* note 29, at 44.

To illustrate further, consider the following example. For the 2008 tax year, a single taxpayer with two children and \$7,000 of earned income is entitled to a credit of \$2,810. However, if that same taxpayer were to have \$13,000 in earned income, she would be entitled to the maximum credit amount of \$4,824. But then further, if this taxpayer's income were to increase to \$25,000, the credit amount would drop back down to \$2,869. If this taxpayer's earned income were to exceed \$38,600, she would no longer be entitled to any tax credit under the EITC. This phasing-in and phasing back out of the credit amount (as demonstrated in the table below) is intended to focus the benefits of the credit on the neediest taxpayers.

TABLE 2

Income Amount (Single Taxpayer)	Credit Amount
\$7,000	\$2,810
\$13,000	\$4,824
\$25,000	\$2,869
\$38,600	\$0

In order to receive the EITC, a taxpayer must first meet certain prerequisites and avoid potential disqualifications. First, recipients must file a tax return, which, in certain instances, they would not otherwise be required to do.³⁴ Also, only taxpayers with valid social security numbers are eligible to receive the EITC.³⁵ There are also certain things that can disqualify a taxpayer from receiving the EITC. For instance, if a taxpayer is within the qualifying amounts of earned income but also has above a certain amount of capital gains income or certain other kinds of investment income, that person will be ineligible for the EITC.³⁶ In addition, if a taxpayer is found to have fraudulently claimed the EITC in a past year or claimed more than she was entitled to, she may be prohibited from claiming the EITC in future tax years.³⁷ If an EITC claim contains an "error . . . attributable to reckless or intentional disregard of the rules," then the taxpayer making the claim will be denied the credit for the next two years.³⁸

34. *See id.* at 22.

35. *See id.* at 5.

36. *Id.* at 7; I.R.C. § 32(i).

37. IRS PUBLICATION 596, *supra* note 29, at 26; I.R.C. § 32(k)(B)(i).

38. Marguerite Casey Found., *supra* note 18, at 1675; I.R.C. § 32(k)(B)(ii).

One central characteristic of the EITC is that amounts granted under the credit are fully refundable to the taxpayer.³⁹ Most credits available to taxpayers through the U.S. federal income tax system are only available to offset taxes owed.⁴⁰ Generally, therefore, if a taxpayer's credits exceed the amount of tax she owes, she essentially forfeits the difference. However, because the EITC is fully refundable, even if the taxpayer owes no tax, she will be eligible to receive as a refund the entire amount of the EITC to which she is entitled.⁴¹ Because the credit only applies to very low income earners, who often owe little to nothing in tax, if the credit were not refundable, it is likely that most of the current recipients would not be able to use it at all. Because of the U.S. federal income tax system's standard deduction and dependency exemptions, many EITC recipients fall below the income level at which taxpayers first owe tax. Moreover, those EITC recipients who do owe tax to the government often owe significantly less than the total amount of their EITC. However, because the EITC is refundable, these taxpayers are still able to take full advantage of the credit.

B. Reasons for Implementing the EITC

One of the greatest difficulties facing anyone studying the EITC is the lack of any explicit Congressional purpose for the credit. As Lawrence Zelenak writes, the EITC is "undertheorized" since Congress has never provided "legislative history explaining the purpose of the credit, except in the vaguest and most general terms."⁴² This lack of articulated purpose has plagued the EITC from its inception and has been the cause of much difficulty in the process of revising and improving it.⁴³ In fact, not only was there no expressed purpose in creating the EITC, various reports offer conflicting intentions and purposes. These different EITC proponents likely have quite different ideas about what the purpose of the EITC is or should be:

The somewhat incoherent nature of current law might be the result of a compromise between conflicting visions of the credit's purpose, rather than the lack of any clear vision, but it is difficult

39. I.R.C. § 32(a)(1).

40. For instance, the Hope and Lifetime Learning tax credits are nonrefundable, and are therefore limited to, at most, the amount of tax owed by the taxpayer claiming the credit. See I.R.C. § 25A(a).

41. The "Allowance of Credit" section of the Code does not limit the amount of the credit to the amount of tax owed, but rather says that the credit may not "exceed the earned income amount." I.R.C. § 32(a)(1).

42. Zelenak, *supra* note 8, at 301.

43. *Id.*

or impossible to find attractive accounts of the purpose of the credit even in the academic literature.⁴⁴

Anne Alstott points out that the absence of an explicit purpose makes for more than just a confused discussion.⁴⁵ In fact, without a stated purpose, any discussion of the EITC will involve many built-in normative assumptions, which may very well pre-determine the outcome of that discussion.⁴⁶ As Alstott writes, “for analytic clarity, critics . . . should make their goals explicit and thus open to debate.”⁴⁷

In the first reports on the institution of the EITC, there were many references to the increasing burden of payroll taxes, in particular the burden these taxes represented for earners on the lowest end of the pay scale.⁴⁸ In addition, early commentators seemed especially concerned that rising food and energy costs were hitting low-income families the hardest and that the government ought to find some way to compensate families for those costs. Offsetting the burden of payroll taxes is repeatedly mentioned as a purpose for the creation of the EITC, but at the same time, some EITC proponents argue for its continuation on the basis of the benefits it provides for families and its ability to respond to the adjustment in the poverty level given different family sizes.⁴⁹ These reasons ultimately have little to do with the burden of payroll taxes.

These two recurring themes appear repeatedly in the discussion of the purpose of the EITC. On the one hand, original proponents of the credit saw its purpose as offsetting payroll taxes for the lowest income earners.⁵⁰ Indeed, the current rate of the credit for recipients with no qualifying children (7.65%) exactly equals the current rate of the payroll tax. This seems to be strong evidence that the underlying rationale of the EITC is linked to payroll taxes, at least for those EITC recipients without qualifying children. On the other hand, the EITC is often promoted as a response to the difference between lower incomes and the official poverty level. The difference in the

44. *Id.* at 346.

45. Alstott, *supra* note 28, at 558.

46. Clearly, the concern that an argument contains presuppositions that determine its outcome is not a new one, and this worry arises in numerous contexts. The reason it is of particular importance here is that the history of the EITC has never made clear the rationale for its existence, so the arguments of both proponents and critics are stuck with no clear starting place.

47. Alstott, *supra* note 28, at 558.

48. AVIVA ARON-DINE, CTR. ON BUDGET & POLICY PRIORITIES, ANALYSIS OF SESSIONS AMENDMENT TO DENY THE EITC TO PEOPLE WORKING HERE LEGALLY AS A RESULT OF THE SENATE IMMIGRATION BILL 2 (2007), <http://www.cbpp.org/6-5-07imm.pdf>.

49. *Id.*

50. Payroll taxes include one-half of the Social Security tax (with the other half being paid by the employer) and the Medicare tax. These are known collectively as FICA (Federal Insurance Contributions Act) taxes.

credit amount and income ceiling level for taxpayers with one child or with two or more children (and, beginning in 2009, the new EITC category of three or more children) seems to be strong evidence of this second purpose. If the intention of the credit were merely to offset the burden of payroll taxes, there would be no reason to adjust the credit amount in relation to family size.⁵¹ Since the credit is currently indexed for inflation and adjusted in response to family size, it seems likely that one additional purpose of the EITC is to supplement the income of working families whose earnings level still leaves them below the official poverty level.⁵² I will return later in the article to a discussion of whether or not these two purposes may be incompatible and whether the EITC in its current form effectively satisfies these two goals.⁵³

C. Comparison of the EITC and Other Federal Subsidy Programs

As a program of redistribution and support for the poorest members of society, the EITC is quite important. It can, of course, never be a complete substitute for welfare, since the EITC provides no benefits to those with no earned income.⁵⁴ Indeed, “earnings subsidies [such as the EITC] are regressive in their low ranges, providing fewer benefits to more needy families rather than greater benefits.”⁵⁵ In order to support those members of society with no wage earnings, the United States continues to administer a traditional welfare system in addition to the EITC. However, because the EITC is targeted at the working poor, it is able to affect significantly larger numbers of people than traditional welfare. In order to see the relative importance of the EITC, it is useful to view the benefits it provides in comparison with those offered by some of the biggest redistribution programs in the United States. In 2003, the Temporary Assistance to Needy Families (TANF) program (the program most commonly known as welfare) provided 24.5 billion in aid to 2.1 million families.⁵⁶ The federal food stamps program gave \$21 billion in benefits to 7.4 million families.⁵⁷ This comparison is illustrated in Table 3.⁵⁸

51. Indeed, even the adjustment in income ceilings for childless workers on the basis of married filing jointly status does not make much sense if the exclusive purpose of the credit is to offset payroll taxes.

