Legislative Recommendation #51
Restructure the Earned Income Tax Credit (EITC) to Make It Simpler for Taxpayers and Reduce Improper Payments

SUMMARY

- **Problem:** The Earned Income Tax Credit (EITC) is one of the federal government’s largest anti-poverty programs, but its eligibility requirements are complex. As a result, millions of eligible taxpayers fail to claim the EITC, while other taxpayers claim amounts for which they are not eligible, leading to a high “improper payments” rate.

- **Solution:** Simplify the EITC by breaking it out into a “worker credit” and a “child credit,” revising the definition of a “qualifying child,” and making other structural changes.

PRESENT LAW

The EITC is a refundable credit for low- and moderate-income working individuals and families. Eligibility for the EITC and the amount of EITC a taxpayer may claim are based on a variety of factors, including the taxpayer’s earned income, the number of qualifying children, and the taxpayer’s filing status. The EITC is not available to taxpayers who have disqualified income (e.g., investment income such as dividends, capital gains, and rental income) that exceeds the applicable limit ($10,300 for tax year (TY) 2022).

The EITC is structured so that as earned income rises, the credit phases in, plateaus at a maximum amount, and then phases out. The phase-in, maximum, and phase-out amounts depend on the taxpayer's filing status and the number of qualifying children. The maximum credit for TY 2022 is $560 if the taxpayer has no qualifying children, $3,733 with one qualifying child, $6,164 with two qualifying children, and $6,935 with three or more qualifying children. An example using a married couple filing jointly with three qualifying children illustrates how the phase-in and phase-out work. For TY 2022, the credit phases in as a couple’s earned income approaches $15,400, plateaus at $6,935 if the couple’s earned income is between $15,400 and $26,299 and phases out until the couple’s earned income reaches $59,187, at which point the credit is $0.

An individual must meet three primary requirements to be a taxpayer’s “qualifying child” for the EITC. First, the individual must have a specific blood or legal relationship to the taxpayer. Second, the individual must share a residence in the United States with the taxpayer for more than half the year. Third, the individual must be under the age of 19 (or under age 24 if a full-time student) or be permanently and totally disabled.
Taxpayers without qualifying children may also claim the EITC. The childless EITC is limited to taxpayers aged 25 to 64. For TY 2022, the credit for workers without qualifying children plateaus at $560 for married-filing-jointly taxpayers earning between $7,300 and $15,299 and for single taxpayers earning between $7,300 and $9,199. The American Rescue Plan Act of 2021 (ARPA) made several changes to the childless EITC that applied only in 2021. For 2021, ARPA raised the maximum EITC from $538 to $1,502, raised the income eligibility caps, expanded the age range of eligible workers to include adults aged 19 to 24, removed the upper age limit, and made qualified homeless and former foster youth eligible to claim the EITC at age 18.

Unemployment compensation (UC) is based on a taxpayer’s earned income and is included in adjusted gross income (AGI) under IRC § 85, but it is generally not included in earned income under IRC § 32 and thus does not count in computing the amount of EITC for which a taxpayer is eligible.

REASONS FOR CHANGE

Enacted in 1975, the EITC is one of the federal government’s largest anti-poverty programs for low-income workers. For TY 2022, taxpayers filed over 21 million returns claiming EITC benefits worth about $57 billion. Overall, the EITC is considered to be an effective anti-poverty program, but its eligibility requirements are complex. As a result, some taxpayers who are eligible for the credit fail to claim it, missing out on this important benefit. At the same time, the program suffers from a relatively high rate of improper payments that could be reduced if the eligibility requirements were simplified.

Notably, the EITC was enacted at a time when families with biological or legal relationships with the claimed children predominated. Modernizing the eligibility requirements to reflect the increasing prevalence of non-traditional families could increase the participation rate among eligible taxpayers, allow guardians other than parents to receive benefits when they are the principal caretakers, and reduce improper payments. Finally, the credit should be made available to taxpayers who enter the workforce at age 19 and taxpayers who remain in the workforce after age 64.

Restructure EITC as Two Credits: A Worker Credit and a Child Credit

The National Taxpayer Advocate recommends restructuring the EITC into two credits: (i) a refundable worker credit based on each individual worker’s earned income, irrespective of the presence of a qualifying child, and (ii) a refundable child credit that would reflect the costs of caring for one or more children.

Worker Credit. Much like the current EITC, the worker credit would phase in as a percentage of earned income, reach a plateau, and then phase out. Unlike the current EITC, the credit amount would depend solely on income and would not vary based on whether the taxpayer is claiming one or more qualifying

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9 IRC § 32(c)(1)(A)(ii).
14 An improper payment is defined as “any payment that should not have been made or that was made in an incorrect amount, including an overpayment or underpayment, under a statutory, contractual, administrative, or other legally applicable requirement” and includes “any payment to an ineligible recipient.” 31 U.S.C. § 3351(4). For fiscal year 2022, the IRS estimates that nearly 32 percent of the total EITC program payments were improper. Payment Accuracy, Fiscal Year 2022 (Nov. 5, 2023).
Increasing the worker component of the EITC would provide a greater incentive to work, which is a main objective of the credit. This structure also would target the credit to the lowest-earning taxpayers based on AGI (a broader measure of income that includes unearned income like capital gains, dividends, rents, and royalties). This would be similar to the current EITC provision that denies the credit to taxpayers with excessive investment income.

