

## The Earned Income Tax Credit and Older Workers

**The earned income tax credit is the most important form of income support for low-income workers. However, the credit for workers without qualifying children is not available to workers over age 64 or under age 25. These age limits should be eliminated. There are better ways to target the credit to persons who depend on earnings for a large portion of their support, and the cost of extending the credit to older and younger workers is relatively small.**

The earned income tax credit (EITC) is the most important form of income support for low-income workers. For tax year 2006, a total of \$44.4 billion was claimed on 23 million tax returns.<sup>1</sup> The EITC is credited with lifting more than 4.5 million people out of poverty in 2005.<sup>2</sup> The credit has also been associated with substantial increases in the labor supply of single mothers and improved economic stability of low-income working families.<sup>3</sup>

The amount of the tax credit increases with income from work (wages, salaries, and self-employment income) and is phased out for higher-income taxpayers. In 2009, workers who do not reside with a qualifying child may receive up to \$457; workers with one qualifying child may receive up to \$3,043; and workers with two or more children may receive up to \$5,028.<sup>4</sup> The EITC is a refundable tax credit, meaning that workers receive their full credit even if they have no income tax liability.

The EITC was designed primarily to relieve the payroll tax burden of low-income workers with children, who might otherwise rely on public assistance programs. The small credit for workers who do not reside with a qualifying child, added as part of an

expansion of the EITC in the Omnibus Budget Reconciliation Act of 1993, is available only to workers at least aged 25 and under age 65. The rationale for the age limits was to limit the cost of the credit and to target it to persons who depend on earnings for a large portion of their support.

However, there are now better ways to target the credit to persons who depend on earnings for a large portion of their support, and the cost of extending the credit to older and younger workers is relatively small.

### No Good Rationale for Age Limits

Older workers with incomes that would qualify them for the childless EITC are among those most at risk of financial insecurity in retirement. Public policies should encourage those aged 65 and over to remain in the workforce as long as they desire and are able to do so, rather than signal to workers that they should retire by denying them eligibility for the EITC.

When the credit for workers without qualifying children was first established, the age at which retirees could receive a full Social Security benefit was 65. The full retirement age is now 66, and it will

rise to age 67 by 2027. Retirees may claim benefits earlier than the full retirement age, but if they do, their monthly benefit is reduced so that the expected lifetime benefit remains constant. For example, workers eligible for a full monthly benefit of \$1,000 who begin to claim benefits at age 62 (the earliest eligibility age) rather than waiting until age 66 will see their benefit reduced to \$750. Workers can increase their benefits by delaying claims beyond the normal retirement age (up to age 70).

The average Social Security benefit for retired workers in November 2008 was just \$1,089, and most retirees depend on a combination of Social Security, earnings, pension benefits, and other savings.<sup>5</sup> As longevity increases, many older Americans will need to continue to work well past age 64 to ensure that they do not outlive their defined contribution pension or other retirement savings.

In 2007, there were nearly 6.7 million workers aged 65 and over who did not reside with a related child. Of these, about 0.3 million were not receiving any Social Security benefits and had earnings less than the EITC cutoff point.<sup>6</sup> Information on who depends primarily on Social Security rather than on earnings is readily available to taxpayers and the Internal Revenue Service (IRS), and is a much better instrument for targeting the EITC to vulnerable workers than the current age test.

Also in 2007, there were 7.8 million workers aged 18 to 24 who did not reside with a related child. Nearly 6.1 million of them were not full-time students, and 5.5 million were not students at all. About 1.7 million part-time students or non-students had earnings below the EITC threshold. These young low-wage workers should also be eligible for the EITC.

When the credit for workers without children was introduced, there was no easy way to identify students, who are likely to depend primarily on their parents for support. However, in 1998 Form 1098-T was created to allow taxpayers and the IRS to verify eligibility for the Hope Scholarship and Lifetime Learning credits and other tax benefits for education enacted as part of the Taxpayer Relief Act of 1997. This form could now be used to identify low-income workers who are students and target the EITC to low-wage non-student workers.

### **Proposals to Expand the EITC**

The age tests should be eliminated, and the EITC should be made available to all income-eligible non-dependent workers who are not full-time students.<sup>7</sup> Nontaxable Social Security benefits could be added to adjusted gross income for purposes of the EITC phase-out, in order to further target the credit to workers who depend on earnings for most of their income.

If this proposal were enacted effective for tax year 2009, about 1.8 million tax units (individual taxpayers or married couples filing jointly) headed by workers aged 18 to 24 would receive an average credit of \$264, and about 0.3 million tax units headed by workers aged 65 and over would receive an average credit of \$263. More than 95 percent of these tax units have incomes in the bottom quintile of the income distribution.<sup>8</sup>

In addition, about 135,000 tax units with workers aged 25–64 would lose an average of about \$210 each, and 13,000 tax units headed by taxpayers aged 65 and over would lose an average of \$162, due to the inclusion of Social Security in income for purposes of the EITC phase-out. These tax units are receiving disability, spousal, widow, or early retiree benefits or are composed of a

### Administering Alternatives to the Age Tests

Each year, educational institutions report tuition and related expenses billed and paid to students and to the IRS on Form 1098-T. The form includes a box indicating whether the student is at least a half-time student. The form could be modified to identify full-time students as well (consistent with the proposal to allow the credit to all who are not full-time students). Or, the credit could be allowed only to non-students and those who are students less than half-time. In either case, the limitation on student status would apply only to workers under age 25.