52. For EITC income categories and ceiling limits, see IRS PUBLICATION 596, *supra* note 29.

53. *See infra* Part V.

54. IRS PUBLICATION 596, *supra* note 29, at 9.

55. Moffitt, *supra* note 9, at 132.

56. Marguerite Casey Found., *supra* note 18, at 1676-77.

57. *Id.* at 1677.

58. *Id.* at 1676-77.

TABLE 3

Name of Program	Number of Families receiving Assistance	Amount of Aid provided
TANF	2.1 million	\$24.5 billion
Food Stamps	7.4 million	\$21 billion
EITC	19.6 million	\$34 billion

As this comparison illustrates, the EITC in its current form provides significantly more in subsidies and affects a much larger number of families than either TANF or the federal food stamps program. This is not in itself an argument for the EITC's continued existence, but it is at least a reason both to evaluate the program as it is currently administered and to determine if a more effective administration is possible.

D. EITC as a Component of the Income Tax System

Many of the criticisms surrounding the EITC are connected to the idea that such a large, complicated, and progressive redistribution program is administered in a covert way through the federal income tax system. I will return to an examination of these criticisms later in this article,⁵⁹ but here I would like to lay out the arguments for incorporating the EITC within the income tax system. One argument for this integration lies with one of the original purposes of the EITC: if the credit is meant to offset the burden placed on taxpayers by payroll taxes, then giving taxpayers a refundable tax credit on their federal income tax return seems a logical solution. In addition, administration through the tax system makes the credit more readily accessible to most recipients. Registering for TANF requires much paperwork and many background checks that are simply not required for the EITC.⁶⁰ Since the U.S. tax system relies on self-reporting, there are no proof

59. For a discussion of these criticisms, see *infra* Part IV.

60. TANF is a federal program, but is administered through the individual states. Therefore, each state must determine what certification requirements will be required for TANF recipients within that state. In Massachusetts, for example, potential applicants are required to meet with a representative of the Department of Transitional Assistance before they can receive the application materials for any kind of financial assistance administered through that department. Massachusetts Office of Health and Human Services, Applying for Public Assistance, <http://www.mass.gov/?pageID=eohhs2terminal&L=4&L0=Home&L1=Consumer&L>

requirements for the EITC.⁶¹ This means that people who are either intimidated by or uninformed about the requirements for TANF can much more easily claim the EITC. Moreover, a credit system run through the IRS and the income tax system avoids many of the stigmas associated with traditional welfare. Since the EITC is only available to those taxpayers who have earned income, recipients of the credit may be less subject to the criticism that society has heaped on welfare recipients.

IV. CRITICISMS OF THE EITC

At this point I will turn to an examination of some of the most common criticisms of the EITC and some possible responses to them. I do not purport to have compiled an exhaustive list of complaints, but I do believe that by the end of this discussion, I will have shown that the EITC should remain as one of the U.S. government's tools in the battle against poverty.

A. *Work Disincentives*

One repeated theme in the criticisms of the EITC, as well as of almost all government-run wealth redistribution programs, is the problem of work disincentives. Any welfare program that has a 100% phase-out rate will have the effect, so the argument goes, of disincentivizing work on the part of the recipients.⁶² If each additional dollar earned results in the loss of a dollar of welfare, the potential recipient has no incentive to work to earn that extra dollar. Indeed, the "rational" person will choose not to work, since welfare will provide the same level of income and allow the person leisure time as well. Of course, such arguments are based on the assumption that welfare recipients are making purely numbers-based decisions and that there is no (or very little) value for them to work as such. These arguments also ignore the stigma attached to the status of "welfare recipient," which itself may serve as something of a work incentive.⁶³ In any case, the design of the EITC is

2=Basic+Needs&L3=Financial+Assistance&sid=Eeohhs2&b=terminalcontent&f=dt_a_c_finassist_apply&csid=Eeohhs2 (last visited Mar. 13, 2009).

61. There are many arguments in favor of requiring pre-certification to claim the EITC. I will address these later in this article. For a discussion of these, see *infra* Part IV.D.2.

62. V. Joseph Hotz & John Karl Scholz, *The Earned Income Tax Credit, in MEANS-TESTED TRANSFER PROGRAMS IN THE UNITED STATES* 141, 163 (Robert A. Moffitt ed., 2003).

63. The idea that receiving welfare is shameful may be a uniquely American phenomenon. "Ideally, the poor and disadvantaged would be better off with a system of social provisions that recognized public assistance as a matter of right – as an entitlement – much like the basic income guarantees in many countries throughout the world." Dennis J. Ventry, Jr., *Welfare by Any Other Name: Tax Transfers and the EITC*, 56 AM. U. L. REV. 1261, 1267 (2007).

intended to minimize the problem of work disincentives. Since the credit is only available to citizens with earned income, the EITC has a built-in work incentive. In addition, the phase-out rates are significantly less than 100%, so that each additional dollar earned within the phase-out income levels results in a loss of mere cents on the dollar in credit. Because of these characteristics, the EITC is politically much more viable than traditional welfare systems because it avoids most of the work disincentive problems created by welfare in its more common forms.

One potential problem in the EITC with regard to work incentives lies in the high marginal rates experienced by taxpayers who find themselves in the phase-out levels of the credit. Since each additional dollar of income earned within the EITC phase-out range results in a reduction of the EITC received, taxpayers in this range experience a marginal tax rate equal to that reduction. For example, a single taxpayer with one qualifying child and an AGI of between \$14,810 and \$32,001 faces a phase-out rate of 15.98%. So if a taxpayer in this category earned \$20,000, she would be subject to the 15.98% phase-out rate.⁶⁴ That is to say, the next \$100 she earned would be a net gain of only \$84.02 since she would lose \$15.98 of the EITC she received before she earned that last \$100.⁶⁵ This marginal rate problem is exacerbated when the EITC recipient is also subject to a positive tax rate. If the additional \$100 of income earned by this taxpayer is subject to a 15% positive tax rate, she will only net \$85 in after-tax income. This positive tax rate, in combination with the marginal rate created by the EITC phase-out, subjects this taxpayer to a marginal rate of 30.98%, significantly higher than many other taxpayers earning much more than she is.⁶⁶ This very large marginal tax rate means that her additional \$100 of earned income will net her only \$69.02.⁶⁷ When this marginal rate is combined with the effect of her higher income on her eligibility for other government assistance programs or other tax credits, that rate may grow even higher.⁶⁸ In this way, the EITC does have a work

64. IRS PUBLICATION 596, *supra* note 29, at 45.

65. This taxpayer's salary of \$20,000 entitles her to a credit of \$2,232, for a total of \$22,232. However, if her income were to increase to \$20,100, she would only be eligible for a credit of \$2,216, for a total of \$22,316. Therefore, although her salary increased by \$100, she only takes home an additional \$84.

66. The rate of 30.98% comes from a combination of the positive tax rate (which is the basic income tax rate) and the loss of the EITC (which can be seen as a constructive tax of sorts).

67. A similar discussion and illustration of the effect of marginal tax rates on taxpayers subject to the phase-out rate of the EITC can be found in SAUL D. HOFFMAN & LAURENCE S. SEIDMAN, *THE EARNED INCOME TAX CREDIT* 11-12 (1990).

68. The loss of eligibility for food stamps, welfare, and other government assistance programs, while clearly not an explicit tax, will reduce income to the taxpayer, and therefore can be considered another "cost" of earning additional income.

disincentive built into it.⁶⁹ Since the EITC is intended to benefit the lowest-income earners, it must incorporate a phase-out system in order to focus its benefits on its intended recipients. Without such a phase-out, the EITC would be available to all taxpayers, which is not the kind of tax credit Congress intended to create with the EITC. Therefore, although the EITC is designed to minimize work disincentives, the problem, to some degree, remains and, indeed, seems unavoidable, because the credit is designed to phase-out at higher income levels.

