Defrauding the American Taxpayer:
The Earned Income Tax Credit
A 2012 Update

By Edwin S. Rubenstein

On tax day 2009, The Social Contract released a study of the Earned Income Tax Credit (EITC). At the time, we noted that the credit had quietly become the largest cash transfer program for low-income families in the United States — dwarfing better-known entitlements such as TANF (cash welfare) and food stamps. Since then federal spending has expanded far more rapidly than anyone had anticipated, while tax revenues have shrunk as a share of GDP.

The deficit rocketed from $0.5 trillion in fiscal year (FY) 2008 to $1.4 trillion the following year, and according to the latest budget will remain at $1.3 trillion in FY 2012. Over the past four fiscal years, federal revenues have stagnated, while outlays have risen nearly 25 percent as a share of GDP.

Entitlement reform is essential if we are serious about cutting the deficit. Reductions in Medicare, Medicaid, and other once “untouchable” entitlements have been proposed. But the EITC? No way. Neither party has shown any interest in cutting the tax credit.

This is a chronic problem. For decades EITC expenditures have grown far faster than those of better-known entitlement programs (see graph at right).

In 1980 EITC was a $1.275 billion program. By 2011 it grew to $55.65 billion — a 43.6-fold increase in 31 years.

Over the same period: Social Security spending increased by 5.8-fold, Medicare was up 11.0-fold, Medicaid grew 19.7-fold, and total entitlement spending rose by a factor of 8.4.

EITC is not as expensive as those other programs — not yet, anyway. But if it sustains these absurdly high rates of increase, it will inevitably become the largest federal entitlement of all. But no one seems to care.

One reason for its relative anonymity: EITC is part of the income tax code. (That’s why we are releasing this updated article prior to tax day April 17.) The tax code is vast — it contains many different deductions, allowances, and credits — of which the EITC is one of the most generous — and important. The credit is not subject to the Congressional budget authorization process.

In recent months the Obama Administration has gone out of its way to promote the tax credit. A November 2011 White House report directed specifically at African Americans notes the “…historic expansions in refundable tax credits Earned Income Tax Credit and Child Tax Credit for low income families.”

EITC is applauded for bringing great gains to blacks:

Earned Income Tax Credit (EITC). The EITC is a refundable tax credit primarily for
low-income working families with children. This tax credit has lifted more children out of poverty than any other single program or category of programs. Under the Recovery Act, the Obama Administration expanded the EITC by creating a “third tier” for families with three or more children, allowing them this year to receive up to $640 more than they otherwise would. The Administration’s expansion of the EITC kept 95,000 African Americans above the poverty line in 2010 alone. This tax credit enables a newly employed single mother of two to supplement her earnings with EITC as soon as she starts work. If this mom earns $20,000 a year, she stands to receive an EITC of around $4,400 for her family.3

In the static analysis favored by the Obama Administration, the credit may indeed appear to “raise” thousands of African Americans out of poverty. But this conclusion focuses solely on the cash received by EITC recipients. It ignores the deleterious impact of EITC on minority wages, family size, and debt. It also turns a blind eye to evidence that EITC encourages illegal immigration, a side effect which in the long run hurts minorities more than EITC money helps them.4

At the end of the day, deficit reduction, by lowering interest rates and increasing private sector confidence, may be the best anti-poverty program of all. But by touting the EITC, Mr. Obama greatly reduces the chances for a smaller deficit.

Mr. Obama’s latest budget, released in February, estimates EITC outlays will be $52.2 billion in FY 2012 — up 29 percent from 2008. By comparison, outlays of the notoriously hard to control Medicaid program are expected to rise 27 percent over that period:

<table>
<thead>
<tr>
<th>Program</th>
<th>FY2008</th>
<th>FY2012Est.</th>
<th>% increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>EITC</td>
<td>$40.6</td>
<td>$52.2</td>
<td>28.6%</td>
</tr>
<tr>
<td>Medicaid</td>
<td>$201.4</td>
<td>$255.3</td>
<td>26.8%</td>
</tr>
<tr>
<td>Medicare</td>
<td>$223.6</td>
<td>$264.0</td>
<td>18.1%</td>
</tr>
<tr>
<td>Social Security</td>
<td>$506.6</td>
<td>$635.2</td>
<td>25.4%</td>
</tr>
<tr>
<td>Food Stamps</td>
<td>$39.3</td>
<td>$85.2</td>
<td>116.8%</td>
</tr>
<tr>
<td>TANF (cash welfare)</td>
<td>$21.8</td>
<td>$20.4</td>
<td>-6.4%</td>
</tr>
<tr>
<td>All Entitlements. ($ trill.)</td>
<td>$1.83</td>
<td>$2.37</td>
<td>29.6%</td>
</tr>
<tr>
<td>All Federal outlays ($ trill.)</td>
<td>$2.97</td>
<td>$3.80</td>
<td>27.7%</td>
</tr>
</tbody>
</table>

