



THE PRESIDENT'S PROPOSAL TO EXPAND THE EARNED INCOME TAX CREDIT

Executive Office of the President and
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"There are other steps we can take to help families make ends meet, and few are more effective at reducing inequality and helping families pull themselves up through hard work than the Earned Income Tax Credit. Right now, it helps about half of all parents at some point. But I agree with Republicans like Senator Rubio that it doesn't do enough for single workers who don't have kids. So let's work together to strengthen the credit, reward work, and help more Americans get ahead."

- President Obama, State of the Union Address, January 28, 2014

Introduction and Summary

The Earned Income Tax Credit (EITC) is among the Nation's most significant tools for reducing poverty and encouraging people to enter the workforce. Expansions of the EITC and the refundable Child Tax Credit (CTC) enacted during this Administration benefit 16 million families with 30 million children and have helped lift about 1.4 million Americans out of poverty. Altogether, the EITC and the refundable CTC now support 32 million working families, lifting 10.1 million people, including 5.3 million children, out of poverty. In addition, research has consistently found that the EITC also boosts incomes by increasing employment, with one recent study finding that the EITC leads about 1 in 10 parents who would not otherwise be working to enter the labor force. As a result, its full effects on poverty and hardship may be even greater than its direct effects.

Workers without qualifying children, however, miss out on these anti-poverty and employment effects of the EITC. The EITC available to workers without children and non-custodial parents (the "childless worker EITC") is small and phases out at very low incomes. As such, it provides little assistance to childless individuals at or near the poverty line and little incentive to enter the workforce. Moreover, the current age restrictions prevent workers younger than 25 from claiming the childless worker EITC, excluding young workers living independently from their parents from its pro-work effects. This represents an important missed opportunity. For individuals at this formative stage of life, encouraging employment and on-the-job experience could help establish patterns of labor force attachment that would persist throughout their working lives.

The President has proposed to address these problems with the current childless worker EITC by doubling the maximum credit to about \$1,000 and increasing the income level at which the credit is fully phased out to about \$18,000 (roughly 150 percent of the Federal poverty line for a single adult). The proposal would also make the credit available to young adult workers age 21 and older and would raise the EITC's upper age limit from 65 to 67, harmonizing it with the recent and scheduled increases in the Social Security full retirement age.

The President's proposal would:

- **Directly reduce poverty and hardship for 13.5 million low-income workers struggling to make ends meet.**
 - Under the President's proposal, 7.7 million workers would be eligible for a larger EITC, while 5.8 million workers would be newly eligible for the credit. (See State-by-State estimates in the appendix.)
 - Those newly eligible would include 3.3 million working young adults age 21 to 24, 300,000 older workers age 65 or 66, and 2.2 million workers with incomes above the current cut-offs.
 - The increase in the credit would lift about half a million people above the poverty line and reduce the depth of poverty for 10 million more.
 - Non-custodial parents likely comprise 1.5 million or more of those benefiting from the proposed EITC expansion. By boosting these parents' incomes – and encouraging work – the expansion may benefit their children as well.
- **Encourage and support work, especially among a number of groups with falling or low labor force participation rates.**
 - Research has consistently found that the EITC for families with children increases employment, especially among single mothers, with the 1980s and 1990s EITC expansions pulling more than half a million people into the labor force.
 - Many experts, including conservative economists, believe a more robust childless worker EITC could replicate these successes, and a UK tax credit available to childless adults did raise labor force participation among that group.
 - Researchers have found that the EITC for families with children has larger effects on work in areas of the country where it is more widely known. A more robust EITC would not only provide a larger financial incentive for work, it would also probably be more salient, and so its pro-work impact might increase more than proportionately.
 - The proposed EITC expansion would target a number of groups with low or declining labor force participation rates or for whom there are other compelling reasons to strongly subsidize work. These include: men without a college education, whose labor force participation rates have been falling for decades, along with their wages; women without dependent children, who comprise a significant share of low-wage workers; young adults not enrolled in school; workers with disabilities; and older workers.

- **Take an important step toward tax reform by shifting resources from unproductive tax loopholes to reducing poverty and supporting work.**
 - Since the 1970s, the tax code has gone from increasing to reducing poverty for families with children, but it still increases the poverty rate among childless households. The President's proposal would make significant progress toward realizing the principle that the tax system should not push people into or deeper into poverty.
 - The President is proposing to pay for the EITC expansion by closing tax loopholes that let some high-income professionals avoid income and payroll taxes that everyone else has to pay. Addressing these loopholes was also a part of Chairman Camp's tax reform proposal released last week. The President is proposing to devote the savings from these provisions to lowering tax rates and cutting taxes for low-income workers, an important step toward reforming the tax code.

Historically, the EITC has enjoyed strong bipartisan support, with EITC expansions signed into law by every President since the EITC was first enacted under President Ford, and under both Democratic and Republican Congresses. More recently, policymakers and experts from both parties have increasingly advocated expanding the childless EITC. (See the box on page 16.) The President's proposal to expand the EITC for childless adults would build on the EITC's success by increasing the return to work for 13.5 million current workers, increasing incentives for other non-parents and non-custodial parents to enter the workforce, and reducing poverty and hardship.

