

HELPING WORKING FAMILIES BUILD WEALTH AT TAX TIME

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Refundable tax credits can help lower-income families build wealth. The earned income tax credit (EITC) is our nation's most effective antipoverty tool. It is a refundable tax credit available to low- and moderate-income households with members who work. In 2017, 27 million tax filers claimed the EITC, receiving an average benefit of \$2,445.¹ For tax year 2017, a married couple with two children and an income of \$40,000 qualified for an EITC of \$2,226, meaning their EITC benefit was the equivalent of 6 percent of their annual income.² Although structured as a wage subsidy, the EITC functions as a lump-sum payment received at tax filing time. Studies and reports from practitioners that serve EITC filers reveal that the vast majority of EITC recipients *prefer* the forced savings mechanism of the EITC to an alternative monthly wage boost.³ EITC claimants interviewed for the book *It's Not Like I'm Poor* primarily used their tax refunds to save, pay down debt, and invest in long-term assets. Researchers for the book concluded that these EITC-eligible families used their tax refunds to “build their aspirations for upward mobility.”⁴ The child tax credit (CTC) is another tool that gives Americans tax relief when they have children in their household. Prior to the recently passed tax reform, this tax credit was worth as much as \$1,000 per qualifying child; under the new legislation it will potentially be double that amount. However, the CTC is not fully refundable like the EITC. Instead, it has a refundable piece, the additional child tax credit, that can help lower-income families support their children.

The EITC and CTC have far-reaching positive impacts. Research shows that these tax credits have an overwhelmingly positive impact on workers and their children. Children in families that receive tax-time benefits such as the EITC and CTC experience improved outcomes from early childhood all the way through retirement. This means better infant health, improved test scores in school, boosted college enrollment, increased earnings as adults, and finally, higher Social Security benefits in retirement.⁵ Research from Columbia University even claims that the EITC improves health outcomes.⁶ This long-term impact is quantifiable: children in families that earned an extra \$3,000, roughly the size of a typical EITC, worked 135 hours more per year once they reached adulthood.⁷

VITA sites provide free tax preparation to help lower-income households access tax credits. The average cost of paid tax preparation is \$261.⁸ For many families, these are dollars that could otherwise go toward monthly bills and emergency savings. The Volunteer Income Tax Assistance (VITA) program helps low- and moderate-

income households with free tax preparation services, including helping them get the EITC and CTC. There are 4,300 VITA sites around the country that prepared more than 1.4 million returns in 2017, generating more than \$2.1 billion in refunds to assist households earning less than \$54,000 in annual income.⁹ VITA grants must be matched by local, state, or private dollars, making the program an example of a true private-public partnership. In addition to helping households with their taxes, many VITA programs deliver other services, such as financial education and savings programs. Today, the VITA program has the highest return preparation accuracy rate of any type of preparer, 93 percent, and serves as a model for competency standards. VITA volunteers are held to a high standard and required to complete training and certification programs each year.¹⁰

Expand EITC eligibility to workers not raising children. So-called childless workers are the only class of workers taxed further into poverty.¹¹ A single worker with no qualifying children living right at the poverty line in 2017 qualified for a credit of just \$225, boosting his or her income by less than 2 percent. If this worker was younger than 25 or older than 65, then he or she would have been completely ineligible. Compare this outcome with that of a single worker with one child filing as a head of household, whose credit would have been \$3,400 in 2017.¹² The Earned Income Tax Credit Improvement and Simplification Act (H.R. 822 in the 115th Congress) would expand eligibility and increase the amount of the credit.¹³ Increasing the EITC benefit for workers not raising children would provide a stronger work incentive and a larger benefit while reducing improper payments.

Help low-income families access free tax preparation services by making the VITA program permanent. In response to the increased demand for the program, funding for the VITA program has grown to \$15 million. However, Congress has never formally authorized the grant program. Codifying Congressional support would give VITA sites more certainty that the grant program will continue. The bipartisan VITA Permanence Act of 2017 (S. 797 and H.R. 2901 in the 115th Congress) authorizes the program, allows for up to \$30 million in annual grant funding, and ensures that VITA sites maintain their already impressive accuracy rates and can continue to expand access to keep up with growing demand.¹⁴

Increase return accuracy by establishing minimum competency standards for paid tax preparers. Surprisingly, a majority of paid tax preparers are not required to meet basic competency standards.¹⁵ All they need is an IRS preparer tax identification number.¹⁶ Paid tax return preparers should be required to take a tax education course, pass an initial basic competency test, and engage in continuing education to demonstrate they have an understanding of current tax filing requirements. Given that 68 percent of filers claiming the EITC use a paid preparer,¹⁷ paid preparers should be held to meaningful standards to ensure they know how to complete returns accurately. The IRS implemented such standards in 2012, but a federal court ruled in 2014 that the IRS lacked statutory authority to establish them.¹⁸ Congress can increase return accuracy by setting these commonsense standards.

Make the CTC available to lower-income families. The recent tax reform legislation doubled the CTC from \$1,000 to \$2,000 per child and extended the CTC so that it starts to phase out for married families with incomes at \$400,000 per year (compared with the previous \$110,000 per year). However, with this legislation, 10 million children in the lowest-income working families would get only a token increase of \$75 or less,¹⁹ and households with children who do not have Social Security numbers are no longer able to access the refundable portion of this credit using individual taxpayer identification numbers (ITINs).²⁰ The CTC needs to be expanded to benefit those households who really need its support. Congress should make the CTC fully refundable and allow households to use their children's ITINs so that the head of household can access this vital credit.

Empower filers to save by establishing a rainy-day EITC. While many low-income workers use the EITC as a makeshift savings tool, it was not built to function as one. One proposal to help more filers build emergency savings, proposed by the authors of *It's Not Like I'm Poor*, would allow workers to defer a portion of their EITC for future use later in the year. Such a reform would take advantage of the unique "financial slack" afforded at tax time, encouraging workers to build up emergency savings. The Refund to Rainy Day Savings Act (S. 2797 in the 114th Congress)²¹ would guarantee that workers have some emergency savings that last beyond their initial tax refund.

This bill allows workers receiving a direct deposit refund to defer 20 percent of their tax refund into a Treasury account that would gain interest. The principal and interest would be directly deposited into their bank account six months later. The bill would also establish a three-year pilot program that would evaluate using matching funds in the Rainy Day EITC to incentivize families to save. If implemented, this rainy-day payment could be used to cover emergencies and expenses that happen later in the year.²²

ENDNOTES

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