Data source: OMB, FY2013 Budget. Tables 1.1 and 11.3.

EITC fraud

Technically, only taxpayers with valid Social Security numbers who are authorized to work in the U.S. are eligible for the tax credit. But identity theft, stolen Social Security numbers, and other scams effectively nullify the restriction. As a result, illegal aliens actually receive the EITC at even greater rates than legal immigrants.

Three years ago we reported that households headed by illegal immigrants from Mexico were three times more likely to receive the EITC than households headed by native-born Americans.3 We noted that the IRS does little to verify the validity of SSNs on tax returns, or the existence of immigrant children, or to ascertain that they’ve lived with the taxpayer for more than 6 months as required by law. Illegal alien husbands and wives often file separate returns in which BOTH claim the same children.

In February 2011 the Treasury Department, in effect, acknowledged that the charges we made against the IRS were valid. An audit of IRS procedures by the Department’s inspector general stated the following:
The Government Accountability Office has listed the Earned Income Tax Credit (EITC) Program as having the second highest dollar amount of improper payments of all Federal programs. The Internal Revenue Service (IRS) has made little improvement in reducing EITC improper payments since 2002 when it was first required to report estimates of these payments to Congress. The IRS continues to report that 23 percent to 28 percent of EITC payments are issued improperly each year. In Fiscal Year (FY) 2009, this equated to $11 billion to $13 billion in EITC improper payments.\(^6\)

The IRS is apparently not interested in cracking down on massive EITC fraud:

TIGTA [Treasury Inspector General for Tax Administration] has conducted a number of audits that have provided the IRS with specific actions that could be taken to reduce improper payments. While the IRS has implemented some of our recommendations, it has not taken actions to address key recommendations aimed at preventing/reducing EITC improper payments.

While illegal immigration is not specifically mentioned as a source of EITC fraud, the use of bogus Social Security numbers and other actions associated with the receipt of EITC by illegal aliens are prominently highlighted. Once again, the IRS is asleep at the switch.

The Treasury Department’s Inspector General is not optimistic that its tax collection agency will clamp down on the massive fraud.

The loss of billions of dollars in improper EITC payments annually calls for more aggressive and immediate actions to reduce improper payments by intensifying efforts to eliminate payment error, waste, fraud, and abuse. Executive Order 13520 requires the IRS to intensify its efforts and set targets to reduce EITC improper payments. The IRS has not met this requirement and, as a result, the risk remains high that no significant improvement will be made in reducing improper EITC payments.\(^7\)

### Another (Even Worse) Tax Credit

EITC is not the only tax credit available to low-income families. The Child Tax Credit (CTC) was signed into law in 1997.

The Obama White House loves the CTC: Child Tax Credit (CTC). The CTC reduces the amount of federal taxes low-income families must pay by up to $1,000, depending on family income, for each qualifying child under the age of 17. For example, a family of four that could otherwise owe $4,000 in taxes might only owe $2,000 after receiving the credit for each of their children. Though the Child Tax Credit was expanded to a maximum of $1,000 per child from $600 per child in 2003, the credit remained unavailable to millions…. In the Recovery Act, the Obama Administration worked with Congress to expand the Child Tax Credit to lower the minimum earned income amount for refundability from about $12,500 to $3,000 — giving many families access to thousands of dollars in additional tax benefits that would have otherwise been lost…. The Administration’s expansion of the CTC kept 199,000 African Americans above the poverty line just in 2010.\(^8\)

CTC is potentially more damaging than the EITC. While EITC payments max out at three children, CTC payments rise by as much as $1,000 for every child in a family. And while EITC payments are phased out as poor families approach the poverty line, households with

