

**DESCRIPTION OF AN AMENDMENT
IN THE NATURE OF A SUBSTITUTE TO THE
CHAIRMAN'S MARK RELATING TO CHANGES
TO THE EARNED INCOME TAX CREDIT**

Scheduled for Markup

by the

HOUSE COMMITTEE ON WAYS AND MEANS

on September 18, 1995

Prepared by the Staff

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INTRODUCTION

The House Committee on Ways and Means has scheduled a markup of various revenue provisions beginning on September 18, 1995. This document, prepared by the staff of the Joint Committee on Taxation, provides a description of present law and the proposed changes to the earned income tax credit (EITC).¹

¹ This document may be cited as follows: Joint Committee on Taxation, *Description of an Amendment in the Nature of a Substitute to the Chairman's Mark Relating to Changes to the Earned Income Tax Credit (JCX-40-95)*, September 18, 1995.

DESCRIPTION OF PROPOSED CHANGES TO THE EARNED INCOME TAX CREDIT

Present Law

In general

Under present law, certain eligible low-income workers are entitled to claim a refundable earned income tax credit. The amount of the credit an eligible taxpayer may claim depends upon whether the taxpayer has one, more than one, or no qualifying children and is determined by multiplying the credit rate by the taxpayer's earned income up to an earned income threshold. The maximum amount of the credit is the product of the credit rate and the earned income threshold. For taxpayers with earned income (or adjusted gross income (AGI), if greater) in excess of the phaseout threshold, the credit amount is reduced by the phaseout rate multiplied by the amount of earned income (or AGI, if greater) in excess of the phaseout threshold. For taxpayers with earned income (or AGI, if greater) in excess of the phaseout limit, no credit is allowed.

As enacted in Public Law 104-7 (H.R. 831), for taxable years beginning after December 31, 1995, a taxpayer is not eligible for the EITC if the aggregate amount of "disqualified income" of the taxpayer for the taxable year exceeds \$2,350. Disqualified income is the sum of:

- (1) interest (taxable and tax-exempt),
- (2) dividends, and
- (3) net rent and royalty income (if greater than zero).

The parameters for the EITC depend upon the number of qualifying children the taxpayer claims. For 1995, the parameters are as follows:

| | Two or more qualifying children-- | One qualifying child-- | No qualifying children-- |
|----------------------------|---|---------------------------|-----------------------------|
| Credit rate | 36.00% | 34.00% | 7.65% |
| Phaseout rate | 20.22% | 15.98% | 7.65% |
| Earned income threshold | \$8,640 | \$6,160 | \$4,100 |
| Maximum credit | \$3,110 | \$2,094 | \$314 |
| Phaseout threshold | \$11,290 | \$11,290 | \$5,130 |
| Phaseout limit | \$26,673 | \$24,396 | \$9,230 |

For 1996, the parameters are given in the following table (dollar amounts are projections expressed in 1996 dollars):

| | Two or more qualifying children-- | One qualifying child-- | No qualifying children-- |
|----------------------------|---|---------------------------|-----------------------------|
| Credit rate | 40.00% | 34.00% | 7.65% |
| Phaseout rate | 21.06% | 15.98% | 7.65% |
| Earned income threshold | \$8,910 | \$6,340 | \$4,230 |
| Maximum credit | \$3,564 | \$2,156 | \$324 |
| Phaseout threshold | \$11,630 | \$11,630 | \$5,290 |
| Phaseout limit | \$28,553 | \$25,119 | \$9,520 |

For years after 1996, the credit rates and the phaseout rates will be the same as in the preceding table. The earned income threshold and the phaseout threshold are indexed for inflation; because the phaseout limit depends on those amounts, the phaseout rate, and the credit rate, the phaseout limit will also increase if there is inflation.

In order to claim the EITC, a taxpayer must either have a qualifying child or meet other requirements. A qualifying child must meet a relationship test, an age test, an identification test, and a residence test.

In order to claim the EITC without a qualifying child, a taxpayer must not be a dependent and must be over age 24 and under age 65. In addition, the taxpayer's principal place of abode must be located in the United States for more than one-half of the taxable year. For purposes of this test, a member of the Armed Forces stationed outside the United States on extended active duty is considered to be maintaining a principal place of abode in the United States.

