

Earned Income Tax Credit

The Earned Income Tax Credit (EITC) is a special Federal income tax credit for low-income workers. The credit reduces the amount of tax they owe (if any) and is intended to offset some of the increases in living expenses and Social Security taxes. Eligible persons who owe no taxes, or whose tax liability is smaller than their tax credit, receive all or part of the EITC as a direct payment. Some workers are prepaid their credits through their employers as “negative withholding” from paychecks. EITC is administered by the Internal Revenue Service as part of its responsibility for collection of Federal income taxes. For tax returns filed through April 1995, 18.3 million of a total of 109.3 million returns (16.7%) claimed earned income tax credits totaling \$24.8 billion.

The EITC was initially enacted as a temporary measure in the Tax Reduction Act of 1975 and made permanent in the Revenue Act of 1978. The intent was to aid the working poor—families with

children who had an income below the poverty level despite having working members. The 1975 Act emphasized two long-term objectives: (1) to offset the impact of payroll taxes on low-income workers; and (2) to encourage low-income persons, who might otherwise receive welfare benefits, to seek employment.

Benefits

The earned income credit amount depends on the taxpayer's number of qualifying children, amount of earning, and modified adjusted gross income (AGI), which includes items such as taxable Social Security benefits and unemployment benefits.

The amount a person can earn in 1997 and still receive a credit must be less than:

- \$25,760 with one qualifying child,
- \$29,290 with more than one qualifying child, or
- \$9,770 without a qualifying child.

The maximum amount of the credit is:

- \$2,210 with one qualifying child,
- \$3,656 with more than one qualifying child, or
- \$332 without a qualifying child.

Income from working is considered earned income even if it is not taxable. This includes wages, salaries, and tips; union strike benefits; long-term disability benefits received prior to minimum retirement age; net earnings from self-employment; voluntary salary deferrals; voluntary salary reductions; and basic quarters and subsistence allowances from the U.S. military.

The EITC amounts are determined by multiplying income by a credit rate. For example, for 1997, the maximum credit an eligible taxpayer with two or more qualifying children can claim is \$3,656, based on a credit percentage of 40% applied to an earned income threshold of \$9,140. This maximum is payable for earned income (or AGI, if greater) up to a phaseout income of \$11,930. Above this income, a phaseout percentage (21.06% for those with two or more children) is applied to the difference between the actual and phaseout income. The result of this calculation, subtracted from the maximum credit, yields the EITC amount.

The EITC amount can be affected by receipt of other types of public program benefits when they are counted in determining AGI and thus serve to reduce the benefit (for example, unemployment insurance benefits are included in AGI). Conversely, the credit has no effect on certain welfare benefits. The earned income credit cannot be used to determine eligibility or benefit amounts for AFDC, Medicaid, SSI, food stamps, and low-income housing.

Eligibility

EITC eligibility and credit amounts generally are determined according to the tax filer's earned income and whether they have

qualifying children who meet age, relationship, and residency tests or meet other requirements.

Relationship Test

The child must be the tax filer's son, daughter, adopted child, grandchild, stepchild, or eligible foster child (this could include a niece, nephew, brother, sister, or cousin).

Residency Test

The child must have lived with the tax filer for more than half the year (the whole year if the child is an eligible foster child). The home must be in one of the 50 States or District of Columbia. For purposes of the credit, U.S. military personnel stationed outside the United States on extended active duty are considered to live in the United States during that duty period.

Age

The child must be under age 19 at the end of the year, be a full-time student under age 24 at the end of the year, or be permanently and totally disabled at any time during the tax year, regardless of age.

Persons without a qualifying child must be age 25 or older but less than age 65, and not be a dependent for whom a dependency exemption is allowable to another taxpayer.

Persons with investment income of more than \$2,200 cannot claim the earned income credit. Investment income is taxable interest and dividends, tax-exempt interest, and capital gain net income.

For 1997, a Social Security number is required for each person listed on the tax return.

Earned income tax credit provisions for 1997

Provisions	Families with—		
	One child	Two or more children	No children
Earned income threshold	\$6,500	\$9,140	\$4,340
Credit percentage	34.0	40.0	7.65
Maximum credit	2,210	3,656	332
Phaseout income	11,930	11,930	5,430
Phaseout percentage	15.98	21.06	7.65
Breakeven income (credit reduced to zero)	25,760	29,290	9,770