<table>
<thead>
<tr>
<th>Action</th>
<th>Potential Savings (Over 5 years)</th>
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<tr>
<td>Comply with regulations requiring some taxpayers who previously filed a fraudulent EITC claim to recertify their eligibility before receiving the EITC in a subsequent tax year.</td>
<td>$330 million</td>
</tr>
<tr>
<td>Ensure taxpayers comply with the law governing EITC qualifying-child eligibility before allowing EITC claims.</td>
<td>$5.6 billion</td>
</tr>
<tr>
<td>Use available third-party data to ensure taxpayers comply with the law requiring individuals to have a Social Security Number that is valid for work when claiming the EITC.</td>
<td>$1.1 billion</td>
</tr>
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Source: Treasury Inspector General For Tax Administration, Reduction Targets and Strategies Have Not Been Established to Reduce the Billions of Dollars in Improper Earned Income Tax Credit Payments Each Year February 7, 2011. Figure 3.
incomes as large as $130,000 are eligible for the CTC.

Then there is the matter of fraud. By law illegal aliens are not eligible for federal tax credits. The IRS enforces this requirement selectively. The agency will not send an EITC refund check to any applicant who has filed a tax return without a Social Security number. As described above, many of those Social Security numbers are fraudulent — stolen from citizens by illegal aliens. But at least the IRS makes EITC applicants go through the charade of appearing legal.

By contrast, IRS processes CTC refund checks for any tax return, whether filed with a Social Security number or not. This includes returns filed with Individual Taxpayer Identification Numbers (ITINs).

The IRS issues ITINs to persons who are not eligible for a Social Security number because they are not authorized to work in the United States. Most are illegal aliens. IRS explains that ITINs are “for tax purposes only,” that they help people here illegally comply with the tax code, and are not intended for any other purpose — like enforcing the immigration laws.

Simply put, the IRS allows illegal aliens to rip off U.S. citizens with impunity — as described below.

The refundable part of the CTC is called the Additional Child Tax Credit (ACTC). When a taxpayer’s CTC payment exceeds his tax liability, IRS sends an ACTC refund check to cover the balance. Indeed, an individual can receive ACTC even if no income tax was withheld or paid.

A Treasury Department audit released in July 2011 accused the IRS of allowing undocumented workers to collect $4.2 billion in ACTC credits in 2010 — almost four times the amount five years earlier. Although undocumented workers are not eligible to receive federal benefits, the Treasury reported that IRS management routinely allows such payments for ACTC.

“The payment of federal funds through this tax benefit appears to provide an additional incentive for aliens to enter, reside and work in the United States without authorization, which contradicts federal law and policy,” the Treasury audit said.

Appropriations for EITC and ACTC credits in FY 2010 were $54.7 billion and $22.7 billion, respectively. They are by far the most expensive refundable tax credits.

Receipt of ACTC payments by individuals not authorized to work here — most of them illegal aliens — is rampant. The $4.2 billion in ACTC credits paid to unauthorized workers in 2010 represented nearly one-fifth of all ACTC payments that year.

When confronted, the IRS insists that the tax code permits the payment of ACTC, but not the EITC, to undocumented workers. This makes no sense. The ACTC was specifically designed to offset some of the work disincentives created by the phase-out of the EITC. Indeed, ACTC benefits phase in at the income levels where EITC starts to phase out: http://www.taxpolicycenter.org/briefing-book/key-elements/family/ctc.cfm The credits are inextricably linked.

Some have argued that the EITC alone is sufficient for very-low-income households with children. The EITC reaches its maximum level of $5,751 for families with three or more children earning $12,000 to $21,000 in 2011 (after which point it starts to phase out). But, unlike the ACTC, the EITC reaches a maximum at three children. Also, the maximum ACTC benefit has doubled — from $500 to $1,000 a child — since the credit was first enacted. And unlike the EITC, child tax credits are available to families with incomes well above the poverty level.

Even the liberal Urban Institute has questioned the need for the Child Tax Credit:

Viewed as a work incentive, the CTC phase-in rules are logical (although there is a ques-
tion as to why lower-income households should be subject to work incentives delivered by two separate programs—the EITC and the CTC). For the majority of recipients, however, the CTC is tantamount to a cash allowance. Viewed simply as a child subsidy, it is hard to understand why the families who most need help are excluded.11

Bottom line: it is not clear why IRS pays illegal aliens one tax credit while denying them the other. What is clear, however, is that ACTC payments to tax returns with ITINs have skyrocketed:

In 2005 796,000 ITIN filers received ACTC payments totaling $924 million. By 2008 1,526,276 ITIN filers received $2.1 million in ACTC payments.

