EARNED INCOME TAX (EITC) CREDIT EXPANSION AND MODERNIZATION

Expanding and modernizing the Earned Income Tax Credit will put more money back in the pockets of the people who need it most. Recent polling suggests such policies would be popular, with 70% of respondents supporting a modernized EITC statewide and 80% supporting such an effort in Chicago.64

BACKGROUND

The Earned Income Tax Credit is a tax credit for low- and moderate-income working people. It offsets payroll and income taxes. The EITC is the nation’s largest cash transfer program returning billions of dollars, no strings attached, back to struggling families to help boost their incomes and stabilize their financial lives.65

Working families with children that have annual incomes below a certain amount are eligible for the EITC. Working people who have no children and have low incomes can receive a very small EITC. The amount of EITC depends on a person’s income, marital status, and number of children. The EITC increases as earnings rise (up to a maximum point), which encourages families to work more hours when possible. Twenty-nine states, plus the District of Columbia, have established their own EITCs to supplement the federal EITC.66 Illinois is one of them.

The EITC is refundable, which means that after offsetting what is owed to the government, filers receive the remainder of the benefit as a refund. The EITC is effective at boosting income and reducing hardship because it lets families keep more of what they earn, and helps them keep working, despite low wages.67

The EITC has been in effect since the 1970s, resulting in decades of research findings.

- The EITC lifts more people out of poverty than any other program.68
- Families primarily use the EITC to pay for necessities, repair homes, maintain vehicles that are needed to commute to work, and in some cases, obtain additional education or training to boost their employability and earning power.69
- People tend to spend their credits quickly and locally, which produces a strong “multiplier effect.” Several studies estimate that the EITC generates around $1.50 - $2 in local economic activity for every $1 in benefits.70 71 72
- Estimates show that for every dollar spent on EITC, the combined federal and state revenue reductions due to reductions in the claiming of other public assistance and increasing taxes paid (sales tax, less public housing and less welfare receipt, higher payroll and sales taxes, etc.) is 87 cents, so that the EITC’s true cost is only 13% the sticker price.73
- Many studies show the EITC encourages work. For example, a recent study found that a $1,000 increase in the EITC led to a 7.3 percentage point increase in employment.74
NEEDED IMPROVEMENTS

While the current EITC is a critical financial stability tool for many low-income workers, it does not reach all people who would benefit from the tax credit, and is insufficient in the face of our current and emerging economic challenges.

1. BROADEN ELIGIBILITY

The EITC leaves out millions of people who are taxed into, or deeper into, poverty and who would benefit substantially from such a credit:

- Low-wage workers with no children, including young people just starting out in work under age 25 and workers over age 64
- Low-wage workers not raising children in the home, including non-custodial parents and adults with grown children
- Unpaid family caregivers with qualifying dependents (children, seniors, and disabled). By expanding the definition of work to include unpaid caregiving we acknowledge that all caregiving is work and should be paid
- Low-income students attending a higher education institution at least half-time75 acquiring skills for their future
- Middle class earners who still experience a gap between earnings and cost of living

2. EXPAND THE BENEFIT AMOUNT

Increasing the EITC amount for all household types will make it a much more meaningful support to address the rising cost of living.77

3. INCREASE PAYMENT FREQUENCY

As currently designed, recipients must wait until after the end of the year to claim the credit, despite having spent the entire year earning it. When budget margins are as tight as they are for people on low-incomes, they may fall behind on expenses or even into debt in the meantime. It increases the likelihood workers will need to rely on predatory lending to get by, and get trapped in a cycle of debt. It also may inhibit people’s ability invest in things they want and need with this discretionary income. Empowering beneficiaries to choose to move outside the annual distribution framework inherited from the tax system and have more flexible options for receiving credit dollars will help the EITC achieve its full potential.78 79
4. CREATING AUTOMATIC FILING OPTIONS

The tax filing process is cumbersome—from keeping and collecting records, finding the right forms, reading fine print, completing worksheets, filling out a tax return, and submitting the return. This annual process could be avoided for the half of tax filers or more that take the simple deduction if the government used the information it already has to automatically prefill their returns for them. The IRS already receives information about our sources of income directly from employers and banks. With automatic filing the IRS can take that information and if the person’s tax status were simple enough, send that taxpayer a return prefilled with the information. The program would be voluntary. Low-income households would benefit tremendously from this simpler filing approach.
EXPLORING ILLINOIS OPTIONS

Our state tax system should raise adequate resources to invest in public priorities and do so in a manner that asks all Illinoisans to pay their fair share. Unfortunately Illinois has a perfectly regressive tax code. Low- and moderate-income families pay higher state and local taxes as a share of their income than do upper-income families. This imbalance reflects states’ heavy reliance on sales, excise (e.g., gas, beer, cigarettes), and property taxes, all of which fall more heavily on families with lower incomes. Our tax code exacerbates income inequality, with low-income people paying a higher share of their income in taxes than the wealthiest. Illinois has the 8th most unfair state and local tax system in the country. Incomes are more unequal in Illinois after state and local taxes are collected than before.

