Defrauding the American Taxpayer - The Earned Income Tax Credit

A Study in Fraud, Abuse, and Liberal Activism

Part 2 of 7
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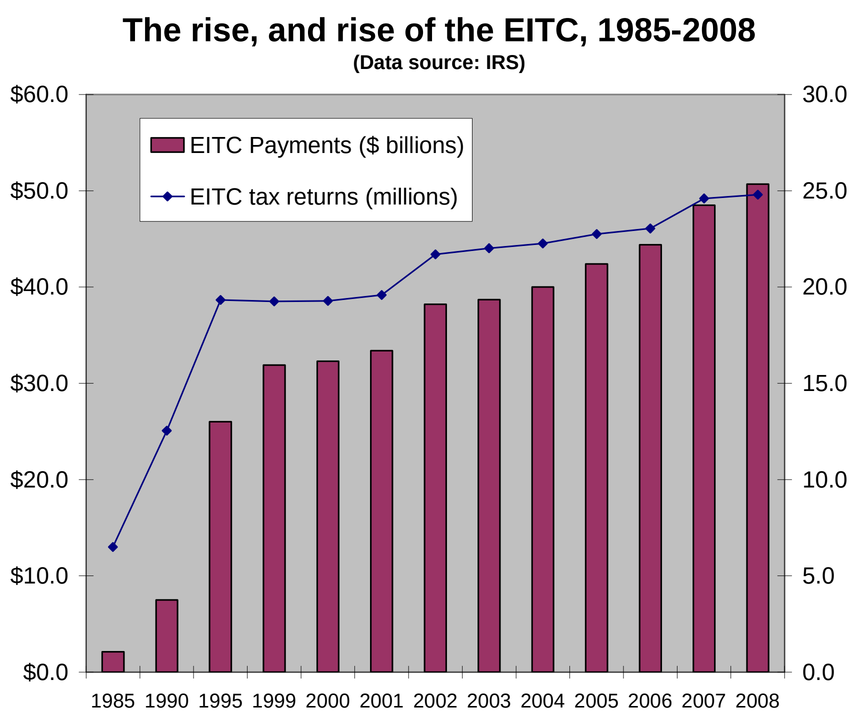
Since it became part of the income tax code in 1975 the Earned Income Tax Credit (EITC) has quietly become the largest cash transfer program in the United States. At more than $60 billion in FY2011, EITC spending is expected to dwarf that of the traditional cash welfare program (TANF.) Nearly twenty-five million households currently receive the tax credit.



Whether measured in dollars or tax returns, the EITC had grown faster than the federal income tax itself. From 1985 to 2008 (the latest year of IRS data) EITC payments grew from $2.1 billion to $50.7 billion, or by an eye-popping 2,314%. By comparison, total Federal income tax revenues rose by a paltry 175% over that period. Similarly, the number of returns claiming EITC rose from 6.4 million to 24.8 million – a 282% increase, over a period when the total number of federal income tax returns increased by a mere 40%.

More than one in four immigrant households received EITC in 2000 – nearly twice the 13.2% recipiency rate of households headed by native-born Americans. And because immigrant households are larger (primarily because of higher fertility) their EITC payments are larger than those received by native households.

Bottom line: immigrants account for about 13% of the U.S. population but receive an estimated 26% of EITC benefits – or approximately $13 billion in 2008.

Yet politicians from Ronald Reagan to Michael Bloomberg have touted EITC as the one anti-poverty program that works. Their enthusiasm reflects the perception that, unlike welfare, EITC payments go only to the working poor – especially families with children.

While welfare benefits are phased out as a recipient's private earnings increase, the EITC credit is *phased in* – increasing work incentives for low income individuals. Only as income approaches the poverty level is the EITC payment phased out.[1]

Bipartisan support for the credit extends beyond the Beltway: In 2010 some 24 states - including the District of Columbia - had their own EITCs. (In the 2008 tax year only 20 states offered the credit.) State EITCs generally mimic the federal EITC structure on a smaller scale, with individuals receiving a state credit equal to a fixed percentage – generally between 15 and 30 percent – of what they receive from the federal credit. San Francisco, New York City, and Montgomery County, Maryland have also enacted EITCs.

