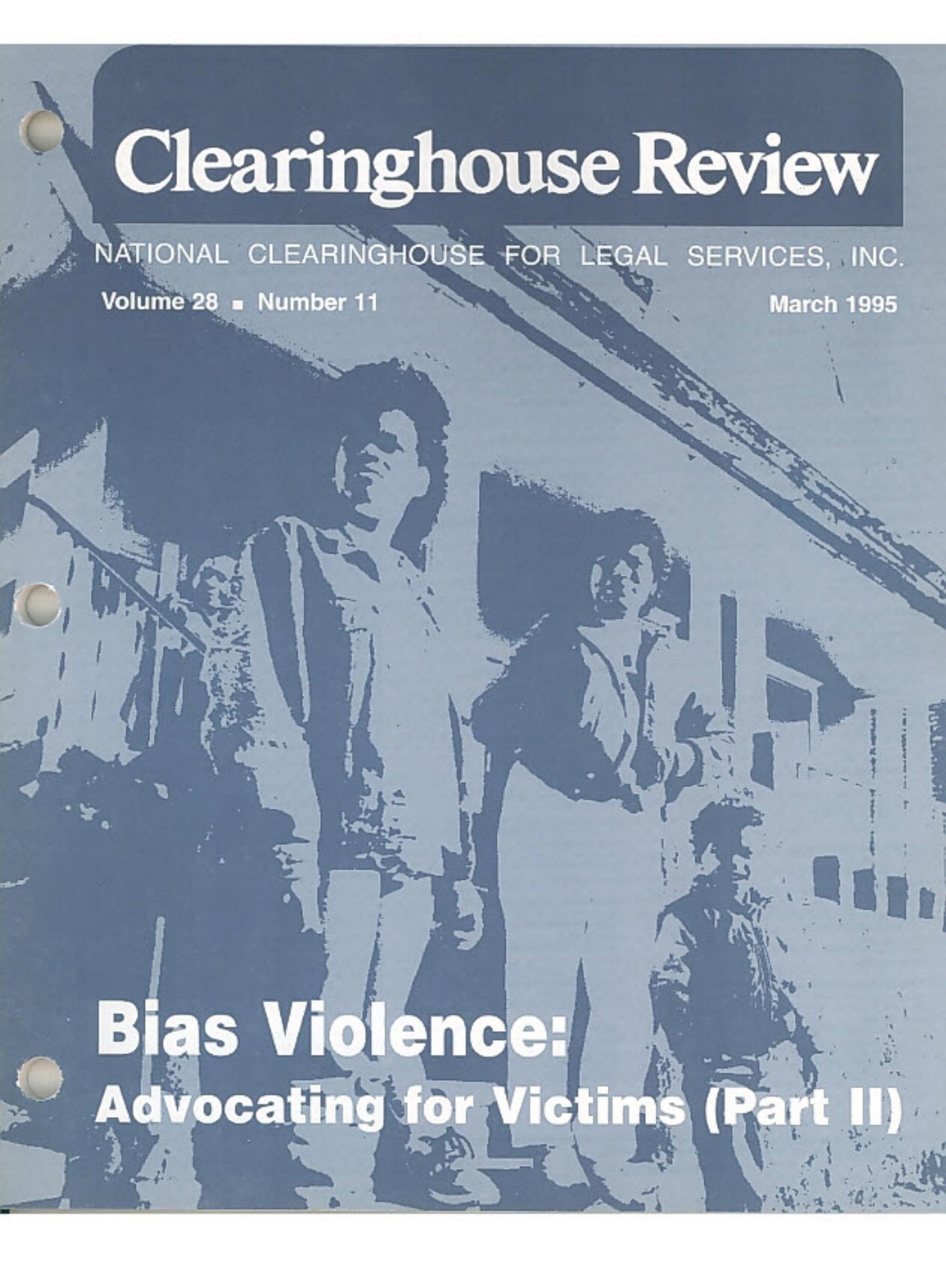


Clearinghouse Review



NATIONAL CLEARINGHOUSE FOR LEGAL SERVICES, INC.