I. Reducing Poverty and Alleviating Hardship

The EITC – as well as the refundable Child Tax Credit, which also supplements earnings for working parents – are among the Federal government’s most effective anti-poverty tools. Together, these policies directly lift 10.1 million people out of poverty, including 5.3 million children, while reducing the depth of poverty for many more. Research shows that families use their EITC refunds to meet basic needs, for example paying utility bills or purchasing clothing, as well as to make investments, such as buying a car, that can help them get ahead.¹

Strengthening the EITC and the Child Tax Credit for Families with Children

From the beginning of his presidency, President Obama has worked to strengthen the EITC and the Child Tax Credit to make them more effective at reducing poverty and hardship among families with children, while also increasing incentives to enter the labor force and get work. The American Recovery and Reinvestment Act of 2009 (the Recovery Act) made important improvements in both credits, specifically:

- **Making the Child Tax Credit available to working parents with low earnings.** In the absence of the Recovery Act improvements, working parents with earnings below about \$14,000 would not be eligible for the Child Tax Credit in 2015, and a single parent with two children would need earnings of about \$25,000 to benefit in full (a married couple would need earnings close to \$28,000). The Recovery Act extended eligibility for the Child Tax Credit to working parents with low earnings, providing about 12 million working families with an average benefit of about \$900 per family in 2015.
- **Expanding the EITC for families with more than two children and married couples.** Families with more than two children face higher costs and have higher poverty rates than smaller families but until 2009 were not eligible for additional help from the EITC. The Recovery Act increased the maximum EITC for these families, while also expanding EITC eligibility for married couples to reduce EITC marriage penalties. These changes will benefit about 6 million working families in 2015.

Together, these provisions benefit 16 million families with 30 million children and directly lift about 1.4 million Americans out of poverty.² In 2010 and 2012, the President fought hard to continue these improvements, working with members of Congress from both parties to extend them through 2017, and he has proposed to make them a permanent part of the tax system.

¹ See for example, Andrew Goodman-Bacon and Leslie McGranahan, “How Do EITC Recipients Spend Their Refunds?” Federal Reserve Bank of Chicago, 2008, http://www.chicagofed.org/digital_assets/publications/economic_perspectives/2008/ep_2qtr2008_part2_goodman_eta.pdf.

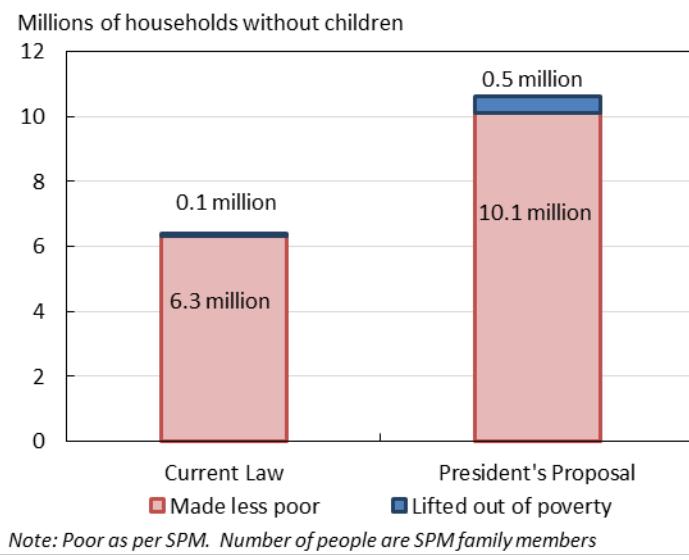
² All poverty calculations in this report use the Census Supplemental Poverty Measure; unlike the official poverty measure, the SPM takes into account taxes, refundable credits, and non-cash transfers. Poverty figures are for 2012, the most recent year for which data are available.

Strengthening the EITC for Childless Adults and Non-Custodial Parents

While an EITC is also available to very low-income working adults without children, three problems with the current childless worker EITC keep it from playing a major role in reducing poverty or encouraging people to enter the workforce. First, the current childless worker EITC is small, with a maximum credit of only about \$500. Second, it phases out at very low incomes. A single worker with income at the poverty line qualifies for a credit of less than \$200 (because the credit is more than half way phased out at that income level), while a full-time minimum wage worker receives less than \$25. Third, the childless worker EITC is available only to workers age 25-64. The exclusion of younger workers is unfortunate, since it prevents the EITC from helping to establish a connection to the labor market at this formative stage in a worker's life.

The President's proposal, described in more detail in the box on page 6, would address all three of these issues. It would double the maximum credit to about \$1,000 in 2015; increase the income levels at which the credit begins to phase out so that single workers would remain eligible up to an earnings level of about \$18,000 (roughly 150 percent of the poverty level); and make the credit available to workers ages 21-66, allowing younger workers to benefit and harmonizing the upper age limit with the recent and scheduled increases in the Social Security full retirement age.

