

Legislative Recommendation #14**Prohibit Offset of the Earned Income Tax Credit (EITC) Portion of a Tax Refund to Past-Due Federal Tax Liabilities****SUMMARY**

- *Problem:* The IRS has discretion to not offset tax refunds to satisfy outstanding federal tax liabilities, but it has not exercised that discretion with respect to Earned Income Tax Credit (EITC) refunds. Reducing the amount of EITC a taxpayer is eligible to receive by withholding a tax refund undermines the purpose of this anti-poverty program.
- *Solution:* Prohibit the IRS from offsetting the EITC portion of a taxpayer's refund to satisfy prior-year tax liabilities.

PRESENT LAW

IRC § 6402(a) generally authorizes the IRS to offset (*i.e.*, withhold) a taxpayer's refund and apply it to satisfy a prior-year federal tax liability, but it does not require the IRS to do so.¹ If a taxpayer can demonstrate that he/she will experience an economic hardship if the IRS offsets his/her refund, the IRS sometimes will “bypass” the offset (*i.e.*, pay the refund). This is referred to as an “offset bypass refund” (OBR).² Similarly, the IRS paid refunds generated by Recovery Rebate Credits (RRCs) enacted during the COVID-19 pandemic without reduction to satisfy a tax debt.³

The EITC is a refundable credit for low-income working individuals and families.⁴ The EITC is claimed on a tax return and is included in the computations that determine whether a taxpayer is entitled to receive a refund and, if so, the amount of the refund.

The Debt Collection Improvement Act of 1996 (DCIA) requires federal agencies to offset certain federal payments to collect outstanding non-tax debts owed to the United States.⁵ However, the amount subject to offset is statutorily limited in some instances, and payments made pursuant to “means-tested” anti-poverty programs, such as Supplemental Security Income and Temporary Assistance to Needy Families, are exempt

1 *Kalb v. United States*, 505 F.2d 506, 509 (2d Cir. 1974), *cert. denied*, 421 U.S. 979 (1975). The IRS is required to offset a taxpayer's refund to certain liabilities, such as non-tax federal debts, past-due child support, and state income tax and unemployment compensation debts. See IRC § 6402(c), (d).

2 Internal Revenue Manual 21.4.6.5.11.1, Offset Bypass Refund (OBR) (Sept. 6, 2022).

3 In the Coronavirus Aid, Relief, and Economic Security (CARES) Act, Congress enacted IRC § 6428, providing for RRCs, payable in advance, which would not be offset to satisfy outstanding liabilities other than past-due child support obligations. See Pub. L. 116-136, § 2201(a), (d)(1)-(3). In the Consolidated Appropriations Act, 2021, Congress enacted IRC § 6428A, providing for additional RRCs, and amended section 2201 of the CARES Act to provide that only the portion of the RRCs that were paid as advance refunds were exempt from offset to satisfy outstanding liabilities other than past-due child support obligations. See Pub. L. No. 116-260, §§ 272(a), 273(b)(1). At TAS's urging, the IRS then exercised its discretion under IRC § 6402(a) to not offset RRCs, whether received in advance or claimed on a tax return, to satisfy outstanding tax liabilities, effective for returns filed on or after March 18, 2021. See, e.g., IRS Fact Sheet, FS-2021-17, QE2, A2 (Dec. 2021), <https://www.irs.gov/pub/taxpros/fs-2021-17.pdf>; IRS Fact Sheet, FS-2022-04, QF2, A2 (Jan. 2022), <https://www.irs.gov/pub/taxpros/fs-2022-04.pdf>.

4 IRC § 32. The Supreme Court has stated: “The earned income credit was enacted to reduce the disincentive to work caused by the imposition of social security taxes on earned income ... and to provide relief for low-income families hurt by rising food and energy prices.” *Sorenson v. Sec'y of Treasury*, 475 U.S. 851, 864 (1986).