The IRS could match Form 1098-T to Form 1040 to verify eligibility of younger workers for the EITC. It could also match Form SSA-1099, showing Social Security benefits, to Form 1040. Matching Forms 1098-T and SSA-1099 to Form 1040 to verify student status and Social Security benefits during or after the filing season would be more difficult than verifying age, which can be done in advance of or contemporaneously with tax filing, using permanent Social Security records. But it would be no more difficult than verifying earnings and other income, as is already done using Form W-2 and Form 1099 matching to Form 1040.

Including Social Security benefits in income for purposes of phasing out the EITC does add some complexity to the calculation of the credit. It would be simpler to exclude older taxpayers with Social Security benefits in excess of a certain amount from eligibility for the credit, but this would create a large effective marginal tax rate on Social Security benefits at that point.

worker under age 65 and a retired spouse. Credit cuts for these taxpayers could be prevented by specifying that Social Security is included in income for EITC purposes only for recipients who have reached the full retirement age. Including Social Security benefits only for persons over the full retirement age would also simplify administration of the credit somewhat.

President-elect Obama has proposed to expand the EITC for workers without qualifying children as well as for workers with children. He would increase credit for workers without children (from a maximum of about \$457 in 2009 to a maximum of about \$550 in 2012), increase the credit further for workers who do not reside with a child but pay child support (to about \$1,100 in 2012), and increase the phase-out threshold for joint filers. He would also increase the credit rate for workers with three or more children.<sup>9</sup>

If President-elect Obama's proposal were enacted, then further expanding the EITC by eliminating the age limits would have a larger effect than it would under current law. About 2.8 million tax units with workers aged 18 to 24 would receive an average credit of \$375, and about 0.6 million tax units headed by workers aged 65 and over would receive an average credit of \$340.

Over the 10-year period 2009 to 2018, extending the EITC to older and younger workers without children would cost \$11.5 billion if President-elect Obama's proposal is enacted and \$5.4 billion if it is not enacted.<sup>10</sup>

Twenty-two states and the District of Columbia also provide earned income tax credits for workers without a qualifying child.<sup>11</sup> Most state credit provisions are tied directly to the federal credit. Thus, if eligibility for the federal credit for workers without children is

expanded, workers in many states will receive an additional state EITC.

## Conclusion

Older workers with incomes low enough to qualify them for the EITC are among the most vulnerable Americans. Tax and other public policies should encourage their efforts to increase their own economic security by remaining in the workforce as long as they choose to do so. Young, low-wage workers would also benefit from income support and inducements to increase their attachment to the labor force. Data on Social Security benefits, earnings, and student status are readily available and can be used to effectively target the EITC to workers, without relying on age tests. Thus, EITC age tests should be eliminated.

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<sup>1</sup> Bryan (2008), Table 4. By comparison, about 1.9 million families per month received Temporary Assistance for Needy Families cash assistance totaling about \$9.9 billion in fiscal year 2006. See U.S. House Committee on Ways and Means (2008), Chart 7-2 and Table 7-8.

<sup>2</sup> U.S. Bureau of the Census (2007), Table RD-REV POV01.

<sup>3</sup> See Meyer and Rosenbaum (2001) and Smeeding et al. (2001).

<sup>4</sup> IRS Revenue Procedure 2008-66, available at [www.irs.gov/pub/irs-drop/rp-08-66.pdf](http://www.irs.gov/pub/irs-drop/rp-08-66.pdf).

<sup>5</sup> U.S. Social Security Administration (2008).

<sup>6</sup> Author's tabulations from the March 2008 Current Population Survey.

<sup>7</sup> Consideration should also be given to providing the credit to workers in extended families. Currently, a worker (such as a grandparent) who lives with a qualifying child may not claim the credit for workers without children, even if another adult (such as the parent) claims the child. See U.S. Department of the Treasury (2008), pp. 55–58, for details.

<sup>8</sup> Estimates of the distributional and revenue effects of expanding the EITC provided by the Tax Policy Center. See: <http://taxpolicycenter.org/numbers/displayatab.cfm?template=simulation&SimID=293>. Income for purposes of distributional estimates is cash income, which generally includes gross income for tax purposes plus nontaxable income (such as

tax exempt interest, nontaxed Social Security, and transfer payments). The income break for the lowest quintile (in 2008 dollars) is \$18,981. See [www.taxpolicycenter.org/TaxModel/income.cfm](http://www.taxpolicycenter.org/TaxModel/income.cfm) for details.

<sup>9</sup> See Barack Obama campaign (2008), p. 46, and Burman et al. (2008), p. 15.

<sup>10</sup> The estimates assume that the IRS is using Form 1098-T to limit receipt of the credit to non-students, and that individuals do not work more or less in response to the credit. If compliance could not be enforced or if individuals changed the amount that they worked in order to receive a larger credit, then the cost of expanding the EITC would be higher. Inducing additional hours of work among low-income taxpayers would generally be desirable, even if it increased the cost of the credit.

<sup>11</sup> Levitis and Koulisch (2008).

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