Figure 1: The President's EITC Proposal Would Reduce Poverty Among Adults Without Children



THE PRESIDENT'S PROPOSAL TO EXPAND THE EITC

The President's proposal would increase the EITC for workers without qualifying children by doubling the phase-in rate and the phase-out rate from 7.65 percent to 15.3 percent and doubling the maximum credit from \$503 to \$1,005. The beginning of the phase-out range would be increased from \$8,220 to \$11,500 for 2015 (from \$13,720 to \$17,000 for joint filers), and the credit would be fully phased out at an income level of \$18,070 for single taxpayers and \$23,570 for married taxpayers filing jointly. All parameters would be indexed for inflation in future years, as under current law.

Table 1: Current Law and Proposed Childless Worker EITC Parameters		
	Current Law	Proposal
Phase-in rate	7.65%	15.3%
Phases in up to	\$6,570	\$6,570
Maximum credit	\$503	\$1,005
Phase-out rate	7.65%	15.3%
Phase-out starts*	\$8,220	\$11,500
Phase-out ends*	\$14,790	\$18,070

* Under both current law and the proposal, levels are \$5,500 higher for married filers.

The proposal would allow taxpayers at least age 21 and under age 67 to claim the EITC, if otherwise eligible. As under current law, however, taxpayers who are eligible to be claimed as someone else's qualifying child or dependent would not be eligible to claim the childless worker EITC (whether or not they were actually claimed as qualifying children or dependents). Thus, full-time students younger than age 24 would remain ineligible for the childless worker EITC, unless they are financially independent of their parents.

Examples

- ❖ **Single worker at the poverty line.** An individual who works 35 hours per week at the minimum wage earns \$12,688, close to the poverty line for a single adult in 2015. Under current law, this individual would receive an EITC of only \$161 (\$503 less 7.65% x earnings over \$8,220). Under the proposal, the worker would receive an EITC of \$823.
- ❖ **A 23-year old earning just above the minimum wage, with an income of \$15,000.** Under current law, this worker is doubly ineligible for the EITC, by virtue of her age and the fact that her earnings are above \$14,790. Under the proposal, she would be eligible for an EITC of \$470.
- ❖ **A 21-year old working 10 hours per week while attending college with the financial support of his parents.** Under the President's proposal, this individual would remain ineligible for the EITC because he would be eligible to be claimed as a dependent.

The proposed EITC expansion would benefit 13.5 million workers. This includes 5.8 million who would be newly eligible for the credit and 7.7 million who would receive a larger EITC.

The individuals who would benefit from the proposed expansion work hard at low-paying jobs. As shown in Table 2, the most common occupations among those benefiting from the proposed expansion are low-wage retail or food service jobs, including cashiers, retail salespeople, waiters and waitresses, and cooks. More than half a million of those who would benefit work as nursing, psychiatric, or personal and home health care aides, providing critical services to sick or elderly people at low pay. Others work as janitors, maids, construction workers or in other physically taxing jobs.

Table 2: The 15 Most Common Occupations Among Workers Benefiting from Proposed EITC Expansion	
	Workers (Millions)
Cashiers	0.7
Retail salespersons	0.6
Waiters and waitresses	0.6
Cooks	0.6
Janitors and building cleaners	0.5
Laborers and freight, stock, and material movers	0.4
Stock clerks and order filers	0.3
Nursing, psychiatric, and home health aides	0.3
Maids and housekeeping cleaners	0.3
Personal and home health care aides	0.3
Ground maintenance workers	0.3
Construction laborers	0.3
Truck drivers	0.3
Child care workers	0.2
Food preparation workers	0.2
Source: CEA calculations from Current Population Survey	

Of the workers benefiting from the expansion, about three quarters live in households with incomes below 150 percent of the poverty line, while virtually all of the rest live in households with incomes below 200 percent of the poverty line. The proposed EITC expansion would directly lift about half a million people out of poverty and reduce the depth of poverty for another 10.1 million people (see Figure 1).

EVIDENCE ON THE EITC AND CHILDREN'S OUTCOMES

In addition to the evidence showing that the EITC encourages work, recent research has found that, by adding to families' incomes, the EITC improves infant health, boosts school-age children's academic achievement, and raises older children's college enrollment rates:

- **Infant health.** The 1993 EITC expansion was found to reduce the incidence of low birth weight by 7-11% per \$1,000 of additional EITC, with part of the mechanism being increased prenatal care.*
- **Academic achievement.** The EITC and refundable Child Tax Credit have been found to improve math and reading test scores, with gains of a third of a standard deviation or more for families eligible for the maximum EITC.** (To put these numbers in context, moving up a third of a standard deviation would be equivalent to moving from the median to about the 63th percentile on a test.)
- **College enrollment.** For older children, researchers have found that the EITC increases college enrollment, with a 2-3 percentage point increase in enrollment per \$1,000 of parents' EITC in the spring of a student's senior year of high school. This is comparable to the impact of State grant programs like the Georgia HOPE Scholarship and implies that, for families receiving close to the maximum EITC, the credit may increase high school seniors' college enrollment rates by 10-15 percentage points.***

While this evidence is less directly relevant to expanding the EITC for workers without qualifying children, it is worth noting that many of those who benefit from the "childless worker" EITC are in fact non-custodial parents. According to estimates by the Urban Institute, non-custodial parents comprise 10-15 percent of those benefiting from the current childless worker EITC, suggesting that non-custodial parents probably comprise 1.5 million or more of those benefiting from the proposed EITC expansion.**** As with the EITC for families with children, boosting these parents' incomes – and encouraging them to enter or remain in the labor force – is likely to benefit their children as well.

