

Legislative Recommendation #16**Prohibit Offset of the Earned Income Tax Credit (EITC) Portion of a Tax Refund to Past-Due Federal Tax Liabilities****SUMMARY**

- *Problem:* Taxpayers who qualify for social welfare benefits generally are low-income and rely on these benefits to pay their basic living expenses. When a taxpayer eligible for the Earned Income Tax Credit (EITC) has an outstanding federal tax liability, the IRS ordinarily will withhold any refund due to satisfy the liability, potentially leaving the taxpayer without sufficient funds to pay expenses. Reducing the amount of EITC a taxpayer receives 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 During the COVID-19 pandemic, the IRS exercised its discretion to pay refunds generated by Recovery Rebate Credits (RRCs) to all eligible taxpayers without reduction to satisfy outstanding tax debts.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). The IRS is required to offset a taxpayer's refund to pay down 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 (IRM) 21.4.6.5.11.1, Offset Bypass Refund (OBR) (Sept. 6, 2022), https://www.irs.gov/irm/part21/irm_21-004-006r.

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. No. 116-136, § 2201(a), (d)(1)-(3), 134 Stat. 281, 335-340 (2020). 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), 134 Stat. 1182, 1965-1978 (2020). 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, IRS Updates 2020 Recovery Rebate Credit Frequently Asked Questions, Q&A-E2 (Dec. 2021), <https://www.irs.gov/pub/taxpros/fs-2021-17.pdf>; IRS Fact Sheet, FS-2022-04, IRS Issues Frequently Asked Questions to Assist Those Claiming the 2021 Recovery Rebate Credit, Q&A-F2 (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, 1321-358 (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

REASONS FOR CHANGE

Like other anti-poverty programs, Congress created the EITC to provide financial support 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 \$18,768.⁸ If a low-income taxpayer has an unpaid tax debt, however, the IRS may offset the taxpayer's refund – including the portion generated by the EITC – to satisfy the debt. Withholding EITC benefits undermines the EITC's anti-poverty objective.

Taxpayers can request an OBR for their refund – including the EITC portion – but the timeframe for making such a request 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. Additionally, the IRS does not widely publicize its offset bypass refund program. As a result, many taxpayers are unaware they can obtain an OBR or learn about the option after it is too late for the bypass to be input. In fiscal year 2023, only 727 taxpayers received OBRs.⁹

To its credit, the IRS has exercised its discretion to not offset tax benefits to satisfy past-due federal tax liabilities in limited cases, but it has not adopted a general policy of protecting EITC refunds from offset. Consistent with congressional recognition reflected in the DCIA 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 portion of the refund that is attributable to the EITC. Programming would be straightforward, rendering it easily administrable.¹⁰

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. § 3716(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://democrats-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 IRS, Compliance Data Warehouse (CDW), Individual Return Transaction File (data as of Sept. 28, 2023).

9 IRS, CDW, Individual Master File Transaction History table (data as of Sept. 28, 2023).

10 The Section of Taxation of the American Bar Association (ABA) has also advocated for a prohibition against offsetting the refunds of EITC recipients. ABA, *Proposals for Improvements in Taxpayer Service* (Apr. 5, 2022), <https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/2022/040522comments.pdf>; 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>.