

Legislative Recommendation #53**Allow Taxpayers the Option of Using Prior Year Income to Claim the Earned Income Tax Credit (EITC) During Federally Declared Disasters****SUMMARY**

- *Problem:* A low-income worker who loses his job due to a federally declared disaster may suffer a double financial hit – loss of wage income and loss of Earned Income Tax Credit (EITC) benefits. On several occasions, Congress has mitigated the EITC impact by allowing affected individuals to claim EITC benefits on the basis of their prior year's income, but on other occasions, similarly affected taxpayers have not received this relief.
- *Solution:* Establish a general rule allowing taxpayers in a federally declared disaster area the option of claiming EITC benefits on the basis of their prior-year earned income.

PRESENT LAW

The EITC is a refundable credit for low- and moderate-income working families. Eligibility for the EITC and the amount of EITC to which a taxpayer is entitled are based on several factors, including the taxpayer's earned income, the number of qualifying children, and the taxpayer's filing status.¹ Taxpayers without qualifying children may be eligible for the "childless EITC."²

IRC § 165(i)(5) defines a "Federally declared disaster" as any disaster determined by the President to warrant federal assistance under the Robert T. Stafford Disaster Relief and Emergency Assistance Act, and it defines a "disaster area" as any area so determined to warrant federal assistance.

On numerous occasions when the President has declared a disaster, Congress has passed legislation to give affected taxpayers who earn less income in the disaster year than the prior year the option of using their prior-year income to calculate their EITC benefits.³ This provision is referred to as the "EITC lookback rule." Most recently, Congress authorized the EITC lookback rule for tax years 2020 and 2021 to provide relief from the COVID-19 pandemic.⁴

REASONS FOR CHANGE

In general, the EITC is designed to incentivize work, and its benefits are only available to individuals who have earned income. During major disasters like the COVID-19 pandemic or hurricanes, many employed individuals experience a disruption in work, a furlough, or a job termination. If these taxpayers had earned income levels that qualified them for EITC benefits, they may suffer a double financial hit. They not only lose the income from their jobs, but because they are no longer earning income, they also may lose their EITC benefits.

1 IRC § 32.

2 *Id.*

3 *See, e.g.,* American Rescue Plan Act, Pub. L. No. 117-2, § 9626, 135 Stat. 4, 157 (2021); Consolidated Appropriations Act, 2021, Pub. L. No. 116-260, § 211, Div. EE, Title II (2020); Disaster Tax Relief and Airport and Airway Extension Act of 2017, Pub. L. No. 115-63, § 504, 131 Stat. 1168, 1183 (2017); Heartland Disaster Tax Relief of 2008, Pub. L. No. 110-343, Div. C, Title VII, Subtitle A, § 701, 122 Stat. 3765, 3912 (2008); Katrina Emergency Tax Relief Act of 2005, Pub. L. No. 109-73, Title IV, § 406, 119 Stat. 2016, 2028 (2005).

4 *Id.*

The EITC lookback rule is designed to provide relief to taxpayers in this circumstance. To illustrate, assume a mother who was consistently employed for several years was laid off when the COVID-19 pandemic struck in early 2020. As a result, she did not have sufficient 2020 earned income to qualify for significant EITC benefits. The EITC lookback rule provided relief by allowing her to qualify for EITC benefits on the basis of her income in 2019.

To date, Congress has authorized use of the EITC lookback rule on a disaster-by-disaster basis. This one-off approach leaves taxpayers (and the IRS) with uncertainty and means that relief is only provided in circumstances where Congress takes an affirmative act. To ensure that all individuals affected by a federally declared disaster receive relief, the National Taxpayer Advocate recommends that Congress revise IRC § 32 to permanently provide this election to all taxpayers who are affected by a federally declared disaster as defined by IRC § 165(i)(5).

RECOMMENDATION

- Amend IRC § 32 to allow taxpayers who are affected by a federally declared disaster as defined by IRC § 165(i)(5) to elect the use of their prior year's earned income to calculate and claim the EITC.⁵

⁵ For legislative language generally consistent with this recommendation, see COVID-19 Earned Income Act, S. 3542 & H.R. 6762, 116th Cong. (2020), except that our recommendation is to make relief permanent rather than specific to a single tax year.