* Hilary W. Hoynes, Douglas L. Miller, and David Simon, "Income, the Earned Income Tax Credit, and Infant Health," National Bureau of Economic Research Working Paper, July 2012.

** Raj Chetty, John N. Friedman, and Jonah Rockoff, "New Evidence on the Long-Term Impacts of Tax Credits," Internal Revenue Service Statistics of Income Working Paper, November 2011, <http://www.irs.gov/pub/irs-soi/11rpchettfriedmanrockoff.pdf>; Gordon B. Dahl and Lance Lochner, "The Impact of Family Income on Child Achievement: Evidence from the Earned Income Tax Credit," American Economic Review, 2012, <http://dss.ucsd.edu/~gdahl/papers/children-and-EITC.pdf>.

*** Daymond S. Manoli and Nicholas Turner, "Cash-on-Hand and College Enrollment: Evidence from Population Tax Data and Policy Nonlinearities," National Bureau of Economic Research Working Paper, January 2014, <http://www.nber.org/papers/w19836>.

**** Laura Wheaton and Elaine Sorensen, "Extending the EITC to Noncustodial Parents: Potential Impacts and Design Considerations," The Urban Institute, May 23, 2009.

II. Encouraging and Supporting Work

The discussion above analyzes the direct effects of the proposed EITC expansion: the reduction in poverty and hardship for individuals who already have earnings that would entitle them to the expanded credit. However, a more robust childless worker EITC would likely also lead some individuals not currently working to enter the labor force. To the extent that occurs, the expansion would do more to boost individuals' incomes and, especially for young adults, to improve their long-term prospects.

Evidence on the EITC and Work

A range of economic research since the 1990s has found that the EITC for families with children has increased work, especially among single mothers. Many different studies, over many years, have shown that the large expansions of the EITC in the 1980s and 1990s significantly boosted employment among mothers who were previously out of the labor force. This research suggests that the EITC expansions raised the labor force participation rate of single mothers by 7 percentage points or more, the equivalent of inducing more than half a million people to enter the labor force.³ According to one recent estimate, the level of incentives currently offered by the EITC causes about 1 in 10 parents who would otherwise be out of the labor force to start working. The pro-work incentives in the EITC also increase earnings by low-income individuals already in the labor force and subject to the "phase-in" incentives, without significant reductions in earnings from those subject to the "phase-out." For instance, for individuals with two children, the phase-in incentives boost total earnings by 25 percent while the phase-out incentives reduce earnings by just 2 percent.⁴

Because the current childless worker EITC is small and phases out at low income levels, there is little direct evidence on the EITC's effect on work among this population. But there is every reason to believe that the same positive effects seen among individuals with children would also apply to childless workers. For example, University of Wisconsin economist John Karl Scholz has argued that more robust wage subsidies could help reverse the long-term labor force

³ See for example, Jeffrey Grogger, "The Effects of Time Limits, the EITC, and Other Policy Changes on Welfare Use, Work, and Income Among Female-Headed Families," *Review of Economics and Statistics*, 2003 and Jeffrey Liebman and Nadda Eissa, "Labor Supply Responses to the Earned Income Tax Credit," *Quarterly Journal of Economics*, 1996.

⁴ Raj Chetty, John N. Friedman, and Emmanuel Saez, "Using Differences in Knowledge Across Neighborhoods to Uncover the Impacts of the EITC on Earnings," *American Economic Review*, 2013, http://obs.rc.fas.harvard.edu/chetty/eitc_nbhd.pdf. According to the paper, each percentage-point increase in an index of awareness of the EITC is associated with a 0.54 percent increase in employment (Table 2, Column 7). The average index level in the country is 2.8 percent (according to slide 44 of http://obs.rc.fas.harvard.edu/chetty/eitc_nbhd_slides.pdf), and the average level of non-employment in the sample of new parents is 16.3 percent. Hence, the increase in employment associated with the EITC as a percent of previously non-employed parents is $.54 * .028 / .163 = 9.3$ percent.

participation declines among men without a college education.⁵ Likewise, MDRC, a respected non-partisan social policy research organization, noted that, “research indicates that for single workers an enhanced EITC could potentially increase employment and incomes by as much as 10 percent.”⁶

In addition, there is direct evidence on the effects of an EITC-like tax credit for childless adults in the United Kingdom. In 2003, the British government made the “Working Tax Credit” available to workers without children. Researchers at the British Treasury found that the Working Tax Credit increased the labor force participation rate of childless adults in their mid-to late-20s by 2-3 percentage points.⁷