Volume 28 ■ Number 11

March 1995

Bias Violence: Advocating for Victims (Part II)

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Helping Low-Income Families Use the Earned Income Credit

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Summary

- Needy families with earned income should now claim earned income credit (EIC) benefits for earnings in 1994.
- Many families now receiving AFDC and other benefits can get the EIC if they had earned income at some time in the past three years or if they now have earnings.
- Families will not receive EIC benefits unless they file a tax return or arrange for advance payments from their employers.
- The EIC was substantially increased in 1994 and will be increased again in 1995 for many families. More families may want to consider having it included in their paycheck.

This column describes the EIC and discusses some basic eligibility rules and issues affecting AFDC recipients.

I. The Earned Income Credit

The earned income credit (EIC) is a "refundable tax credit." If a family does not owe any federal income tax, the family is paid the full EIC. If the family owes tax, the EIC reduces the tax. If any of the EIC is left over after the tax is paid, the amount left over is paid to the family. Payment comes either from IRS when a tax return is filed or from the employer during the year.

An estimated 18.1 million families will receive a total of \$19.6 billion in EIC credits and payments (averaging approximately \$1,080 per family) for earnings in 1994. /1/ A family must file a tax return using Form 1040 or Form 1040A (not Form 1040EZ) and include Schedule EIC with its return to claim the credit. If a family fills in the information on the front of Schedule EIC, IRS will figure out the amount of the EIC. For 1991, 1992, and 1993, families may file a return now if they did not file before or may file an amended return. /2/

In 1993, Congress amended the law to make major improvements in the EIC starting with the 1994 tax year. These improvements include a substantial increase in the credit available to families and, for the first time, the availability of a credit to low-income adults without children.

II. Families Eligible for the EIC

Who is eligible? A family is eligible for the EIC if it contains at least one "qualifying child." A qualifying child is a child under age 19 at the end of the year; under age 24 at the end of the year, and a student; or permanently and totally disabled, regardless of age, at any time during the year. /3/ Qualifying children include natural children and their descendants, step children, adopted children, and eligible foster children. An eligible foster child is a child "who the taxpayer cares for as the taxpayer's own child." /4/ A qualifying child must have resided in the home more than half of the year, except for an eligible foster child, who must have lived with the taxpayer the entire year. /5/

These are only general descriptions of the basic eligibility rules. Special rules apply in certain circumstances. For example, a person may not in the same year be both a "qualifying child" for another taxpayer and claim the credit herself or himself as an eligible individual. /6/ Also, a married child may not be a "qualifying child" unless certain requirements are met. /7/

How much can these families get? For 1994 earnings, the credit for families with one child is equal to 26.3 percent of earned income for income up to \$7,750. For families with two or more children, the rate is 30 percent of up to \$8,425 in earned income. The maximum credit for 1994 earnings is \$2,038 for families with one child and \$2,528 for families with two or more children. For incomes above \$11,000, the credit goes down gradually to \$0 at an income of \$23,750 for families with one child and \$25,300 for families with two or more children. /8/

Earned Income Credit for 1994 Earnings

Earned Income:

lower range

middle range

higher range

Family with one child

26.3%

of earnings up to

\$7,750

\$2,038

for earnings between

\$7,750 and \$11,000

gradually reducing to \$0

for earnings between

\$11,000 and \$23,750

Family with two or more children

30%

of earnings up to \$8,425

\$2,528

for earnings between
\$8,425 and \$11,000
gradually reducing to \$0
for earnings between
\$11,000 and \$25,300

Workers without children
7.65%
of earnings up to
\$4,000
\$306
for earnings between
\$4,000 and \$5,000
gradually reducing to \$0
for earnings between
\$5,000 and \$9,000

III. Eligibility for Adults without Children

Under a new provision, very low-income workers without children are eligible for a small EIC for income earned in 1994. To be eligible for the credit, workers (or their spouses) have to have been at least age 25 and under age 65 on December 31, 1994; had earnings of less than \$9,000 in 1994; lived in the United States for at least half of the year; and not have been claimed as a dependent by another taxpayer. /9/ The maximum credit is \$306. Workers without children filing for the EIC do not need to file a Schedule EIC. All they need to do is write "EIC" on the earned income credit line on their tax forms. Unlike families filing for the EIC, childless workers can use Form 1040EZ.