Louis Kaplow argues that the work disincentives created by the EITC and the high marginal tax rates that it produces may actually be optimal, economically speaking.⁷⁰ If the high marginal rates result in work disincentives focused specifically on low-skilled workers, Kaplow argues, this may be an optimal result. Of course, this argument cannot completely justify the high marginal rates of the EITC and the work disincentives produced by those rates, because it is not possible to determine whether it is only, or even primarily, lower-ability individuals who are disincentivized to work by those high rates. Kaplow writes:

[S]uppose that it is possible to observe perfectly which individuals have abilities below some low level Then that group can be given a high transfer [grant], which would not be very costly to finance because [the grant] could be fairly low for everyone else without fear that such individuals would be destitute since, by assumption, they all can earn at least a minimal income.⁷¹

Much of Kaplow's argument, as he himself acknowledges, hinges on being able to identify those members of society with higher and lower work abilities in order to determine the optimality of work incentives and disincentives. Kaplow admits, "[S]ignals about ability will be noisy. Even though some features, such as age or certain disabilities, can be observed nearly perfectly at low cost, there will usually be differences in ability associated with these characteristics. And other traits, including some disabilities, cannot be observed perfectly."⁷² This discussion of the necessity of grants to the lowest-ability workers (as well as the difficulty associated with identifying those workers) will be an important part of the section of this article discussing the relation between welfare and the EITC.⁷³

69. This so-called work disincentive may be unavoidable, and not only in the context of the EITC, given the necessities of a progressive tax system. Indeed, a progressive tax structure in general may be viewed as a work disincentive.

70. LOUIS KAPLOW, *THE THEORY OF TAXATION AND PUBLIC ECONOMICS* (2008).

71. *Id.* at 165.

72. *Id.*

73. *See infra* Part IV.D.2.

Even given the potential optimality of work disincentives, Kaplow also argues that there may be externalities that influence whether or not work disincentives will be a positive thing.

It is often suggested, for example, that parents serve as role models for their children, so the failure to work perpetuates poverty, harming both the children (and future generations) and others, such as by increasing crime. Additionally, individuals who work, having less free time, may themselves be less likely to engage in criminal activity. Also, there may be a psychological externality to other citizens who derive utility (or avoid negative utility) from the fact that lower-income transfer recipients work. On the other hand, if parents, especially single parents, are encouraged or forced to leave the home for a greater period of time, child care and supervision may suffer.⁷⁴

Kaplow is arguing that, at a minimum, the question of whether or not work incentives are to be avoided is one that requires further study. Indeed, this is likely an empirical question, although any empirical results will have to be evaluated in light of policy choices about what ends the EITC is intended to achieve.

In contrast, Anne Alstott points out that talk of “work disincentives” in the context of the EITC may be paternalistic and entirely inappropriate. If the purpose of the EITC is to make the recipients better off in some way, that purpose is satisfied by allowing recipients to choose whether to work the same number of hours and receive more money, or work fewer hours and receive the same amount of money with additional leisure time.⁷⁵ In this way, if the EITC’s work disincentives are thought of only in terms of the labor supply that the credit increases or decreases, then the free choice of potential recipients is ignored. Higher income earners are assumed to have the choice between more income and more leisure, so perhaps one purpose of the EITC ought to be making this choice available to lower income earners as well. Alstott’s argument is not that giving more leisure to lower income earners ought to be the only intention of the EITC, but rather that this may be one other purpose of the credit. In addition, economic arguments that focus exclusively on “work incentives” in the context of the labor economy ignore important other potential positive effects that the EITC may have:

[I]f EITC recipients use their additional time for nonmarket work, such as care for children, the elderly, and the sick, their choice benefits these other people and, potentially, society as a whole. Thus, the potential labor-supply reductions that some policy

74. KAPLOW, *supra* note 70, at 174.

75. Alstott, *supra* note 28, at 554-55.

analysts find so troubling actually would increase the well-being of the poor. In economists' terms, these free and rational choices between work and leisure maximize utility, which is the central norm that animates traditional economic analysis.⁷⁶

In that case, even if the marginal rates created by the phase-out rate of the EITC do result in some "work disincentives" as envisioned by traditional labor economics, on balance the credit "maximizes utility" when utility is understood in this broader sense.

B. The EITC and Families

At this point I will turn to the criticism that the EITC does not treat differently situated individuals equally, but first I would like to pause for a moment to consider so-called "marriage penalties," which are found throughout the tax code.⁷⁷ The basic idea behind this criticism of the tax code is that because income tax rates and income limits do not always double for married people who file joint tax returns, these people suffer a penalty for their married status.⁷⁸ To illustrate using 2008 tax rates, if Miss A has an income of \$70,000 and files singly with no dependents, she will have a standard deduction of \$5,450, and her marginal tax rate will be 25%.⁷⁹ If she marries Mr. B (who was previously in the same earning and income tax situation as Miss A), they will have the option of filing separately or jointly. If they are each married filing separately, they will be prohibited from taking certain deductions that would otherwise be available to them.⁸⁰ On the other hand, if they file a married filing jointly return, they will have a standard deduction that is double what each of them had separately, but their income ceiling for the purposes of determining their tax rate will not double.

76. *Id.* at 555.

77. "Marriage penalties and bonuses in the federal individual income tax are defined as the increase or decrease in taxes that some married couples incur because they pay taxes as couples rather than as individuals." CONG. BUDGET OFFICE, FOR BETTER OR FOR WORSE: MARRIAGE AND THE FEDERAL INCOME TAX 2 (1997), available at <http://www.cbo.gov/ftpdocs/0xx/doc7/marriage.pdf>.

78. This is less true since the amendments to the tax rates promulgated by the Bush Administration. In recent years the income ceiling for married taxpayers has grown to almost double that of single taxpayers.

79. The marginal tax rate is the rate of tax due on the last dollar of income. For 2008 marginal tax rates and standard deductions, see INTERNAL REVENUE SERVICE INSTRUCTIONS, FORM 1040, available at <http://www.irs.gov/pub/irs-pdf/i1040.pdf>.

80. For example, the education credits, the child care credit, and the EITC cannot be claimed by taxpayers filing with the status married filing separately. In addition, if one spouse itemizes deductions, the other spouse's standard deduction will be zero, forcing that spouse also to itemize deductions. Internal Revenue Service, Frequently Asked Tax Questions and Answers, <http://www.irs.gov/faqs/index.html> (last visited Mar. 14, 2009).

Therefore, their joint income of \$140,000 will incur a marginal income tax rate of 28% (this is the penalty part!).⁸¹ So, although their total income remains the same as before, the married couple pays tax at a higher rate than two single individuals.

Of course, if Mr. B has no income and he marries Miss A, Miss A's income tax rate will remain the same, but she will be entitled to twice the standard deduction. Because of this possibility, it is often argued that adjusting the tax rate so that taxpayers who are married filing jointly have an income ceiling of twice their single counterparts really results in a "marriage bonus." That is, switching from filing individually to married filing jointly status results in the bonus of being entitled to twice the income of a single person at the same tax rate. If only one member of the married couple is working, there seems to be even less of an argument for allowing this kind of bonus for the status of married filing jointly. In any case, people generally seem to agree that an income tax system with progressive tax rates will always result in either a "marriage bonus" or a "marriage penalty."⁸² Our current tax system has tended to choose the so-called "marriage penalty."⁸³

This same criticism regarding the marriage penalty is also made of the EITC. Since the credit has an income ceiling, and the number of children counted levels off at two (three, starting in tax year 2009), married couples are likely to be entitled to less of a credit than two unmarried people. For instance, in tax year 2008, two unmarried people, each with two children and each with annual earned income of \$13,000, will each be entitled to the maximum credit amount of \$4,810.⁸⁴ Therefore, even if these people live together, and even if the children each of them claims as dependents are their children with each other, these two taxpayers will be entitled to a combined EITC of \$9,620.⁸⁵ However, if these same two people get married, they will have to report a combined income of \$26,000 and will be limited to the EITC

81. Tax Policy Center, Individual Income Tax Rates, Standard Deductions, Personal Exemptions, and Filing Thresholds, http://taxpolicycenter.org/taxfacts/Content/PDF/individual_rates.pdf (last visited Mar. 14, 2009).