Moreover, the President’s proposal would not only increase the financial incentives the childless worker EITC provides, it would also probably increase its salience. A roughly \$1,000 maximum credit and an expansion to modestly higher income levels likely increases the chance that workers are aware of the credit, allowing it to influence their decisions. Consistent with this, research on the EITC for families with children has found that the credit has larger effects on work in areas of the country where people are more aware of it.⁸

These increases in work would not just put more money in the pockets of childless workers but may also benefit society in broader ways. Individuals who work are more likely to get married, more likely to support children not in their custody, and more likely to stay out of prison. An expanded childless worker EITC could also encourage formal over informal sector work, benefiting workers by encouraging them to accrue Social Security earnings credits and benefiting society by increasing participation in the more productive formal economy. In addition, as discussed in the box on page 8, researchers have found that the EITC for families with children improves children’s outcomes. Non-custodial parents likely comprise 1.5 million or more of those benefiting from the proposed EITC expansion. By boosting these parents’ incomes – and encouraging work – the expansion may benefit their children as well, for example, by making it possible for them to fulfill their child support responsibilities.

⁵ John Karl Scholz, “Employment-Based Tax Credits for Low-Skilled Workers,” Hamilton Project, December 2007, http://www.brookings.edu/~/media/research/files/papers/2007/12/12%20taxcredit%20scholz/12_taxcredit_scholz.pdf.

⁶ MDRC, “MDRC Selected to Implement and Evaluate Earned Income Tax Credit Expansion in New York City,” July, 2013, <http://www.mdrc.org/news/announcement/mdrc-selected-implement-and-evaluate-earned-income-tax-credit-expansion-new-york>.

⁷ Ian Mulheirn and Mario Pisani, “The Labour Supply Effect of the Working Tax Credit: A Quasi-Experimental Evaluation,” 2006, <http://wpeg.group.shef.ac.uk/Archive/refereeing2006/papers2006/Pisani.pdf>.

⁸ Chetty, Friedman, and Saez, 2013.

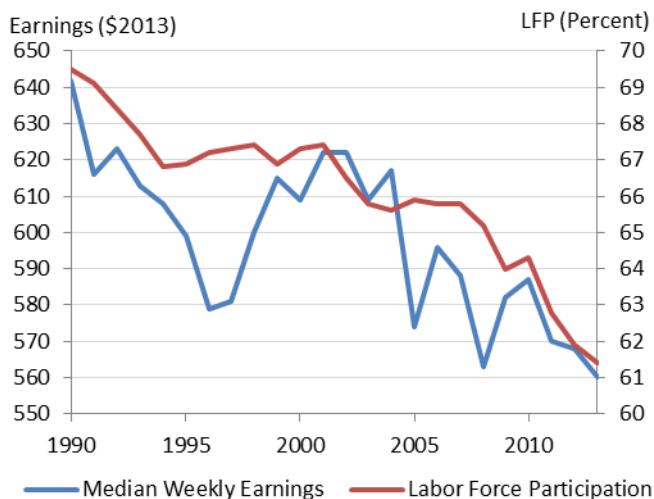
Building on the Current EITC's Success

The case for expanding the childless worker EITC is especially strong because an expansion will target a number of groups with low or declining labor force participation rates, or for whom there are other compelling reasons to strongly incentivize work. These groups include:

- **Men without a college education, especially minority men.** Since 1973, the labor force participation rate of men with a high school degree or less has fallen by 14.2 percentage points, and the trend accelerated since the start of the Great Recession in 2007. The decline has been particularly sharp for less educated African-American men, whose labor force participation rate has fallen by 17.9 percentage points. While the forces behind these trends are complex, it is noteworthy that the decline in labor force participation has coincided with declines in real wages, with median weekly earnings for men with a high school diploma or less falling by 12.8 percent since 1990 after adjusting for inflation. (See Figure 2.)

An expanded childless worker EITC would help ameliorate these trends by subsidizing earnings for less-educated men without custodial children, just as the EITC for families with children does for millions of less-educated working parents. Before taking into account any increases in labor force participation that might result, the proposed EITC expansion will benefit 7.4 million low-income working men, including 1.1 million African American and 2.1 million Latino men, according to Council of Economic Advisers (CEA) estimates. (See Table 3.)