This change could also substantially reduce improper payments. The IRS receives Forms W-2 and other information reporting documents directly from employers and other payors of income. For that reason, it can accurately verify income amounts for EITC recipients who are employees, by far the largest group of EITC claimants.

Child Credit. The child credit would be designed as a fixed amount per qualifying child, subject to an AGI phase-out, and would replace the portion of the existing EITC that is based on the number of qualifying children. It could be consolidated with or replace the Child Tax Credit (CTC). This could be accomplished in various ways, and proposals to expand the CTC might provide a starting point for developing the new credit. One option is to adopt ARPA’s changes to the CTC and modernize the definition of a qualifying child. Some of ARPA’s CTC changes included increasing the maximum credit amount per qualifying child from $2,000 to $3,000 ($3,600 for children under six), making the credit fully refundable for certain taxpayers, increasing a qualifying child’s age from 17 to 18, and changing the income phase-outs.

Remove Age Eligibility Restrictions

As described above, the childless worker credit is generally available only to taxpayers between the ages of 25 and 64. We recommend expanding eligibility to include all taxpayers over the age of 18. There are an estimated 32 million individuals under the age of 25 and over the age of 64 who are participating in the workforce. This includes about 21 million individuals under the age of 25 and about 11 million individuals over the age of 64. Consistent with the EITC program’s dual mission of alleviating poverty and providing a work incentive, we do not believe these individuals should be excluded from EITC eligibility.

Unemployment Compensation

Taxpayers who receive UC based on their employment earnings cannot use their UC income to qualify for the EITC. The apparent rationale for not counting UC is that the EITC was designed largely to provide a work incentive. However, UC is paid exclusively to individuals who were working and became separated from their jobs due to no fault of their own. During the COVID-19 pandemic, for example, millions of individuals lost their jobs when certain segments of the economy, including restaurants, hotels, and airlines, substantially reduced their workforces. In other instances, local disasters such as hurricanes, tornadoes, and wildfires adversely affect segments of the economy and lead to mass layoffs. Because UC is effectively a replacement for lost wages, we do not believe these individuals should be excluded from EITC eligibility.

16 Proposals frequently couple an increased childless EITC or worker credit with an increased minimum wage. See, e.g., Isabel V. Sawhill & Quentin Karpilow, Raising the Minimum Wage and Redesigning the EITC, Brookings Inst. (Jan. 30, 2014), https://www.brookings.edu/research/raising-the-minimum-wage-and-redesigning-the-eitc. Some experts caution that without a minimum wage, the EITC’s effects on labor supply would reduce wages and allow employers to capture some of the credit’s benefit. See Austin Nichols & Jesse Rothstein, The Earned Income Tax Credit, Economics of Means-Tested Transfer Programs in the United States, vol. 1, at 137 (Robert A. Moffitt ed., 2016), http://www.nber.org/books/moff14-1.

17 IRC § 32(i).

18 A relatively small percentage of EITC claimants are self-employed individuals. The IRS receives somewhat less information from third-party payors with respect to self-employed individuals.


and because UC benefits are only paid for a limited number of months, treating UC as earned income solely for purposes of the EITC would provide additional support for low-income families while still maintaining the nexus between working and receiving the EITC.\textsuperscript{21}

**Modernize the Definition of a Qualifying Child**

The qualifying child rules of the current EITC structure may not reflect real-life living arrangements. The number of households made up of “traditional families” (married parents with only biological children) has declined over time, while alternative family types, such as families led by single parents or cohabitating adults, have increased.\textsuperscript{22} In recent years, slightly more than half of children living in families with incomes at or below 200 percent of the Federal Poverty Level were in families headed by married couples.\textsuperscript{23} This means nearly half of low-income children live in non-traditional families, with additional complexities arising when children experience change in family structure during the year or from year-to-year.\textsuperscript{24}

That point bears emphasis: Nearly half of all low-income children now live in non-traditional families. To ensure the target population receives the EITC, the eligibility rules should be revised to account for this reality. For example, instead of focusing on biological relationships, the definition of a qualifying child should consider which adult provides primary care for the child. This approach could focus on factors such as who makes medical appointments for the child, who prepares meals for the child, and who is the contact for the child at school. Since the EITC is a credit for lower income families, its eligibility requirements should accurately reflect the target population.\textsuperscript{25}

**RECOMMENDATIONS**

- Separate the EITC into two refundable components: a worker credit and a child credit.
- Expand the age eligibility for the EITC to individuals who have attained age 19 (age 18 in the case of qualified homeless or former foster youth and age 24 for specified students), with no upper age limit.
- Amend IRC § 32(c)(2)(A)(i) to include unemployment compensation as EITC-qualifying earned income.
- Amend IRC § 32(c) to modernize the definition of a qualifying child to better reflect evolving family units.\textsuperscript{26}

\textsuperscript{21} We recognize an unintended consequence of including UC in AGI is that it may diminish a taxpayer’s EITC claim, and in some instances, may make taxpayers ineligible to claim the EITC.


\textsuperscript{26} Relevant considerations should include which adult performs caregiving and makes caregiving decisions for the child, including factors like who prepares meals, who transports the child to school, and who makes medical appointments for the child. For a more detailed discussion on modernizing the definition of a “qualifying child,” see National Taxpayer Advocate Fiscal Year 2020 Objectives Report to Congress vol. 3, at 17 (Earned Income Tax Credit: Making the EITC Work for Taxpayers and the Government), https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/JRC20_Volume3.pdf.