82. For a more detailed explanation of the marriage bonus/penalty problem, see CONG. BUDGET OFFICE, *supra* note 77.

83. *Id.* at 2.

84. IRS PUBLICATION 596, *supra* note 29, at 44.

85. An excellent example of this tax situation can be seen in Massachusetts. Under current Massachusetts law, same-sex marriage is legal in the state, and same-sex married couples must file as married on their state tax returns. However, because their marriages are not recognized by the federal government, they must file their federal tax returns individually. Therefore, a same-sex couple married in Massachusetts with four children must file as two single taxpayers on their federal return. Each taxpayer could claim two of the children on his return for EITC purposes, thus maximizing the credit for which this family would be eligible.

category of “two or more” dependent children, and the amount of their credit will drop to \$3,290.⁸⁶ These numbers are illustrated in Table 4.

TABLE 4⁸⁷

Filing Status	Income	EITC	Total
Single, two children each		(\$9,620 total)	\$17,810 each
A	\$13,000	\$4,810	\$35,620 total
B	\$13,000	\$4,810	
Married, four children (“2 or more” for EITC purposes)	\$26,000	\$3,290	\$29,290 total

Because of this significant difference in the amount of EITC these two families will be entitled to (\$9,620 for the unmarried family vs. \$3,290 for the married family), this aspect of the EITC seems to be working as a strong disincentive for marriage.

In tax year 2008, the income ceiling for EITC recipients who are married filing jointly is \$3,000 higher at each credit level (no children, one child, and two or more children) than it is for single taxpayers.⁸⁸ Beginning in tax year 2009, in addition to the new category of “three or more children” the income ceilings will be increased by \$5,000 for married taxpayers filing jointly. In this way, the tax system does try to address the problem of the marriage penalty with regard to the EITC. However, allowing an extra \$3,000 (or \$5,000) of income for married recipients of the EITC certainly does not offset the radical difference in credit amounts in the above example. In addition, there is no attempt in the current EITC to address the possibility that a married family will have more children than its unmarried counterpart. Therefore, under the current EITC model, two unmarried people with two children each will always be entitled to a larger EITC than a married couple with four children.

Lawrence Zelenak’s proposal for revising the EITC as a family-size adjustment to the minimum wage attempts to address at least one of the

86. Internal Revenue Service, Tips and Guidance for Estimating Credit Amount, http://apps.irs.gov/app/eitc2008/Forward_2008_Calc.do (last visited Mar. 23, 2009).

87. Again, these numbers will change, and the problem will be slightly remedied in tax year 2009 by the addition of the “three or more children” category introduced by the ARRA. However, for families with four or more children, the problem will remain.

88. IRS PUBLICATION 596, *supra* note 29, at 5.

problems introduced by the EITC “marriage penalty.” Zelenak proposes eliminating the cap on the number of children that taxpayers can claim for EITC purposes.⁸⁹ In this way, a married couple with four children would be able to claim all four of these children for the EITC, rather than being limited to the category of “two or more” children (“three or more” beginning in tax year 2009). Of course, there may be great political barriers to instituting a change to the EITC of the kind that Zelenak proposes. With regard to the problem of “marriage penalties” in the EITC, Zelenak acknowledges that any version of the EITC that involves a phase-out plan will have to involve either marriage penalties or marriage bonuses.⁹⁰ Since the intention of the EITC is to focus benefits on low-income workers, the credit has to invoke a phase-out rate or some kind of income ceiling so that the credit is not available to those who earn more than the targeted income levels. Since penalties are inevitable, the best (and perhaps only) response to this problem may be to compromise and provide penalties (or bonuses) for everyone! As Zelenak writes, “[b]y providing a joint return phase-out threshold slightly higher than the phase-out threshold for single parents, current law adopts a version of this compromise approach, but it is a version not far removed from the marriage penalties-only approach.”⁹¹ Perhaps a compromise that reaches a little further and provides a bit more of a ceiling increase to married couples (the approach hinted at in the 2009 ARRA changes), or allows categories with higher numbers of children for married couples, would work to ease the imbalance to some extent.

One additional solution to this problem may lie in addressing the problem of single taxpayers who share households and child-rearing responsibilities but are not married to each other.⁹² Since this seems to be the category of people who are benefiting most from the current credit structure, a solution focused on addressing this category may be more properly targeted. Perhaps a new category of taxpayer could be created – unmarried filing jointly. The tax system could require all taxpayers who share a household to file with this status, and if they choose not to, they would be treated in a manner similar to the current status of married filing separately. Since such a radical change in the structure of the tax system may not be politically viable, perhaps the change could be limited to recipients of the EITC. Having stricter standards for EITC recipients than for other taxpayers is not a new idea. There are currently very strict rules regarding claiming a child as a

89. Zelenak, *supra* note 8, at 341.

90. In what may be an attempt at definitional parity, Zelenak refers to marriage bonuses as single penalties. *See id.* at 341-42.

91. *Id.* at 342 (footnotes omitted).

92. Again, consider the example of a same-sex couple, married for state law purposes but not for federal law purposes.

dependent for EITC purposes.⁹³ Requiring household reporting for EITC recipients would also address multigenerational families. Under the current system, in a household with a grandparent, a parent, and four children, the grandparent can file an EITC tax return claiming two of the children and a parent can claim the other two children on her return. Again, the cumulative credit amount available to this family would be significantly larger than the amount available to a family headed by a married couple.

There are two important complications to such a plan that would certainly need to be addressed. First of all, Congress would need to revisit the question of the EITC's original purpose before making such a change. If the intention is to treat like financial situations alike, then such a change may be sensible. However, perhaps Congress does intend to treat multigenerational families or families headed by an unmarried couple differently from a family headed by a married couple. This seems unlikely, but if that is the case, then those intentions need to be addressed in any changes made to the structure of the credit and its marriage penalties. Second, requiring EITC recipient families to file as "households," while non-EITC recipient families with the same structure (either multigenerational or headed by an unmarried couple) continue to file individually, may involve a deep inequity in which the tax system should not engage. Should we require EITC recipient families to define their family structure differently than their higher-earning counterparts? This may counter some of the benefits reaped by running the EITC through the tax system in the first place. Requiring different family structure definitions may reintroduce a stigma to the status of EITC recipient that administration through the tax system is currently able to avoid. On the other hand, focusing the benefits of the EITC on those who most need it, and ensuring equal treatment and fair distribution of the benefits available through the EITC, may require some solution of this kind and may justify any inequity it introduces.

If the purpose of the EITC is merely to offset the burden of payroll taxes on those taxpayers earning the least, then it makes sense that all taxpayers with equal income should be treated equally by the EITC. The payroll taxes are imposed equally on taxpayers, regardless of the number of children they have and regardless of whether or not they are married. Therefore, if offsetting payroll taxes is the intention of the EITC, then the sole determinant of the amount of the credit should be income level, and the number of children and marital status should be irrelevant.

However, as is by now clear, the EITC is used for more than merely offsetting payroll taxes. The credit is also viewed as a supplement to the traditional welfare system, offering government assistance to those who do not qualify for welfare because they have earned income, but who still live

93. Internal Revenue Service, *Tips and Guidance for Determining Qualifying Children for EITC*, http://apps.irs.gov/app/eitc2008/Forward_Qualifying_Child.do (last visited Mar. 14, 2009).

with income levels that put them below the poverty line. If this is a goal of the EITC, then it makes more sense that differences in family structure should result in different credit amounts. After all, the poverty level itself is relative to the size of the family. It is clear that a married couple with two children will need more income in order to enjoy the same standard of living as a single person with the same income. Therefore, the amount of the credit and the income level at which it phases out should reflect the differences among families of different sizes if the EITC is intended to be a response to the poverty level.

The problem remains that the EITC only goes so far in responding to differences in family structure. The limitation to three categories of taxpayers (no children, one child, and two or more children), with the addition of a fourth category beginning in tax year 2009, does not account for the variety of family structures among U.S. taxpayers. If, as I wrote in the previous paragraph, the EITC is intended to be a response to the changing poverty levels encountered by families of different sizes, then limiting the number of children a taxpayer can claim for EITC purposes limits the effectiveness of the credit in this regard. After all, the poverty level for a married couple with five children is significantly higher than the level for a married couple with only two children.⁹⁴ And yet, for EITC purposes, in tax year 2008, these two families are treated the same way.⁹⁵ This clearly results in an uneven treatment of different family structures. And this relation between the amount of the EITC and the official national poverty level is not trivial. In 2001, 4.7 million people had their income levels raised above the poverty line because of the EITC.⁹⁶ If the poverty level is a meaningful number, representing a subsistence level of earnings for taxpayers and their children, then perhaps it should play a larger role in determining the amount of EITC for which families (especially larger families) are eligible.