Figure 2: Earnings and Labor Force Participation Rates for Men with a High School Degree or Less

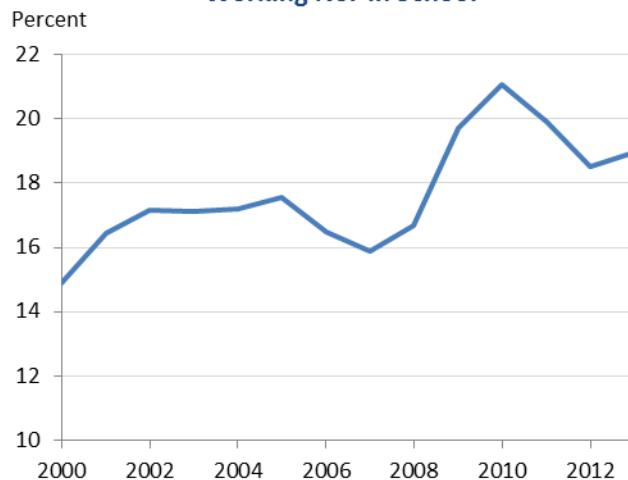


- **Women working at low wage jobs.** Women, including women without dependent children, comprise a disproportionate share of low-wage workers. For example, not only are 55 percent of minimum wage and near-minimum wage workers women, but about

one third are women without children living at home, workers who would not be eligible for the EITC for families with children. In addition, women disproportionately benefit from making the EITC more available to older workers. Overall, CEA estimates that 6.1 million working women would benefit from the President's proposal.

- **Young adults not enrolled in school.** Since 2000, the share of 21-24 year olds enrolled in school has increased, but the share who are working has fallen by a larger amount, resulting in an increase in the share of young adults who are neither working nor in school. (See Figure 3.) The President's proposal would extend the EITC to 3.3 million workers age 21-24, according to Treasury estimates, so that the EITC would encourage work during the crucial years at the beginning of young people's careers and, in particular, encourage young people to choose the formal over the informal economy. (As explained in the box on page 6, the proposed expansion would maintain the current law rules that prevent the EITC from benefiting full-time students who are not self-supporting.)

Figure 3: Share of 21-24 Year Olds Neither Working Nor in School



- **Workers with disabilities.** Many workers with disabilities exit the labor force from low-wage jobs where they have trouble making ends meet.⁹ A number of experts have suggested that a stronger childless worker EITC could help encourage and enable some workers with less severe disabilities to remain in the labor force.¹⁰ The combination of a

⁹ Some of those who leave the workforce due to a disability ultimately become eligible for Social Security Disability Insurance benefits. Data from the Social Security Administration show that, among workers who ultimately apply for Social Security Disability Insurance, about one third had incomes in the range to benefit from the President's proposed EITC expansion in the several years before they applied for SSDI, suggesting that the proposal is well targeted to reach this group.

¹⁰ See for example, Jerry L Mashaw and Virginia P. Reno (eds.), Balancing Security and Opportunity: The Challenge of Disability Income Policy, National Academy of Social Insurance, 1996; David C. Stapleton, "Bending the Employment, Income, and Cost Curves for People with Disabilities," Center for Studying Disability Policy, 2011, https://www.realeconomicimpact.org/data/files/other%20documents/disability_bendemploy_ib.pdf; and David

stronger EITC for these workers and access to affordable health coverage through the Affordable Care Act could make continued employment possible for some people with disabilities – a positive for our economy and for these workers. Workers with disabilities are disproportionately likely to claim the childless worker EITC, and CEA estimates that, of those who would benefit from the President’s proposal, about 10 percent, or 1.3 million workers, have a self-reported disability.¹¹

- **Older workers.** Currently, the EITC for workers without dependent children is unavailable to workers age 65 and older, an artifact of the period when the Social Security full retirement age was 65. The President’s proposal would modernize the EITC age limit by allowing workers age 65 and 66 to claim the credit, consistent with the scheduled rise in the full retirement age to 67. This modernization is consistent with the Administration’s broader goal of helping older workers who wish to do so remain in the labor force and would benefit 300,000 working seniors, according to Treasury estimates.

Table 3. Workers Benefiting from Childless Worker Expansion(millions)	
	Total
ALL	13.5
LESS THAN AGE 25	3.3
AGE 25-64	9.9
64-65	0.3
MEN	7.4
WOMEN	6.1
AFRICAN AMERICAN	2.0
LATINO	3.3
WHITE	7.2
ALL OTHER	1.0
WITH A SELF-REPORTED DISABILITY	1.3

Source: CEA calculations from Current Population Survey data

Autor, “The Unsustainable Rise of the Disability Rolls in the United States: Causes, Consequences, and Policy Options,” November 23, 2011, <http://economics.mit.edu/files/6880>, which all discuss how an increase in the childless worker EITC might benefit workers with disabilities.

¹¹ Disability is defined as a self-reported disability that limits an individual’s ability to work.

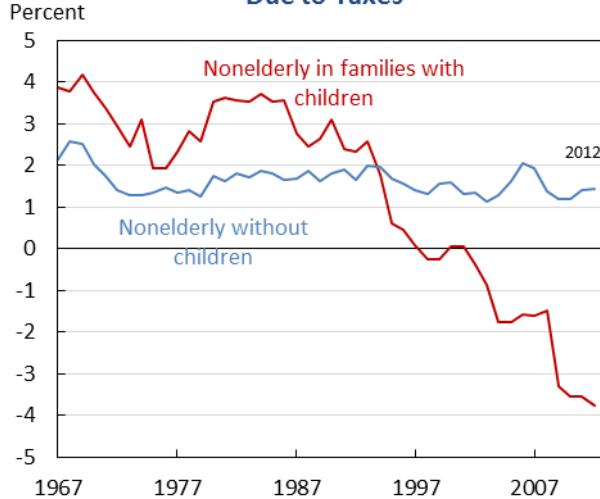
III. Reforming the Federal Tax System

While there is sharp disagreement over many aspects of tax reform, a few key goals are widely shared, among them making the tax system more pro-work and eliminating wasteful spending through the tax code. In addition, at least since President Reagan signed into law the Tax Reform Act of 1986, there has been widespread agreement on the principle that Federal taxes should not push people into or deeper into poverty and should expand opportunity. The President's proposal to expand the childless worker EITC would advance all of these goals, without adding to deficits.

