

The Earned Income Tax Credit: State EITCs, Noncompliance, & Wages for Low-Skilled Jobs

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Tools to Build the Financial Strength of
Low-Income Families and Communities**

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Today's Remarks

- Briefly discuss what we know about impacts of **State EITC programs** on employment & poverty reduction.
- Then talk about evidence of two *unintended consequences* of EITC:
 - *EITC non-compliance* may promote *compliance in other poverty-reduction programs*.
 - Effects of EITC on *wages in low-skilled labor markets*.

States with EITC

State or Local Government	Percentage of Federal Credit	Is Credit Refundable?
1. Colorado (Only in budget surplus years)	10%	Yes
2. Connecticut	30%	Yes
3. Delaware	20%	No
4. District of Columbia	40%	Yes
5. Illinois	10%	Yes
6. Indiana	9%	Yes
7. Iowa	14%	Yes
8. Kansas	17%	Yes
9. Louisiana	3.5%	Yes
10. Maine	5%	No
11. Maryland	Up to 50%	Yes
12. Massachusetts	15%	Yes
13. Michigan	6%	Yes
14. Minnesota	Average 33%	Yes
15. Nebraska	10%	Yes
16. New Jersey	20%	Yes
17. New Mexico	10%	Yes
18. New York	30%	Yes
19. North Carolina (expired after TY 2013)	4.5%	Yes
20. Ohio (started in FY 2014)	5%	No
21. Oklahoma	5%	Yes
22. Oregon	6%	Yes
23. Rhode Island	25%	Partially
24. Vermont	32%	Yes
25. Virginia	20%	No
26. Wisconsin	4% – 1 child 11% – 2 children 34% – 3+ children	
27. New York City	5%	Yes
28. Montgomery County, Maryland	72.5% of Maryland credit	Yes

Internal Revenue Service, U.S. Treasury

Impacts of State EITCs

What do we know about impacts of State EITCs?

- Considerable evidence that federal EITC has sizable impacts on *employment rates* of low-skilled, less-educated individuals [Hotz & Scholz, 2003; Nichols & Rothstein, 2015]
- Same is true for *reduction in poverty* [Bitler, Hoynes & Kuka, 2014]
- In case of state EITCs, *key questions* are:
 - 1 Is there an added impact of state EITC & how sizable is it?
 - 2 Are impacts large enough to make state EITC cost-effective?

Impacts of State EITCs

Limited number of studies & findings.

- Neumark & Wascher [*National Tax Journal*, 2001]:
 - Variation in size of state EITC *increases earnings* of poor families by increasing their employment.
- Neumark & Wascher [*Industrial & Labor Relations Rev.*, 2011]:
 - State EITC *increases employment of low-skilled single women with children*; higher min wage enhances this positive effect.
 - Conversely, more generous state EITC either *reduces or has no-effect on employment of low-skilled single men & childless women*; higher min. wage enhance this negative effect.
 - Results appear due to differences in EITC generosity by child status.

Impacts of State EITCs

Limited number of studies & findings (cont.):

- Gunter [*National Tax Journal*, 2013]:
 - State EITC *increases regular employment of single fathers* and *decreases their informal employment*
 - Overall, no change in total employment.
 - This increase in *on the books* employment increases revenues from state income taxes.

Bottom Line:

- 1 State EITCs do appear to have effects on employment & poverty, but effects depend on other policies (min. wage) & provisions of EITC (qualifying child).
- 2 We don't know whether state EITCs are *cost effective*. Need to assess costs & benefits.

EITC Noncompliance Issues

In 2013:

- 22% – 26% of Federal EITC claims had “improper payments”
- Improper payments were between \$13.3 and \$15.6 Billion.

Table 2: Estimated EITC Improper Payments for Fiscal Years 2007 – 2013

Year	Minimum Improper Payments %	Maximum Improper Payments %	Minimum Improper Payments (Billions) [†]	Maximum Improper Payments (Billions) [†]
2007	23%	28%	\$11.6	\$13.8
2008	23%	28%	\$12.0	\$14.1
2009	23%	28%	\$12.2	\$14.5
2010	24%	29%	\$16.4	\$19.7
2011	21%	26%	\$14.2	\$17.4
2012	21%	25%	\$11.7	\$13.7
2013	22%	26%	\$13.3	\$15.6

Source: IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns*, August 2014.

[†] All amounts in 2013 constant dollars.

- EITC returns more likely to be filed by Paid-Preparer than are non-EITC returns.
- These preparers are more likely to be with tax preparation firms or “unenrolled return preparers” & less likely to be CPAs.