It is important to note here that this limitation on the number of children a taxpayer can claim for tax purposes is not present throughout the Code. Indeed, there are no limitations on the number of children a taxpayer can claim for the dependent exemption or for the child tax credit.⁹⁷ So why this

94. For 2008, the U.S. federal poverty level for a family of four is \$21,200, in the 48 contiguous states. For a family of 7 that amount rises to \$32,000. Annual Update of the HHS Poverty Guidelines, 73 Fed. Reg. 3971-72 (Jan. 23, 2008).

95. Beginning with tax year 2009, the family with 5 children will move up to the EITC category of "three or more children," which will go some way towards alleviating this difference, but, of course, the criticism still remains, since the larger family gets no larger credit to account for the last two children.

96. Marguerite Casey Found., *supra* note 18, at 1677.

97. See INTERNAL REVENUE SERVICE, PUBLICATION 501, EXEMPTIONS, STANDARD DEDUCTION, AND FILING INFORMATION 11 (2008), *available at* <http://www.irs.gov/pub/irs-pdf/p501.pdf> (last visited Mar. 14, 2009) [hereinafter IRS PUBLICATION 501]; INTERNAL REVENUE SERVICE, PUBLICATION 972, CHILD TAX

difference in the EITC? There are differing theories about why the EITC treats number of children differently than the rest of the Code. Some critics believe that the limitation on the number of children for whom a taxpayer can receive credit, for EITC purposes, is intended as a disincentive to having more children. According to this theory, if the EITC were available in larger amounts for each additional child that a taxpayer had, there would be a strong incentive to have more children in order to receive a larger credit. This limitation is the government's way of telling the working poor that they should not have more children until they can afford to care for them without the help of the EITC. This argument seems at least partly problematic, though, since it does not seem likely that an additional tax credit of about \$2,000 a year would be enough of an incentive to encourage families earning only about \$12,000 a year to incur the costs of another child. Indeed, the idea that family size calculations are made on the basis of tax credits seems a bit odd altogether.

However, even if the limitation is not intended as a disincentive, there is a more convincing argument that it is intended as a "stern message" to the working poor about increasing their family size and having more children for whom they would have difficulty caring financially. If this is the reason for the limitation on the number of children, it is, again, an interesting question whether or not the intended recipients are getting the message. And what, exactly, is the intended effect? Does the government intend to prevent the growth of families in the lowest income levels only? And, if that is the intention, what is the point of punishing those families who have already grown? If the people who feel the effects of this "stern message" are the children of low-income parents who have four or more children, then perhaps the government should rethink whether or not this is an effective strategy. Surely we do not want to punish children in order to make an impression on their parents.

C. Accounting for Wealth

The EITC is intended to be a response to the needs of people who have earned income but who do not have enough money to satisfy their basic needs. Because the credit focuses on earned income, pre-existing wealth could be a problem for the EITC. After all, capital gains and dividend income is not "earned" income within the definitions of the income tax code.⁹⁸ Beyond that, any accumulated wealth that a taxpayer has is not income at all, and "[t]he current EITC . . . does not incorporate a wealth requirement of any kind."⁹⁹ But surely a taxpayer with large amounts of

CREDIT 2 (2008), available at <http://www.irs.gov/pub/irs-pdf/p972.pdf> (last visited Mar. 14, 2009) [hereinafter IRS PUBLICATION 972].

98. I.R.C. § 32(c)(2).

99. Alstott, *supra* note 28, at 571.

wealth who either receives capital gains or dividend income, or who lives off of her accumulated wealth, is not an intended recipient of the EITC. Therefore, the Code needs to eliminate these sorts of taxpayers from the recipient pool of the EITC.

The current version of the EITC does attempt to exclude taxpayers with other sources of income from receiving the credit, but as Alstott points out, there is still no requirement that EITC recipients report assets on their returns, as long as those assets are not producing income.¹⁰⁰ So the taxpayer with \$100,000 stuffed under his mattress may still be eligible for the EITC, but the taxpayer with \$100,000 in the stock market, who earns dividends or capital gains from his investments, is likely to be ineligible for the EITC because of the current requirements.

Within the current EITC, taxpayers must report investment income separately, and if it exceeds a certain amount (currently \$2,900), that taxpayer will be ineligible for the credit.¹⁰¹ This measuring of dividend and capital gain income serves as a proxy to an actual reporting of amounts of accumulated wealth and still works within the confines of the larger income tax system, since the amount of dividend and capital gain income is reported elsewhere on the taxpayer's income tax return. However, some critics argue that this extra reporting requirement makes claiming the EITC significantly more difficult, and thus lowers the chances that eligible taxpayers will realize that they are eligible. In this way, these critics argue, the EITC participation rate will drop even lower if such a reporting requirement is introduced.¹⁰² In addition, while this dividend and capital gains reporting requirement does capture some accumulated wealth held by potential EITC recipients, it does not encompass all such wealth. Therefore, even with this remedial reporting requirement, many taxpayers with accumulated wealth or other sorts of non-taxable income will not be required to report that wealth or income anywhere on their income tax returns, and they will remain eligible for the EITC.

The problem in the current system stems from the fact that the EITC uses the same definition of income as the U.S. federal income tax system generally. Since the U.S. federal income tax system does not currently tax wealth, there is no built-in way to measure that wealth.¹⁰³ The EITC has traditionally used the income tax system definition of income as a way to simplify the program and to keep it incorporated with the general tax system. This trade-off between trying to keep the administration of the EITC as

100. *Id.* at 571-72.

101. Internal Revenue Service, EITC Thresholds and Tax Law Updates, <http://www.irs.gov/individuals/article/0,,id=150513,00.html> (last visited Mar. 14, 2009).

102. For a discussion of participation rates, see *infra* Part IV.D.1.

103. A tax on wealth would require annual reporting of assets held by a taxpayer, and a commensurate tax on the current value of those assets. Our tax system does not require such reporting, and, as it stands, the government only taxes income accumulated in a particular tax year.

simple as possible and trying to ensure fairness by only allowing people in need to claim the credit makes choosing the best strategy difficult. Here again it seems that if the policy objectives of the EITC could be made clearer, then the choices regarding how best to administer the credit would be made easier.

D. Difficulties Related to Claiming the EITC

1. Participation Rates

Even though the EITC is widely claimed and clearly affects the lives of many taxpayers, there is still a problem of participation. That is, many taxpayers and their families who are eligible for the EITC are not claiming it.¹⁰⁴ Of course, the number of people who fall into this category is difficult to estimate, since the very problem comes from the fact that they are not reporting themselves! People in this country who earn below the minimum amount required to pay taxes are not actually required to file an income tax return at all.¹⁰⁵ In order to claim the EITC, however, these same people would be required to file a return.¹⁰⁶ Since in many of these instances no returns are being filed, it will always be difficult to estimate how many eligible households are not receiving the credit. One estimate claims that over 4.3 million taxpayers who were eligible for the EITC did not claim the credit. Of that number, about 28% represented households with three or more qualifying children.¹⁰⁷ In the current system, if a taxpayer files a return and is in fact eligible for the credit but does not claim the EITC, the IRS will notify the taxpayer of her eligibility and she will likely ultimately receive the credit. But the taxpayer who has so little income that she is not required to file a return will likely not file, will not learn about the EITC, and so ultimately will not receive it.

One important measure that many groups have taken in order to address this problem is to inform people about the EITC and the eligibility requirements. These outreach programs are often held in public housing projects or other low-income areas, in order to inform income earners about

104. In a recent Congressional hearing on the EITC, many lawmakers were more focused on the lack of participation than on noncompliance. "I would think the IRS would be outraged that so many who qualify are not applying for that money," said Representative Xavier Becerra. Diane Freda, *Lawmakers Say IRS Must Do More to Heighten Taxpayer Awareness of EITC*, DAILY TAX REP., Feb. 14, 2007, at G-10.