Federal Taxes and Poverty

In 1967, a married couple with one child at the poverty line paid about 10 percent of its income in Federal income and payroll taxes. (See Figure 5a.) Federal taxes pushed millions of families below the poverty line, raising the overall poverty rate by 3.2 percentage points, 3.9 percentage points for nonelderly households with children.

Figure 4: Increase (+) / Decrease (-) in Poverty Rate Due to Taxes



Since the 1960s, however, the creation and expansion of the EITC and the refundable Child Tax Credit have resulted in a Federal tax system that reduced poverty among nonelderly households with children by 3.7 percentage points in 2012 – the mirror image of the 1960s tax code. (See Figure 4.)

But while the tax system has reversed its role from increasing poverty to decreasing poverty among families with children, the story is strikingly different for households without children. Childless individuals faced an effective tax rate of 15 percent in 1967. Although this rate fluctuated somewhat over the next 45 years, in 2012, the average tax rate for these households remained essentially unchanged. (See Figure 5b.) As such, today, childless workers are the sole

demographic group pushed into poverty by the Federal tax system, with the tax system increasing the poverty rate for nonelderly households without children by about 1.4 percentage points.

Figure 5a: Federal Tax Rate at Poverty Earning Level for Married Workers

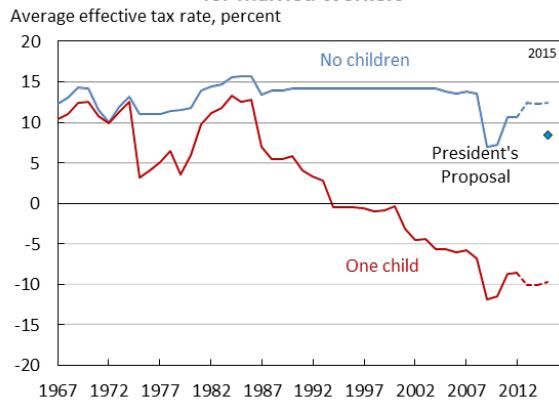
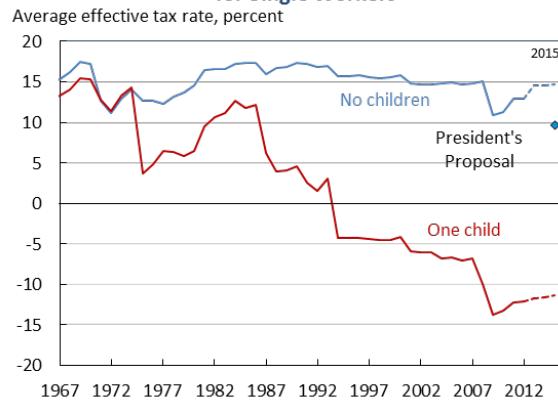


Figure 5b: Federal Tax Rate at Poverty Earning Level for Single Workers



While the President’s proposal would not fully achieve the goal of offsetting Federal taxes for workers in poverty, it would make significant progress. Under the proposal, the EITC would, for the first time, fully offset Federal taxes for those in deep poverty. For a single worker with income at the poverty line, the proposal would reduce total Federal tax liability by about \$700, and the individual would no longer owe Federal income taxes. Overall, as noted above, the President’s proposal would lift about half a million people out of poverty compared to current law, reducing the poverty rate for households without children by about 0.3 percentage points.

Shifting Resources from Wasteful to Pro-Work Tax Benefits

As discussed above, the President’s proposal to expand the childless worker EITC would advance the goals of making the tax system more pro-work and anti-poverty. Consistent with the President’s commitment to fiscal responsibility, the \$60 billion cost of the proposal would be paid for by eliminating tax benefits that do not promote work or growth, primarily:

- **Taxing carried interest as ordinary income.** The managers of private equity funds and other investment partnerships often receive a share of future investment returns (“carried” interest) in addition to a salary. But current law allows them to treat this income as capital gains, which are subject to no more than a 23.8% income tax rate and exempt from payroll and self-employment taxes. This tax rate is significantly below the income and payroll taxes that a manager would owe on comparable salary income and is less than the effective Federal income and payroll tax rate for a single childless worker making \$50,000. The President proposes to tax carried interest income like other types of earnings, so that investment fund managers are subject to the same tax rules as everyone else.