Table 4: Likelihood of Claiming EITC by Type of Preparer, TY 2006-07

	Did not Claim EITC	Claimed EITC
Self-Prepared	43%	29%
IRS Preparer	2%	3%
Paid-Preparer	55%	68%
CPA	16%	6%
National Tax Preparation Firm	5%	21%
Unenrolled Return Preparer	10%	26%
Preparer used, type unknown	18%	8%

Source: See Table 2.

- Percent of overclaims & % of Total EITC claim that was overclaimed are high for all preparers but IRS-authorized ones.
- They are high for paid preparers, who may have incentive to overclaim.

Table 5: EITC Non-Compliance by Preparer Type, TY 2006-07 [2008 \$]

Type of Preparer	Percent of overclaims	Dollar overclaim percent [†]
Self-Prepared	47%	39%
IRS-authorized Preparers	26%	13%
Paid Preparer	51%	39%
Attorney	35%	29%
CPA	49%	31%
Enrolled Agent	46%	29%
Employee of Taxpayer	58%	5%
Friend/Relative	37%	19%
National Tax Return Prep Firm	44%	30%
Unenrolled Preparer	54%	40%
Type Unknown	72%	73%

[†] Dollar overclaim % is EITC overclaims divided by total EITC claims. These are the upper-bound estimates.
Source: See Table 2.

EITC Noncompliance Issues

- Largest share of improper EITC claims are due to “qualifying child” errors.
- While income misreporting occurs, it is much smaller source of problem.

Table 6: EITC-Related Errors as Percentage of Total Overclaim Dollars Weighted Population Estimates, Annual Average, TY 2006-2008 NRP

Error type	Percentage of Total Overclaim Dollars
Qualifying child error	42% – 54%
Income misreporting (all types combined)	24% – 32%
Self-employment income alone	15% – 23%
AGI and investment income alone	5% – 8%
Wage income alone	3% – 6%
Filing status error	9% – 17%
Error corrected in processing	3% – 3%
Rules for all taxpayers claiming EITC	1% – 5%
Tiebreaker error	1% – 2%
Rules for taxpayers claiming EITC without children	0% – 1%

Source: See Table 2.

- Qualifying child errors are due, in part, to complexity of the definition of these children.

Uniform Definition of a Qualifying Child

Relationship	Residency	Age	Support	Joint Return
Client's son, daughter, stepson, stepdaughter, adopted child, foster child, brother, sister, half-brother, half- sister, stepbrother, stepsister or a descendent of any of them	Same principal residence as your client for more than half the tax year	* Under age 19 at the end of the year * Under age 24 if a full- time student for at least five months of the year * Permanently and totally disabled during the year	Did not provide more than one-half of own support	Did not file a joint return (other than only to claim a refund of withheld taxes) with the child's spouse

Source: Working Families Tax Relief Act of 2004 amended in 2008.

EITC Noncompliance Issues

And, potentially some *unintended consequences* of non-compliance due to qualifying child errors:

- Hotz & Scholz [*National Tax Journal*, 2008] found sizable fraction of *non-custodial fathers* in Wisconsin claimed EITC but *did not meet* qualifying child requirement.
- But, as a result of claiming EITC, their labor earnings were “captured” in state’s Child Support Case Registry & more likely to make court-ordered *child support payments*.
- **Policy Trade-off:** *Greater non-compliance* with EITC provisions (qualifying child), can *increase compliance* with child support awards.
- **Note:** Proposed expansion of EIC for *childless* individuals & households would reduce/eliminate this trade-off.

EITC & Wages in Low-Skilled Labor Markets

Employment effects of (federal & state) EITC appear to have *consequences for wages in low-skilled jobs*.

- Economic theory argues that increases in supply of labor, all else equal, *wages should fall* in competitive labor markets.
- Lower wages affect *all workers* in market.
- EITC induced significant increase in labor supply of single women with children, i.e., those eligible for EITC's most generous credits.
- But other workers – low-skilled women and men with no children – weren't eligible for generous EITCs.

EITC & Wages in Low-Skilled Labor Markets

Rothstein [*AEJ: Economic Policy*, 2010] assesses *incidence* of EITC effects on *wages in low-skilled labor markets*.

- Wages in low-skilled labor markets *do decline* as result of EITC, due to increased supply of single mothers.
- Increased employment of single mothers offsets loss in wages, resulting in *higher labor earnings*.
- Among low-skilled *childless men & women*, lower wage rates lowers their employment, thereby *reducing labor earnings*.
- And *employers benefit from lower wages* for low-skilled workers.
 - Rothstein estimates employers capture \$0.36 of each dollar “spent” in EITC.