Illinois is one of 29 states that offer a targeted tax credit to low- and moderate-income workers and their families that helps offset the regressive impact of sales and excise taxes. Illinois increased its EITC from 10% of the federal credit to 14% in 2017 and to 18% in 2018. Nearly one million Illinois households received the federal EITC in 2018. The average amount of the federal credit for Illinoisans was $2,517 per household, bringing $2.3 billion back into Illinois.

We can build on this foundation to make some important changes to increase the power of the EITC for Illinois families and make it more responsive to our evolving families, jobs and cost of living.

By modernizing Illinois’ EITC we can:

1. **Reach More People:** Broaden eligibility to include low income family caregivers, low income students in school half time or more (47,000 in Illinois), and people with incomes into the middle class.

2. **With More Support:** Significantly increase the percent of the federal credit that the state credits households.

3. **Provided More Frequently:** Create options for periodic payments versus only annual.

4. **Made Easier:** Create an automatic filing option.

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Total State and Local Taxes in Illinois

![Bar chart showing the distribution of total state and local taxes in Illinois.](chart.png)

<table>
<thead>
<tr>
<th>Income Group</th>
<th>Percentage</th>
</tr>
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<tbody>
<tr>
<td>Lowest 20%</td>
<td>14.4%</td>
</tr>
<tr>
<td>Second 20%</td>
<td>12.4%</td>
</tr>
<tr>
<td>Middle 20%</td>
<td>12.6%</td>
</tr>
<tr>
<td>Fourth 20%</td>
<td>11.8%</td>
</tr>
<tr>
<td>Next 15%</td>
<td>11.0%</td>
</tr>
<tr>
<td>Next 4%</td>
<td>9.4%</td>
</tr>
<tr>
<td>Top 1%</td>
<td>7.4%</td>
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The Institute on Taxation and Economic Policy in partnership with the Economic Security Project modeled a number of scenarios to modernize the EITC for the task force.83

### Model Features

<table>
<thead>
<tr>
<th>SCENARIO</th>
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<td>HIGH EITC</td>
<td>50%</td>
<td>75K ($37.5K IF CHILDLESS)</td>
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<tr>
<td>LOW EITC</td>
<td>25%</td>
<td>LARGER OF $50K OR FED EITC (25K IF CHILDLESS)</td>
<td>$800</td>
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These options reach low-income and middle-class families. Over 2 million Illinois households would benefit from either getting a higher credit than the current Illinois EITC or newly getting credit due to expansions. Importantly, the poorest people and families with children benefit the most, significantly reducing child poverty, while also supporting people in the middle class who desperately need financial stability. Because people of color and rural residents have higher levels of poverty, it also provides a significant boost to these communities.84

The high model both makes significant progress towards the task force’s goals and moves the dial significantly towards a much more equitable tax system in Illinois.

Illinois has the upside of building upon an existing EITC but the downside of a fiscal environment that is very challenging. As state leadership revisits and reforms the state’s current flat income tax inclusion of a significant, modernized EITC as part of this plan would be catalytic.
EXPLORING CHICAGO OPTIONS

1. Bolster Outreach: Reach more people by increasing uptake of the current EITC through outreach programs. This would have an immediate impact and bring families and the city needed cash flow that is currently being left on the table so to speak. It is estimated that 1 in 5 people who are eligible for the EITC do not receive it. For some it is because they don’t have to file taxes. For others it is lack of information or awareness about the program. Research shows that low program awareness and understanding and informational complexity contribute to the puzzle of low take-up. There are many routes forward:

- Promoting, investing in and expanding free tax prep services to maximize receipt of EITC and other tax credits. For example, Volunteer Income Tax Assistance (VITA) sites offer free tax preparation services to low-to-moderate-income working people and are staffed by volunteers certified by the IRS. One of the most effective ways of ensuring that families who are eligible to receive the EITC actually receive it is through free tax preparation.
- Explore ways to encourage for-profit preparers to boost EITC take-up responsibly. There are far more EITC claimants than there are free tax preparer resources.
- Launching direct marketing mail and digital campaigns inclusive of texting, digital ads, direct email, mail, and earned media. Many tools have been created and tested to spread the word, including www.eitcoutreach.org. Chicago has been a pioneer in this, leading annual public-private campaigns to increase awareness of the credit; there is much success to build from. Local media, utility companies, large employers, and community groups publicize the availability of the EITC and other tax benefits to low-income workers and neighborhoods. Since the campaign’s inception low-income residents have received millions of dollars each year back.
- Some target groups, such as those who receive Temporary Assistance for Needy Families benefits, while others reach out to entire communities. Some areas are exploring mandatory notifications from employers if they think people are eligible, and some are engaging in school based outreach.
- Partnerships with community groups and labor unions through events and materials.

A 5% increase in federal EITC uptake among eligible Chicagoans would likely cover more than 19,000 additional families and add over $52 million in economic benefit to families directly.

2. Offer Pre-Populated EITC Forms: Assess feasibility of an initiative to identify Chicagoans who are eligible for the Earned Income Tax Credit (EITC) in prior years and use that information to fill out and mail amended tax returns so people could claim their credits. The NYC Department of Finance took the unprecedented step of analyzing Federal tax information to identify New Yorkers who were eligible for the Earned Income Tax Credit (EITC) in prior years and used that information to fill out and mail amended tax returns so people could claim their credits. The EITC helps low-income families to stabilize—and even grow—their family finances. In two years, the project successfully helped low-income workers successfully claim more than 22,000 credits totaling almost $14 million. This year New York State will conduct a similar statewide mailing and Maryland, Virginia, and Kansas are also working with the IRS to replicate the program.

The City of Chicago offers free, confidential tax help at locations across Chicago from late January through mid-April in partnership with Ladder Up. Qualified Chicago families and individuals can receive free tax return preparation and e-filing. Trained volunteer tax preparers assist residents in completing and electronically filing Federal and Illinois tax returns for the current tax year and, in some cases, for prior years. They also assess if residents qualify for the Earned Income Tax Credit (EITC), Child Tax Credit (CTC), and/or student financial aid for college. http://www.taxprepchicago.org/
3. **Explore Creation of a Chicago Earned Income Tax Credit**: The city does not currently have an income tax nor an EITC. Creation of such requires developing the mechanisms by which a city EITC would work, such as working closely with the state, piggybacking on IRS EITC claims information, and learning from Washington state. New York City has a city EITC set at 5% of the federal and recipient get their refunds through state filings, while the District of Columbia has most generous in country at 40% match of federal (100% of childless workers). Montgomery County (MD) has a local EITCs and San Francisco has a one-time EITC (different structure) as well. The creation of a modern citywide refundable EITC in Chicago can build upon and go beyond those and build on any state wide EITC expansion and modernization.

EITCs can be particularly helpful in cities because their tax systems rely heavily on excise taxes, property taxes, and in most cases sales taxes. Because of this reliance, low- and moderate-income families in these states pay a higher share of their income in taxes than wealthier families.

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Given the significant gaps between incomes and cost of living, it behooves Chicago to consider instituting an Earned Income Tax Credit alongside any new broad-based revenue generation initiatives in the coming years. Whether supported through an expansion of the Illinois EITC or the creation of a Chicago EITC, the high scenario below shows that a tangible difference in family economic stability is possible.

**PROGRESS: CHICAGO EITC PERIODIC PAYMENT PILOT**

Chicago has already pioneering testing of some of these innovations. In 2014, the Center for Economic Progress, Office of Chicago Mayor Rahm Emanuel, Chicago Housing Authority and the University of Illinois at Urbana-Champaign launched the Periodic Earned Income Tax Credit Payment Pilot Project, a year-long pilot program to provide quarterly advance EITC payments to a cohort of 343 households. Participants in the program reported significantly lower borrowing, more stable finances and less financial stress for low- and moderate-income families. Read the full results of the project here: [https://news.illinois.edu/view/6367/307052](https://news.illinois.edu/view/6367/307052).

Investments in a modernized EITC for working and middle class will help Chicago and Illinois:

- REDUCE POVERTY
- ADDRESS RISING COST OF LIVING AND HOUSING
- REDUCE INEQUALITY
- MAKE TAXES FAIRER
- BOOST OUR LOCAL ECONOMIES