To satisfy the identification test, taxpayers must include on their tax return the name and age of each qualifying child. For returns filed with respect to tax year 1995, taxpayers must provide a taxpayer identification number (TIN) for all qualifying children who were born on or before October 31, 1995. For returns filed with respect to tax year 1996, taxpayers must provide TINs for all qualifying children born on or before November 30, 1996. For returns filed with respect to tax year 1997 and all subsequent years, taxpayers must provide TINs for all qualifying children, regardless of their age. A taxpayer's TIN is generally that taxpayer's social security number. Some taxpayers are exempt from social security taxes because of their religious beliefs. These taxpayers do not have a social security number; instead, the Internal Revenue Service (IRS) administratively assigns them a taxpayer identification number.

Mathematical errors

The IRS may summarily assess additional tax due as a result of a mathematical error without sending the taxpayer a notice of deficiency and giving the taxpayer an opportunity to petition the Tax Court. Where the IRS uses the summary assessment procedure for mathematical or clerical errors, the taxpayer must be given an explanation of the asserted error and a period of 60 days to request that the IRS abate its assessment. The IRS may not proceed to collect the amount of the assessment until the taxpayer has agreed to it or has allowed the 60-day period for objecting to expire. If the taxpayer files a request for abatement of the assessment specified in the notice, the IRS must abate the assessment. Any reassessment of the abated amount is subject to the ordinary deficiency procedures. The request for abatement of the assessment is the only procedure a taxpayer may use prior to paying the assessed amount in order to contest an assessment arising out of a mathematical or clerical error. Once the assessment is satisfied, however, the taxpayer may file a claim for refund if he believes the assessment was made in error.

Description of Proposals

Modify definition of adjusted gross income used for phasing out the credit

The definition of AGI used for phasing out the credit would be modified by including the following items:

- (1) Social Security benefits not subject to income tax, and
- (2) nontaxable distributions from pensions, annuities, and individual retirement arrangements (but only if not rolled over into similar vehicles during the applicable rollover period).

Deny eligibility for individuals without qualifying children

In order to claim the EITC, a taxpayer would have to have a qualifying child.

Increase phaseout rates

The phaseout rate of the EITC would be increased to 23 percent for taxpayers with two or more qualifying children and to 18 percent for taxpayers with one qualifying child. With these changes, the parameters of the credit for 1996 would be as follows:

| | Two or more qualifying children-- | One qualifying child-- |
|----------------------------|---|---------------------------|
| Credit rate | 40.00% | 34.00% |
| Phaseout rate | 23.00% | 18.00% |
| Earned income threshold | \$8,910 | \$6,340 |
| Maximum credit | \$3,564 | \$2,156 |
| Phaseout threshold | \$11,630 | \$11,630 |
| Phaseout limit | \$27,126 | \$23,608 |

For years after 1996, the credit rates and the phaseout rates would be the same as in the preceding table. The dollar values would continue to be indexed, as under present law.

Deny credit to individuals not authorized to be employed in the United States

Taxpayers would not be eligible for the EITC if they do not include their taxpayer identification number (and, if married, their spouse's taxpayer identification number) on their tax return. Solely for these purposes and for purposes of the present-law identification test for a qualifying child, a taxpayer identification number would be defined as a social security number issued to an individual by the Social Security Administration other than a number issued under section 205(c)(2)(B)(i)(II) (or that portion of sec. 205(c)(2)(B)(i)(III) relating to it) of the Social Security Act (regarding the issuance of a number to an individual applying for or receiving Federally funded benefits). Thus, if an individual obtained a social security number solely because

that individual is an applicant for, or a recipient of, Federally funded benefits, the individual would be ineligible to claim the EITC.

Use mathematical error procedures for certain omissions

If a taxpayer fails to provide a correct taxpayer identification number, such omission would be treated as a mathematical or clerical error. If a taxpayer who claims the EITC with respect to net earnings from self-employment fails to pay the proper amount of self-employment tax on such net earnings, the failure would be treated as a mathematical or clerical error. Thus, any notification that the taxpayer owes additional tax because of these omissions would not be treated as a notice of deficiency.

Effective Date

The proposals would be effective for taxable years beginning after December 31, 1995.