Then came the Great Recession. The American Recovery and Reinvestment Act of 2009 increased ACTC benefits for both legal and illegal workers. The Act lowered the threshold income at which ACTC kicks in to $3,000 from $12,500.

The predictable result: more illegal alien recipients and a larger payment per recipient. By 2010 2.3 million ITIN filers claimed ACTC totaling $4.2 million. The average ACTC payment per illegal alien (ITIN) tax return rose from $1,399 in 2008 to $1,803 in 2010.

We do not mean to suggest that ACTC fraud is limited to illegal aliens. In fact, the credit is received by far more taxpayers filing with Social Security numbers than with ITINs. To be sure, many of the former are illegal aliens filing with stolen Social Security numbers.

However, ITIN taxpayers are far more likely to claim ACTC benefits. In 2010, for example, 72 percent of all ITIN filers claimed the ACTC versus only 14 percent of individuals who filed tax returns with a Social Security number. More importantly, the fraction of ITIN tax returns claiming the ACTC has increased dramatically.

The inescapable conclusion: IRS knowingly enables illegal aliens to defraud honest taxpayers. It has allowed itself to become a political arm of the Obama Administration. Sen. Orrin Hatch (R-Utah), ranking member of the Senate Finance Committee, takes the Administration and its compliant tax agency to task:

“The disconcerting findings in this report demand immediate attention and action from Congress and the Obama Administration,” Hatch said when the Treasury report was issued. “With our debt standing at over $14.5 trillion and counting, it’s outrageous that the IRS is handing out refundable tax credits... to those who aren’t even eligible to work in this country.

Many individuals who are not authorized to work in the United States, and thus not eligible to obtain a Social Security Number (SSN) for employment, earn income in the United States. The Internal Revenue Service (IRS) provides such individuals with an Individual Taxpayer Identification Number (ITIN) to facilitate their Department of the Treasury to seek clarification filing of tax returns. Although the law prohibits aliens residing without authorization in the United States from receiving most Federal public benefits, an increasing number of these individuals are filing tax returns claiming the Additional Child Tax Credit (ACTC), a refundable tax credit intended for working families. The payment of Federal funds through this tax benefit appears to provide an additional incentive for aliens to enter, reside, and work in the United States without authorization, which contradicts Federal law and policy to remove such incentives.”

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EITC and Population Growth

Three years ago we wrote:

EITC originated as an income supplement for low-income workers. Somewhere along the line its purpose seems to have changed. Today it is a program whose benefits are heavily contingent on parenthood.13

Since we wrote those lines, EITC’s pro-procreation bias has become even more pronounced. The reason: a
fourth EITC bracket — for families with three or more children — was added in 2009. This change significantly increased the financial incentive to have children (see graph below).

In tax year 2008 a family with no children received a maximum EITC payment of $438; a family with one child received up to $2,917; two or more children bumped the maximum credit to $4,824. Thus the presence of children triggered an 11-fold rise in EITC payments ($438 to $4,824) in 2008.

On tax returns filed this April (tax year 2011), childless families will be eligible for an EITC payment of up to $464; a family with three or more children will receive up to $5,751. Thus the presence of children triggers a 12.4-fold rise in EITC payments — $5,751 versus $464.

By having children a family can increase its EITC payment by as much as $5,287 today versus $4,386 in 2008. That’s an increase of $901, or 20.5 percent, in EITC’s pro-procreation incentive.

As seen in the graphic, the pro-procreation incentive is slated to rise still further in tax year 2012.

Not surprisingly, the IRS estimates that roughly half of improper EITC payments involve fraudulent child custodial claims.

But most children claimed on EITC tax returns are real — and therein lies the problem. The decision to have children may be influenced, at least in part, by the tax credit. The pro-procreation incentives are particularly acute for immigrants — for the simple reason that the credit represents a larger share of their incomes.

The Census Bureau projects that immigrants and their U.S.-born children will account for 79.5 percent of U.S. population growth between 2010 and 2050. U.S.-born children of immigrants, not the immigrants themselves, are expected to be the major driver. While native-born women are having fewer babies, fertility among their foreign-born counterparts has generally continued to increase.