5 See Debt Collection Improvement Act of 1996, Omnibus Consolidated Rescissions and Appropriations Act of 1996, Pub. L. No. 104-134 § 31001 110 Stat. 1321, 1321 (1996), (codified at 31 U.S.C. § 3716). The offsets are carried out through the Treasury Offset Program.

from offset when exemption is requested by the head of the agency administering the program.⁶ The EITC is sometimes referred to as a means-tested benefit, although it does not meet the DCIA definition of that term.⁷

Nevertheless, the amount of the EITC depends in part on the amount of a taxpayer's earned income. In 2022, for example, joint filers with no qualifying children who earn more than \$22,610 will be ineligible for the credit; if they have two qualifying children and earn more than \$55,529, they will be ineligible for the credit. All other filers with no qualifying children who earn more than \$16,480 in 2022 will be ineligible for the credit; those with two qualifying children who earn more than \$49,399 will be ineligible for the credit.⁸ Any taxpayer with more than \$10,300 of investment income in 2022 will be ineligible for the credit.⁹

REASONS FOR CHANGE

Like other anti-poverty programs, Congress created the EITC to provide financial assistance for low-income individuals and families and to reduce poverty. The average adjusted gross income of taxpayers who received the EITC for tax year 2020 was \$20,174.¹⁰

Taxpayers whose EITC refund is subject to offset may request an OBR, but the timeframe for requesting an OBR is narrow. The IRS must approve an OBR between the date the return is filed and the date the IRS assesses the tax shown on the return. This period is approximately ten to 20 days when a return is filed electronically. In fiscal year 2022, only 377 taxpayers received OBRs.¹¹

To its credit, the IRS has exercised its discretion to not offset some tax benefits to satisfy past-due federal tax liabilities, but the IRS has not adopted a policy of protecting EITC refunds from offset. Consistent with congressional recognition that offsets may impose economic hardships on recipients of federal benefits, the National Taxpayer Advocate recommends that Congress prohibit the IRS from offsetting the portion of a taxpayer's refund attributable to the EITC.

To be clear, we are not recommending that the full refund subject to offset be released – just the amount of the refund that is attributable to the EITC. Programming would be straightforward, rendering it easily administrable.¹²

RECOMMENDATION

- Amend IRC § 6402(a) to prohibit offset of the EITC portion of a taxpayer's refund to satisfy prior-year tax liabilities.

6 31 U.S.C. § 3716(c)(3)(B). "Means-tested programs" are those which base eligibility on a determination that the income and/or assets of the beneficiary are inadequate to provide the beneficiary with an adequate standard of living without program assistance. 31 C.F.R. § 285.5(e)(7)(i). The Secretary of the Treasury has the discretion to exempt payments made under programs which are not means-tested, when so requested by the payment agency. 31 U.S.C. § (c)(3)(B); 31 C.F.R. § 285.5(e)(7)(ii).

7 See, e.g., House Committee on the Budget, *What you Need to Know About Means-Tested Entitlements* (May 1, 2017), <https://budget.house.gov/publications/report/what-you-need-know-about-means-tested-entitlements>, and Congressional Budget Office, *Federal Means-Tested Programs and Tax Credits – Infographic* (Feb. 11, 2013), <https://www.cbo.gov/publication/43935>.

8 Rev. Proc. 2021-45, 2021-48 I.R.B. 764.

9 *Id.*

10 IRS, Compliance Data Warehouse (CDW), Individual Return Transaction File (data as of Oct. 28, 2022).

11 IRS, CDW, Individual Master File Transaction History table (data as of Oct. 28, 2022).

12 The Section of Taxation of the American Bar Association (ABA) has also advocated for a prohibition against offsetting the refunds of EITC recipients during the pandemic. ABA, COMMENTS REGARDING REVIEW OF REGULATORY AND OTHER RELIEF TO SUPPORT TAXPAYERS DURING COVID-19 PANDEMIC (Jan. 15, 2021), <https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/2021/011521comments.pdf>.