105. For the tax year 2008, married couples filing jointly do not have to file an income tax return if their joint income is below \$17,900. Internal Revenue Service, *To File or Not to File*, IRS Tax Tip 2009-27, <http://www.irs.gov/newsroom/article/0,,id=105097,00.html> (last visited Mar. 14, 2008).

106. *Id.*

107. Philip J. Harmelink, Thomas M. Porcano, James A. Richardson & William M. VanDenburgh, *The Challenge of the EITC*, 100 TAX NOTES 955, 957 (2003).

the EITC and what they must do in order to claim their credit. The programs range from informing people about the existence and purpose of the EITC to helping people file their income tax returns in order to claim the credit. The IRS itself sponsors the Volunteer Income Tax Assistance (“VITA”) program, and activist organizations such as the Children’s Defense Fund, the Association of Community Organizations for Reform Now, and countless community development and neighborhood action organizations have spent millions of dollars on outreach in order to inform taxpayers of their rights with regard to the EITC.¹⁰⁸ VITA sites are located throughout the country, and they are just what they sound like – volunteers assist low-income taxpayers in completing and filing their income tax returns, facilitating the claiming of millions of dollars in EITC. This program, and the organizations that host the sites, operates in low-income communities to inform taxpayers about the EITC and about what they must do to claim the credit. Outreach programs such as these are very likely to increase awareness of, and therefore use of, the EITC. In addition, outreach programs may reduce the need among EITC recipients to use paid preparers and Refund Anticipation Loans (“RALs”).¹⁰⁹ Unless the intended recipients are aware of and claim the credit, no amount of improvements in the drafting and administration of the EITC will change its effectiveness. In this regard, outreach is extremely important.

2. Noncompliance

Noncompliance in the EITC is as much a problem as is noncompliance in other areas of the income tax system. Indeed, the IRS estimates that approximately \$250 billion to \$300 billion of tax revenue is lost annually due to noncompliance in all areas of the Code. With regard to the EITC, approximately \$10 billion annually, or one-third of all EITC payments, are estimated to be noncompliant.¹¹⁰ In addition to these problems of noncompliance, approximately half of all EITC returns are estimated to be filed in error.¹¹¹

There seem to be two possible explanations for these large noncompliance numbers: this noncompliance could be the result of intentional fraud, or it could be unintentional error incurred because of the complexity of the return system for the EITC. I have already discussed the problem of the complexity of the EITC in several of the previous sections of this article.¹¹² In general, complexity seems to be a problem because of the conflict between wanting the administration of the EITC to be fair, while still

108. Marguerite Casey Found., *supra* note 18, at 1674.

109. For a discussion of Refund Anticipation Loans, see *infra* Part IV.D.3.

110. Harmelink, Porcano, Richardson & VanDenburgh, *supra* note 107, at 955.

111. *Id.*

112. See *supra* Parts III.C-D, IV.B.1.

wanting the credit to be easily available to those who need it. This issue comes up with regard to the credit amount and family size, and also with regard to the question of preexisting wealth. Large amounts of noncompliance may be another argument for the simplification of the EITC (as it is an argument for the simplification of the tax code in general), but determining just how much noncompliance comes from the problem of complexity, and therefore how much of a difference simplification would make, would likely require much empirical research. On the other hand, if the noncompliance with regard to the EITC is primarily a result of intentional fraud, then other steps must be taken to address this problem.

The U.S. federal income tax system relies in large part on self-reporting. Because the administration of the EITC is housed in the income tax system, unlike almost all other social welfare programs, the EITC also has a self-reporting component. Most other social benefits programs require some proof of eligibility, and have some external monitoring component. However, as I discussed earlier in this article,¹¹³ part of the appeal of the EITC is that it does not have the stringent reporting and eligibility requirements that, for instance, the TANF program has. Again, there may be significant policy reasons to maintain the self-reporting status quo of the EITC, even if that means incurring the risk of intentional fraud.

In 2003 the IRS announced a revised plan that would require precertification of some of the individuals claiming the EITC.¹¹⁴ Under this proposal, the certification process would require “higher risk” taxpayers to establish their relationship with any children they were claiming for EITC purposes and prove those children’s satisfaction of the residency test before the taxpayers file their returns.¹¹⁵ These elements of the EITC claim are the hardest to prove (and to disprove), and the IRS is worried that “[d]ue to the fact that targeted taxpayers come from a low-income environment, subsequent collections of audit amounts are problematic.”¹¹⁶ So if taxpayers from this certain class fraudulently claim children on their returns, it will be very difficult for the IRS to recover the money if the government only finds out about the fraud later. This may be true, and it may be even harder for the IRS to successfully recover overpayments made to these taxpayers than to others, but there are certainly some policy and social justice concerns about allowing a precertification process such as this to go forward.

The IRS proposal regarding EITC precertification for certain “high-risk” taxpayers would require the targeted taxpayers to complete extensive paperwork and obtain third-party affidavits in order to prove the truth of certain claims on their tax returns. Such extensive proof is not required of most taxpayers because, as I mentioned earlier, the U.S. system relies

113. See *supra* Part III.D.

114. Harmelink, Porcano, Richardson & VanDenburgh, *supra* note 107, at 959.

115. *Id.*

116. *Id.* at 960.

primarily on self-reporting. So there seems to be a significant concern about “the social justice in requiring extensive documentation that is not required by other taxpayers, despite wide ranging noncompliance.”¹¹⁷ Indeed, the numbers at the beginning of this section reveal that less than five percent of the loss of revenue from noncompliance relates to the EITC. This is not to diminish the importance of that lost revenue, but the IRS’s reasons for wanting to step up documentation with regard to EITC payments (namely that these taxpayers do not have a lot of money, so they will be hard to recover from) is not the kind of policy argument that justifies such a difference in treatment. Noncompliance with regard to the EITC is clearly a significant problem, and intentional fraud in EITC claims may be a problem that the government must address.¹¹⁸ However, in this instance, the government’s beliefs about the types of people who claim the EITC are allowing this particular kind of noncompliance to erode equal treatment of all taxpayers.

3. Cost to Recipients

Through the years, the United States has seen a rise in the number of professional tax preparation agencies offering services to American taxpayers. Some think that the rise in the use of these services has been a direct response to the increasing complexity in the U.S. income tax system.¹¹⁹ One significant problem facing those who advocate the maintenance of the EITC is the high percentage of EITC recipients who use paid tax preparers to assist them in filing their returns. Indeed, it seems that approximately 70% of taxpayers who claim the EITC have used a paid tax preparer.¹²⁰ In contrast, only about 60 percent of non-EITC recipient taxpayers used paid preparers.¹²¹ Perhaps this means that filing for the EITC is even more complicated than non-EITC filings, requiring those who wish to claim the EITC to hire professional help when completing their returns. Or, what seems more likely, paid tax preparers are seeking out EITC-eligible individuals in order to offer their services and collect their fees.

Even more concerning than the high usage of paid preparers is the number of EITC recipients who receive RALs at exorbitant fees. For instance, in 2003, 57% of RAL recipients received the EITC.¹²² These loans cost EITC recipients \$519 million in fees, but about two-thirds of these

117. *Id.* at 961.

118. There does not seem to be clear empirical data showing how much of the EITC noncompliance is a result of confusion in the face of the EITC’s complexity and how much is intentional fraud. Such data would need to be uncovered before any radical government response to fraudulent noncompliance would be justified.

119. *See, e.g.,* Lawrence Zelenak, *Justice Holmes, Ralph Kramden, and the Civic Virtues of a Tax Return Filing Requirement*, 61 *TAX L. REV.* 53, 70 (2007).