Over the nearly 40 years of EITC’s existence, the share of births to foreign-born mothers has risen faster than the foreign-born share of the U.S. population.

It would be absurd to suggest that immigrants have children solely to get a larger tax credit. At the same time, groups with the highest EITC eligibility rates also have the highest fertility rates. Even a tiny increase in fertility rates, if maintained over the decades, will have enormous consequences.

The role of the EITC in the nation’s demographic destiny cannot be denied.

**EITC and the Culture of Debt**

For poor families, the tax refund check is often the largest single sum of money they receive during the year. They may need the money immediately, however. Refund Anticipation Loans (RALs) give them cash quickly — sometimes in the same day or even within an hour of filing their tax returns. But they are costly.

Nearly three-quarters of all EITC recipients hire commercial tax preparers to do their returns. It’s not so much the tax preparation, it’s the loans — the instant cash — that attracts so many poor taxpayers to these companies. And for the H&R Blocks of the world, it’s big money. When you add up the interest payments, preparation costs, and other fees, an EITC recipient can spend more than 10 percent of the credit just to receive the credit.

Our study detailed the risks RALs pose to borrowers:

The mechanics of RALs are stacked against the taxpayer. Commercial tax preparers like H&R Block act as loan brokers, but banks actually issue the refund loans. Before transferring the RAL proceeds to the taxpayer the banks deduct interest, the tax preparer’s fees, loan application fees, and all other charges. As part of the RAL process, the taxpayer must authorize the IRS to send the refund directly (electronically) to the bank to repay the loan.

The hapless EITC beneficiary is responsible for paying the loan in full no matter how much of the anticipated refund the IRS actually releases. The IRS can deduct any outstanding federal debts — e.g., back taxes, child support, or student loans — from the EITC pay-
ment. If the taxpayer cannot repay the RAL, the lender may send the account to a debt collector.

There is good news and bad news on the RAL front.

Good news: The IRS recently announced a policy that increases the financial risk for commercial tax preparers and banks that issue RALs. Starting with the 2011 tax year the tax agency will no longer provide these companies with the “debt indicator” used to facilitate the loans. The debt indicator is simply an IRS e-mail sent to tax preparers after they file an electronic tax return. It contains information on back taxes owed, unpaid child support, or other payments their client owes the federal government — monies that can be deducted from EITC refunds.

In announcing the change, IRS Commissioner Doug Shulman stated, “as we prepare for tax season every year, we look at past practices and consider whether they still make sense. We no longer see a need for the debt indicator in a world where we can process a tax return and deliver a refund in 10 days. We encourage taxpayers to use e-file with direct deposit so they can get their refunds in just a few days.”

The change will likely reduce the availability and volume of RALs issued by private tax preparation services:

It is still unknown what the short-term and long-term impact of this decision will be on the RAL industry. However, for smaller tax preparers it is likely that they will think twice about offering RALs during the 2011 tax season. On the other hand, some of the bigger tax preparation companies may look for alternative ways to offer RALs while raising the cost. These larger companies may rely on a returning customer’s debt indicator from prior years or on a taxpayer’s credit score. Either way, it is becoming more difficult and more risky for these companies to offer refund anticipation products. Even before the IRS announced the elimination of the debt indicator, many banks who had previously provided RAL loans decided to get out of the risky RAL business...

Bad news: By pushing commercial companies out of the EITC business, the IRS is increasing the clout of liberal activist groups that offer free tax preparation service. Foremost among them: The Center on Budget and Policy Priorities (CBPP).

CBPP has harnessed a large network of community organizations, schools, state and local governments, labor unions, and advocacy groups to its EITC outreach campaign. Members receive a “Tax Credit Outreach Campaign Kit” — updated annually — outlining CBPP’s strategy for promoting the credit and linking eligible workers to free tax filing assistance. Flyers in Hmong, Tagalog, and eighteen other languages — designed to hook immigrants into the EITC culture — are prominent features.

In recent years CBPP has lobbied for expanding eligibility and increasing EITC payment amounts. The clamp-down on RALs is unlikely to offset the expansion of this program touted by liberal activists — and the White House.

Endnotes

3. Ibid.
4. These side effects are discussed in my Spring 2009 TSC article.
7. Ibid., page 10.
10. Ibid.