IV. The EIC and AFDC Recipients

How many AFDC families are eligible for the EIC? Hundreds of thousands of families who are now receiving AFDC are also eligible for the EIC. In any given month in fiscal year 1992, the most recent year for which data are available, an average of 7.4 percent of families receiving AFDC had earnings. /10/ Since 4.8 million families received AFDC in 1992, /11/ about 355,000 AFDC families were eligible for the EIC each month. In some states the percentage of AFDC families with earned income was much higher (Wyoming: 26 percent; Alaska, Iowa, Maine, Montana, North Dakota, Utah, and Wisconsin: 15 -- 19 percent). /12/ Many other families who are now receiving AFDC had earned income at some point in 1994. Other current AFDC families had earnings at some time in 1991, 1992, and 1993 and may still claim an EIC payment for those years.

How Much Can Families on AFDC Receive? If they had sufficient income in 1994, families can receive the maximum EIC of \$2,038 for a family with one child or \$2,528 for a family with two or more children. Of course, most AFDC families do not have enough earnings to get the maximum EIC. But even "average" AFDC families with earnings may get a significant benefit. According to

the most recent information available, the average monthly gross earned income of AFDC families with earned income is about \$335. /13/ The 1994 EIC for a family earning \$335 per month comes to about \$88 per month for a one-child family and \$100 per month for a family with two or more children.

Families do not have to be working now to be eligible for the EIC. It must be remembered that families are eligible for the EIC if they had earned income at some time during the year for which they file the tax return. Many families now receiving AFDC who do not now have earned income are eligible for an EIC for 1994 or earlier years if they had earned income in those years. These families may now file a tax return (or amended return if applicable) for such years and claim the credit.

V. Specific Rules Regarding the EIC and AFDC

State General Assistance is not discussed since the rules may vary in every state. States may, if they wish, disregard the EIC in determining eligibility in their GA programs. /14/

A. Disregard of EIC as Income and Resource

185% cap. The EIC is disregarded in determining whether gross income is below 185 percent of the applicable standard of need. /15/

Exclusion as resource for two months only. The EIC is counted as a resource beginning with the second month after the month in which it is received. /16/ Advocates will need to counsel clients that they might become ineligible for AFDC if the EIC brings them above the resource limit and they do not spend down to the limit or convert the excess amount into exempt resources.

Exclusion from countable income in calculating AFDC grant. No matter how an AFDC recipient receives the EIC, it cannot be counted as income in calculating the amount of her AFDC grant. /17/ If the recipient gets advance payments from the employer, the agency should subtract those payments from income before determining eligibility or benefit amount. If the recipient gets a check from the IRS, the agency should not count that check as income. Both the EIC and income tax refunds are disregarded. Among other things, this means the lump-sum income rule cannot apply to an EIC or a tax refund payment from the IRS. /18/

The rule that the EIC may not be counted as income, and may not be counted as a resource in the month it is received and in the next month applies to Medicaid, SSI, and various subsidized housing programs as well. /19/ For food stamp eligibility, neither can the EIC be counted as income and as a resource for one year after it is received. /20/

B. Removal of Past Limitation on Eligibility

Effective with earnings received in January 1991 and thereafter, receipt of AFDC and other benefits can have no effect on eligibility for the EIC. Under the law for tax years through 1990, a family was ineligible for the EIC if its benefits exceeded its earnings.

VI. The EIC in 1995 and Filing for Advance Payment

In 1995, the amount of EIC that families with two or more children can receive will increase. Although the maximum credit for families with one child will remain approximately the same, more families will be eligible to receive the maximum. For families with two or more children, the credit will be increased to 36 percent of income up to \$8,425. The resulting maximum credit is \$3,033. For families with one child, the EIC will be 34 percent of earned income up to \$6,000. This results in a maximum credit of \$2,040. /21/

Due to the increasing value of the EIC, more workers may wish to consider having a portion of their EIC added to their paycheck rather than receiving all of it at once as a tax refund. Workers who choose this option will receive approximately half of their EIC added to their paychecks each week and the rest will be provided to them as year-end refund when they file their tax returns.

Families (but not workers without qualifying children) can have the EIC added to their paychecks by filing with their employer Form W-5 (the Earned Income Credit Advance Payment Certificate). These forms should be available from their employers or they can be ordered by calling 1 -- 800 -- TAX -- FORM.