120. Harmelink, Porcano, Richardson & VanDenburgh, *supra* note 107, at 957.

121. Marguerite Casey Found., *supra* note 18, at 1682.

122. *Id.* at 1684.

individuals did not realize that the RAL was, in fact, a loan.¹²³ RALs are often offered by professional tax preparers to their customers on the basis of their anticipated refunds. Using an RAL allows the taxpayer to take the refund amount home that same day, but at a significant cost, usually around \$100. “Given that it takes the IRS only 10 days, on average, to process an electronically filed return and electronically deposit a refund into a taxpayer’s bank account, the overall concern is that low-income taxpayers may use RALs unnecessarily”¹²⁴ In order to collect these large loan fees, paid tax preparers are likely to encourage EITC recipients to take an RAL, and therefore the use of RALs is likely much higher among people using paid tax preparers. Finally, in order to receive an electronic deposit of the refund amount, the taxpayer must have a bank account into which that money can be deposited. However, many low-income individuals and families do not have bank accounts, and so are not eligible to have their refunds direct-deposited. This just extends the amount of time that it will take the IRS to get the refund to the taxpayer, and thus increases the chance that the taxpayer will be tempted to take an RAL.

Since the EITC is aimed at the lowest-earning and neediest taxpayers in the United States, and since the credit is intended to alleviate some of the financial pressures experienced by these families, it is worrisome that these same neediest families may be spending a significant amount of their credit (and refund) on unnecessary services related to receiving the credit. Indeed, if a taxpayer receives an EITC payment of \$1,735, that individual could expect to pay \$220 in tax preparation and RAL fees – an amount that represents 12.7% of the total credit.¹²⁵ In order to avoid this dilution of the effect of the EITC, the government, in conjunction with public service organizations, must continue to work to inform people about the real cost of RALs and also offer help to EITC recipients in completing and submitting their tax returns. The same outreach programs I discussed with relation to the participation rates of the EITC¹²⁶ can be used to meet these needs. Having more volunteer preparers available would also help to reduce the numbers of people who currently diminish the net value of their credit by using paid preparers to file their returns. Another possible solution to the problem of RALs would be more government regulation of the process, including federal limits on the amount of the fees that companies offering such services could charge. This problem must be addressed if the government wants to ensure that the EITC is properly available in its full amount to those for whom it is intended. Outreach programs and the government should also work to ensure that more low-income workers and EITC recipients open bank accounts so

123. *Id.*

124. *Id.*

125. *Id.*

126. *See supra* Part IV.D.1.

that direct deposit of refund amounts. Making this option available to EITC recipients would likely reduce the need for them to take an RAL.

A related concern regarding the use of the EITC is the form in which most recipients get their payments. The EITC is available to eligible taxpayers as a monthly payment over the course of the taxable year, as an addition to that taxpayer's paycheck, the so-called Advanced Earned Income Credit ("AEIC"). However, receiving the EITC in this form requires completing and filing additional paperwork, and most EITC-eligible taxpayers are not even aware that such an option exists. Therefore, most EITC recipients receive their credit in the form of a one-time lump sum payment in the Spring, after they have filed their tax returns for the previous year. One concern about this method is that the requirements of other social benefits programs will encourage EITC recipients to spend this money soon after they receive it, rather than using it over the course of the year to help the family with their normal living expenses. If EITC recipients place the lump sum of their refunds in a bank account, these retained assets may ultimately disqualify the recipient from benefits to which they would otherwise be entitled. Perhaps this means that outreach should also encourage EITC-eligible taxpayers to participate in the AEIC program, thus receiving their credit in monthly payments over the course of the taxable year.

E. Proposals for Change

1. Raising the EITC vs. Raising the Minimum Wage

In recent years there has been much discussion of the importance of raising the national minimum wage.¹²⁷ This discussion fits together interestingly with a discussion of the EITC. This debate also requires a clear identification of what purposes are intended to be served. If raising the minimum wage is intended to help working families, a more effective way to achieve the same end may involve raising (or improving) the EITC. Many minimum wage workers are high school students or retirees. If the minimum wage is increased, then some benefits will be directed towards them, rather than towards working families. Since the EITC focuses its benefits directly towards low-income earners with children, while still allowing some benefits to single or childless workers, raising the EITC would focus those benefits more explicitly on working families.¹²⁸ Another significant contrast between

127. The Fair Minimum Wage Act of 2007, Pub. L. No. 110-28, §§ 8101-8104, 121 Stat. 112, 188-89, ultimately raised the federal minimum wage to \$7.25 per hour, and President Obama has promised to raise it further, to \$9.50 per hour by 2011. See Obama-Biden, Plan to Combat Poverty, <http://www.barackobama.com/issues/poverty/#make-work-pay> (last visited Mar. 15, 2009).

128. The EITC goes some way towards addressing this concern by imposing a minimum age requirement on childless recipients. In order to receive a credit in the "no children" category, the taxpayer must be age 25 or over. I.R.C. § 32(c)(1)(A)(ii).

the minimum wage and the EITC lies in determining who provides the benefits. One standard argument regarding the minimum wage is that employers must bear the brunt of any increase in wages.¹²⁹ In contrast, the EITC is a government program, and any increase would be borne by the government. This increase in expenditure would have to be matched by an increase in revenue, which is an important consideration in determining whether expanding the EITC is a possibility.

If the minimum wage were to be increased as a result of recent debates, it will be important to determine just how this would (or should) impact the EITC. If minimum wage levels were to be raised, one potential result would be that fewer people will be eligible for the EITC. This may be an acceptable result, but it may be that eligibility levels should be raised in response to an increase in minimum wage levels. Again, answering this question will depend on articulating just what it is that the EITC is meant to achieve. If the EITC is meant to be a response to the poverty level, then an increase in the minimum wage need not affect the eligibility levels or amounts given under the EITC. However, if the EITC is meant to be a benefit available to the lowest-income earners in the United States, then increasing the minimum wage will require an increase in the EITC eligibility levels as well. In that way, the lowest-income earners will continue to be eligible for the EITC, even with their new earnings levels.¹³⁰

2. Integrating the EITC and Welfare

Some of the most withering criticisms of the EITC are related to the very high marginal rates brought on by the credit.¹³¹ Not only can these high marginal rates have the effect of creating powerful work disincentives, but also, with regard to the first dollars of income earned, the marginal rates can seem like a punishment for working.

Because, TANF welfare subsidies are often significantly reduced with the first dollar of income earned, there is inevitably a huge drop in government subsidies at the very lowest income levels. People who have been receiving TANF but begin to earn income will lose their entire welfare subsidy, but will only begin to receive the EITC in very small amounts. Only when they reach higher income levels will they qualify for the maximum amounts of the EITC. A more sensible system would be one that more

129. A detailed discussion of arguments regarding the minimum wage is outside of the scope of this paper. For an explanation of the minimum wage and its effect on the economy and on working families, see DAVID NEUMARK & WILLIAM L. WASCHER, *MINIMUM WAGES* (2008).

130. Historically, income ceilings and EITC amounts have increased slightly each year. If a minimum wage increase had the effect of causing inflation, any EITC increase would have to adjust accordingly, to ensure that recipients were, economically speaking, in at least the same situation as before.

131. See *supra* Part IV.A.

smoothly progresses in subsidy amounts from non-earners to very low earners. If it were possible to integrate the phasing-out of welfare subsidies with the subsidy for low-income earners that is currently available through the EITC, then the high marginal rates currently experienced by both subsidy recipients would likely be ameliorated. However, because TANF is administered through independent state agencies and the EITC is administered through the federal income tax system, there is currently a significant gap between the administration and the policy-making of the two systems. As Kaplow points out, the current system and its "apparent deviation from optimality seems to be a product of unintegrated thinking."¹³²

Integrating these two programs would require bringing discussions of welfare back into the public eye, and so it seems unlikely to happen in the near future. However, if it were possible to integrate the phasing-out of welfare subsidies with the subsidy for low-income earners that is currently available through the EITC, then the high marginal rates currently experienced by both subsidy recipients would likely be ameliorated, possibly to optimal levels. As Kaplow argues, "it is artificial and misleading to view components of the system in a vacuum. It is also inappropriate to allow arbitrary properties, such as phase-out targets, to guide analysis."¹³³ An integrated approach to subsidies for no-income and low-income earners would address this problem. However, it would also likely require the EITC to be removed from the administration of the income tax system, which would eliminate the benefits of this form of administration.¹³⁴ If it is the EITC's existence as a refundable income tax credit that makes it so politically viable, then it is, at a minimum, unclear how integration with a non-tax system federal subsidy would affect the EITC's future.