BIPARTISAN SUPPORT FOR EXPANDING THE CHILDLESS WORKER EITC

Expanding the EITC for childless workers is supported by a bipartisan group of policymakers, researchers, and commentators. Most recently, Senator Rubio voiced his support for efforts to make work pay for single adults without children, proposing a wage enhancement for workers both with and without children. Other conservatives have also endorsed expanding the EITC or providing wage subsidies to childless workers and non-custodial parents:

Glenn Hubbard, Former Chairman, White House Council of Economic Advisors; Dean, Columbia School of Business: “Increasing the credit for childless workers to an amount closer to that for families with children would augment the direct work incentive and help counter poverty among the working poor.”*

Gary Becker, Nobel laureate economist, University of Chicago: “The working poor should not be required to have dependent children before they qualify for help.”**

Ross Douthat & Reihan Salam, The Weekly Standard: “Republicans have long celebrated entrepreneurship and the idea of self-help. But among the very poor, the obstacles to self-help remain formidable... The earned-income tax credit is one policy that's worked brilliantly. By rewarding poor mothers and fathers who work for a living, it has made a serious dent in child poverty. But the EITC does little for childless workers struggling to make ends meet, particularly the less-educated single men who are at the root of the poverty problem.”***

Michael Strain, Resident Scholar, American Enterprise Institute: “Despite its obvious appeal, the [current] EITC has some shortcomings ... it gives very little help to childless workers. ... The program could be amended easily to offer more support to childless workers.”****

* http://www.washingtonpost.com/opinions/tax-reform-is-the-best-way-to-tackle-income-inequality/2014/01/10/112710ea-68ca-11e3-a0b9-249bb34602c_story.html

**<http://www.businessweek.com/stories/1996-06-02/how-to-end-welfare-as-we-know-it-fast>

*** <http://www.freerepublic.com/focus/f-news/1517992/posts>

**** <http://www.nationalreview.com/article/365999/more-minimum-wage-michael-r-strain/page/0/2>

- **Closing loopholes that allow professional services businesses to avoid self-employment payroll taxes.** All workers, including those who are self-employed, owe payroll taxes on their earning to support Social Security and Medicare. But some high-income professionals can escape this responsibility by reclassifying much of their earnings as distributions from certain pass-through entities, without changing anything about the nature of their work. (This loophole has sometimes been referred to as the “Gingrich” loophole.) In total, this tax avoidance is projected to take \$5 billion per year from the Social Security and Medicare Trust Funds by the end of the decade. The President proposes to close this loophole by extending the payroll tax to cover distributions from certain pass-through entities engaged in a professional service business such as law, consulting, or lobbying.

Together with the EITC expansion, these proposals will help reorient the tax code to reward work for low-wage workers while making sure that highly compensated professionals pay taxes on their incomes like everyone else. In his recently released tax reform plan, Ways and Means Chairman Camp also proposed to address these two loopholes. The President is proposing to devote the savings from these provisions to cutting taxes and lowering tax rates for low-income workers, an important step toward reforming the tax code.

Conclusion

The EITC is among the strongest policy tools for reducing poverty and encouraging people to enter the workforce. The poverty rate has declined by nearly 40 percent since 1967, in part because the EITC and the refundable Child Tax Credit (which did not even exist then) now reach 32 million working families each year. The EITC also encourages hundreds of thousands of parents to enter, re-enter, or remain in the labor force.

It is therefore not surprising that the EITC has historically had broad bipartisan support. President Reagan proposed a major EITC expansion during his tenure that was included in the 1986 Tax Reform Act, which he called “the best antipoverty, the best pro-family, the best job creation measure to come out of Congress.”¹² To this day, conservatives have joined with progressives to highlight the many benefits of the EITC and argue for its expansion.

The President wants to work with Congress to enact common-sense tax reforms. The EITC is a policy area where Republicans and Democrats can come together to make the tax code more pro-work and pro-growth while helping some of the most vulnerable members of society.

¹² The Chicago Tribune, October 23, 1986.

Appendix: State-by-State Estimates

Appendix Table 1: Number of Workers Benefiting from the Proposed EITC Expansion by State

State	Thousands of Workers	State	Thousands of Workers
Alabama	200	Nebraska	77
Alaska	38	Nevada	110
Arizona	238	New Hampshire	59
Arkansas	122	New Jersey	350
California	1,541	New Mexico	93
Colorado	207	New York	892
Connecticut	142	North Carolina	381
Delaware	36	North Dakota	30
Florida	1,025	Ohio	515
Georgia	483	Oklahoma	150
Hawaii	60	Oregon	164
Idaho	66	Pennsylvania	566
Illinois	537	Rhode Island	47
Indiana	281	South Carolina	202
Iowa	122	South Dakota	38
Kansas	117	Tennessee	296
Kentucky	187	Texas	1,025
Louisiana	190	Utah	101
Maine	64	Vermont	33
Maryland	210	Virginia	312
Massachusetts	272	Washington	261
Michigan	470	West Virginia	83
Minnesota	224	Wisconsin	252
Mississippi	129	Wyoming	25
Missouri	259	Washington, D.C.	25
Montana	52	Other Areas	136

Source: US Department of Treasury, Office of Tax Analysis