Enthusiasm for the credit has blinded policymakers to its problems. The EITC program is dominated by fraud. Year after year about one-third of all EITC returns are based on illegal multiple returns, phony Social Security numbers, or claims of non-existent children or spouses. A disproportionate share of illegal alien households receives the benefit.

Washington's love affair with EITC has allowed the minimum wage to decline in real value. Native workers have suffered as a result. So have labor unions. In effect, EITC subsidizes employers who hire low-wage immigrants and reject equally qualified natives.

[1] For a tax return claiming two dependent children, the Earned Income Tax Credit in 2008 equaled 40% of the first $12,060 of earned income, thus reaching a plateau of $4,824, and staying there until earnings increase beyond $15,752, at which point the credit starts phasing out at 21%, reaching zero as earnings reach $38,646. The dollar amounts are indexed annually for inflation.

No one should be surprised, therefore, that Walmart, the U.S. Chamber of Commerce, and most liberal activist groups, are major EITC supporters.

For most poor families, the tax credit check is the largest single sum of money they will receive during the year. Most receive it after filing income taxes. But some need the money immediately and they can get it - for a price. A niche financial sector thrives by lending EITC recipients immediate cash in return for a hefty chunk of their credit check.

The cost to the poor of these so-called Refund Anticipation Loans (RALs) has been estimated at 6% of the entire EITC program.

Widespread availability of high-interest RALs made poor borrowers easy marks for sub-prime mortgage hucksters. The resulting defaults have pushed the entire economy to the brink of collapse. While the sub-prime story is well known, few are aware of EITC's role in introducing the poor to the culture of debt.

Has EITC lived up to its hype? In answering this, consider the following:

While EITC started as an anti-poverty program, the number of the tax returns claiming the credit rose 25-times faster than the poverty population over the past two decades.[2]

EITC benefits rise sharply with parenthood; poverty rates for families with children have risen faster than those for childless families since the credit was created.

Illegal-alien households are eligible EITC at greater rates than households headed by legals.legal immigrantfor the immigrant friendly of poverty programs; illegal immigrants comprise a far larger share of the poverty population now.

While EITC's payment structure is supposedly pro-family, a larger share of poor children live in single-parent households now than when the credit started.

Implication: the EITC is a textbook case of unintended consequences. (The Great Recession may be among them.)

The **good news:** The Obama administration is well aware of these problems. As evidence, this sage advice excerpted from a memo prepared for the incoming Obama Administration and the new Congress:

"…The current federal EITC provides large benefits to families with children, mostly single mothers, and minimal benefits to singles, even though

[2] http://www.census.govprod2008pubsp60-235.pdf

declining wages have affected all low-income workers. These disparities create disincentives to work in the formal labor market and for poor men and women to marry, cohabitate, and coparent. Strategies that expand the current EITC would reduce family and child poverty but could perpetuate existing inequities…" http://www.mdrc.org/recommendation_8.html:

The **bad news**: The Obama administration has increased EITC payments for poor families with three or more children, thereby exacerbating the program's perverse incentives.

Our take: The more Mr. Obama "changes" things, the more they remain the same.

Legislative history

EITC was the brainchild of Senate Finance Committee Chairman Russell Long. An arch conservative, Long was detested by liberals who saw him as an obstacle to expanding the welfare state. True to form, he worked to defeat President Nixon's Family Assistance Plan – a negative income tax scheme which would have effectively doubled the size of the welfare rolls. [Jodie T. Allen, "Present at the Creation," Chatterbox, Dec. 13, 1999.]

But the Senator was not averse to giving poor people a helping hand – as long as it was done in a way to encourage rather than discourage work. His own welfare reform plan accomplished that by *guaranteeing* a public sector job to any family head needing work. The guaranteed jobs paid less than the minimum wage, so as not to encourage people to abandon more demanding private sector employment. To help people cope with poorly paying jobs, Long added the EITC as a "work bonus" to help the new workers pay their Social Security taxes.

At its inception in 1975 the net cost of the Senator Long's welfare plan was about $4.3 billion – with $1 billion going for the EITC – big, big money in those days and more than a 60 percent increase over what Washington was then spending on welfare. The credit has been expanded a number of times, most notably by Ronald Reagan in 1986, Bill Clinton in the early 1990s, and George W. Bush in 2001.