3. President's Advisory Panel on Federal Tax Reform

In November 2005 President Bush's Advisory Panel on Federal Tax Reform published its proposals for change in the federal income tax system, entitled *Simple, Fair, & Pro-Growth: Proposals to Fix America's Tax System*.¹³⁵ This quite thorough report suggested changes to the tax system as a whole and included proposals for reform of the current EITC. According to the proposal, the changes would better ensure progressivity in the tax system by incorporating diverse elements of the current system. Under the panel's proposal, six of the current credits or deductions aimed at families and/or low-income earners would be combined so that only two credits would remain. The current standard deduction, personal exemption, child tax credit,

132. KAPLOW, *supra* note 70, at 168.

133. *Id.* at 169.

134. For a discussion of these benefits, see *supra* Part III.D.

135. PRESIDENT'S ADVISORY PANEL ON FEDERAL TAX REFORM, *SIMPLE, FAIR, & PRO-GROWTH: PROPOSALS TO FIX AMERICA'S TAX SYSTEM* (2005), available at <http://www.taxreformpanel.gov/final-report/>.

and head of household increase in the standard deduction amount would be combined into a “Family Credit.”¹³⁶ The current EITC and refundable child tax credit would be combined into a “Work Credit.”¹³⁷

The Panel’s arguments for making these changes rely primarily on the increase in simplicity introduced into the tax system by reducing the number of credits available to taxpayers and by combining their eligibility requirements. Under the current system, there are varying eligibility requirements for the various credits available to taxpayers. For instance, a child must be under 17 in order to qualify for the child tax credit, but may be up to 23 for EITC purposes.¹³⁸ This difference requires that taxpayers who may qualify for both credits work through two different sets of rules for the same child. Indeed, none of the justifications for the existence of either the child tax credit or the EITC seem to adequately explain why there should be such a radical difference in the eligibility requirements for these two credits. On the other hand, since the EITC is aimed at low-income earners and the child tax credit is available to all taxpayers with children under the age of 17, that may serve as sufficient justification for the difference. Perhaps we want to make a larger credit available for a longer period of time to those who qualify for the EITC, and the same is not true for all taxpayers with children. Of course, in order to be able to make a determination like this, the justifications for and purposes behind these credits would need to be made clear, something that is still lacking.

The Panel claims that adjusting these qualifications so that they align more closely need not radically change the credit system as such. “The Panel’s objective is not to fundamentally change the amount or availability of these benefits, but to ensure that these provisions serve their intended purposes as efficiently as possible and with greater simplicity and transparency.”¹³⁹ They argue that the complexity of the current system is unjustified and has the negative result of making the EITC effectively unavailable to many of its intended recipients. The Panel points to the problem of paid preparers, the high level of error in EITC claims, and the high rate of eligible individuals who do not claim the credit as evidence of the current EITC’s problems. The proposed Work Credit would, the Panel claims, radically simplify the process so that individuals could claim the credit themselves or elect to have the IRS compute their credit for them.¹⁴⁰ While having the IRS compute the credit is a way to avoid the need for paid preparers, such an option is currently available with regard to the EITC. However, presumably allowing the IRS to calculate your credit for you will take longer than having a paid preparer do it, and so the same reasons that people currently seek out paid preparers (speed, convenience, and simplicity)

136. *Id.* at 63.

137. *Id.* at 63-64.

138. *Id.*

139. *Id.* at 64.

140. *Id.* at 68.

will continue to influence their choices. In addition, simplifying the process will not necessarily induce those who do not currently claim the credit to make the effort to file for it. Indeed, without an accompanying outreach program aimed at community support and awareness-raising, this new proposal will not likely have any more success on that front than does the current system.

Interestingly, the Panel includes in its proposal an explanation of why they believe that the EITC *must* phase out over higher income levels. In the course of its work, the Panel designed a potential scheme that “included a Work Credit without a phase-out and an additional tax rate that, together, would provide marginal tax rates that increase steadily as taxpayers earn more, instead of the marginal tax rate spikes found in the current EITC structure.”¹⁴¹ The elimination of the high marginal tax rates created by the EITC does seem to be a valuable addition, but ultimately the Panel decided *not* to make the Work Credit available to all taxpayers, because “the compliance costs and additional burden imposed on all taxpayers outweighed the potential benefits of simplicity and smoother increases in marginal tax rates for eligible Work Credit recipients.”¹⁴² The Panel decided that keeping the Work Credit focused on the same group for whom the current EITC is available was ultimately a more feasible option and was more likely to keep in place the progressive tax structure of the current system.

V. CONCLUSIONS

As a presidential candidate, Barack Obama denied that he believed in “redistribution,” but he has committed to continuing, and even expanding, the EITC program. Indeed, the changes to the EITC introduced in the ARRA are a step in the right direction. Whether or not politicians wish to identify the EITC as a program for the redistribution of wealth, it remains one of the largest wealth transfer programs currently operating in the United States. Given the long history of the program, as well as its extensive reach, understanding the mechanics, the rationale, and the success of the EITC seems critical now, as the credit grows even more important.

The EITC remains a more politically viable transfer and subsidy payment than many others that are available only to those who do not earn income. This political viability, while not a complete justification for the maintenance of any system, should not be too quickly discounted either. Since its inception, support for the EITC has been quite strong, and markedly stronger than support for programs such as TANF, which are often considered much more controversial. In any case, the mere fact that the EITC has been largely supported in the almost thirty years since it was introduced should, at

141. *Id.* at 69.

142. *Id.*

a minimum, be considered strong evidence of its effectiveness and political viability.

One significant hurdle faced by supporters of the EITC and those who propose maintaining and expanding the credit lies in the continuing lack of an explicit purpose. While the EITC has continued to enjoy strong political support, it has also continued to suffer from an absence of any clearly articulated purpose. Many reasons for its existence have been proposed, and it may be the case that the EITC's continued presence in fact satisfies many needs in the government's redistributive system. The EITC's ability to offset the burden of payroll taxes on the lowest income earners has regularly been a strong reason for maintaining the subsidy. However, this purpose cannot justify the increase in subsidy amounts for larger families or married couples. If the EITC were intended *merely* to offset payroll taxes, then the amount offered through the credit should exactly match the amount collected in payroll taxes. That is currently true only for taxpayers with no children. Another reason for maintaining the EITC that has been regularly cited by its supporters is the credit's ability to ease the burden experienced by those who lose their welfare subsidies as they begin earning income. The EITC is able to subsidize low-income earners without explicitly changing the requirements for receiving TANF. In this way, low-income earners are not punished for going to work, and the work disincentives that many find in the welfare system are somewhat alleviated. Finally, the current model for the EITC is often justified on the grounds that the credit is intended to help families in proportion to their size, in the same way that other federal redistributive programs account for family size in determining the subsidy amount. However, again, the EITC only responds to family size to a certain extent, since the credit stops increasing once a family has two children (three children, beginning in tax year 2009).

Regardless of the purpose behind the credit, as long as the EITC continues as a part of the tax system, it makes the most sense for its intended recipients to know about it and file for it. The current system is underutilized, and many low-income earners who qualify for the EITC either do not know about the credit or fail to file for it, and so do not receive it. Alternatively, many of those who do file for the credit do so through paid preparers and use RALs to receive their credit, immediately using a large portion of the credit to pay the costs associated with that loan. Both of these problems could be addressed through a better public outreach system notifying people of the existence of the EITC and helping them to file for the credit. Awareness of the program can be increased through various social services agencies (and indeed, already happens in these contexts), but assistance in filing for the credit is a problem that requires more specific expertise. Currently, private groups seem to have taken on the responsibility

of providing outreach and assistance with regard to the EITC.¹⁴³ This model is actually quite good, since the groups tend to be focused on the particular problems of the EITC and may be best able to help qualified EITC recipients move through the system. As a result of their concentrated work in this particular area, these groups may ultimately become the source of proposed changes to the EITC, potentially making it more efficient and more effective.

The idea of effecting wealth redistribution directly through the income tax system, so that refundable tax credits can work as a subsidy to earned income, is a good one. It may be true that the American system can be improved, and there are, as I have shown in this article, already suggestions for ways to effect that improvement. However, whatever changes may be made to the EITC in the future, it will be important to maintain its central characteristics of being administered through the income tax system, subsidizing the earnings of low-income workers, and varying in amount in response to family size.

143. There are a variety of different groups currently offering such assistance. Some examples include Community Development Corporations (CDCs), local bar associations, and student organizations, among others.