Since the EIC is based on the families' total income, workers should not file for advance payment if they work more than one job, have a working spouse, plan to marry during the year, or expect their income to increase substantially during the year. Such workers risk being overpaid through advance payments and owing the government money at the end of the year.

Earned Income Credit for 1995 Earnings

Earned Income:

lower range

middle range

higher range

Family with one child

34%

of earnings up to

\$6,000

\$2,040

for earnings between

\$6,000 and \$11,000

gradually reducing to \$0

for earnings between

\$11,000 and \$23,765

Family with two or more children

36%

of earnings up to

\$8,425

\$3,033

for earnings between

\$8,425 and \$11,000

gradually reducing to \$0

for earnings between

\$11,000 and \$26,000

Workers without children

7.65%

of earnings up to

\$4,000

\$306

for earnings between

\$4,000 and \$5,000

gradually reducing to \$0

for earnings between

\$5,000 and \$9,000

VII. Helping Low-Income Families Receive the EIC

Many low-income families with earned income may not know about the EIC, the possibility of obtaining advance payments, and the need to file a tax return to claim the EIC for past years.

The Center on Budget and Policy Priorities reports that recent studies have shown:

- Each year about 200,000 eligible families do not get the EIC because they use Form 1040EZ.
- Hispanic families are more likely to be eligible, but less likely to apply.
- Eligible families in states with no income tax are less likely to apply.
- Fewer than one in ten families filing for the EIC know they can get the EIC in their paychecks.

The Center on Budget and Policy Priorities has prepared an information kit containing posters, informational pamphlets, and suggestions for advocates. /22/

Advocates should seek to have welfare departments provide notice of the availability of the EIC to all current recipients, as well as to denied applicants and past recipients. Families currently

receiving transitional child care or Medicaid benefits are by definition needy families with earned income who could benefit by such notification. Notification should include information that the EIC generally cannot be counted as income, or as a resource for two months, for purposes of determining eligibility or benefit amount for AFDC, SSI, Medicaid, and many other benefits, and cannot be counted as income, or as a resource for one year, for food stamps eligibility.

Footnotes

/1/ Staff of House Comm. on Ways & Means, 103d Cong., 2d Sess., Overview of Entitlement Programs, 703 (Comm. Print 1994) [hereinafter 1994 Greenbook].

/2/ Families generally may file an amended return for any of the previous three years by using Form 1040X. Of course, if a family owed taxes for a year for which it did not file a return, the amount of taxes and penalty owed may be more than the EIC.

/3/ 26 U.S.C. Sec. 32(c)(3)(C).

/4/ *Id.* Sec. 32(c)(3)(B).

/5/ *Id.* Sec. 32(c)(3)(A).

/6/ *Id.* Sec. 32(c)(1)(B).

/7/ *Id.* Secs. 32(c)(3)(B)(ii), 151.

/8/ *Id.* Sec. 32(b); 1994 Greenbook, *supra* note 1, at 700.

/9/ 26 U.S.C. Secs. 32(b)(2)(B), 32(c)(1)(A).

/10/ 1994 Greenbook, *supra* note 1, at 402.

/11/ *Id.* at 395.

/12/ *Id.* at 414 -- 15.

/13/ *Id.* at 406 (1992 data).

/14/ New York, e.g., does so. N.Y. Soc. Serv. Law Sec. 131-a(8)(viii).

/15/ 42 U.S.C. Sec. 602(a)(18).

/16/ *Id.* Sec. 602(a)(7)(B)(iv).

/17/ *Id.* Sec. 602(a)(8)(viii).

/18/ 45 C.F.R. Sec. 233.20(a)(3)(iv)(E) (Oct. 1, 1993) provides that tax refunds other than the EIC are not counted as income. This regulation has not been revised to reflect the statutory amendments to 42 U.S.C. Secs. 602(a)(8)(A)(VIII), 602(a)(18), requiring disregard of the EIC. The regulation has no effect to the extent it is inconsistent with the statute. HHS has advised states of these changes by HHS Family Support Administration Action Transmittal 91-3 (Jan. 29, 1991).

/19/ 26 U.S.C. Sec. 32(j).

/20/ 7 U.S.C. Sec. 2014(g)(3).

/21/ 26 U.S.C. Sec. 32(b).

/22/ See box accompanying this article for information about contacting the Center on Budget and Policy Priorities.