Center *for* Public Policy Priorities

Policy Brief

THE EARNED INCOME TAX CREDIT, THE CHILD TAX CREDIT, AND THE CHILD AND DEPENDENT CARE CREDIT

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The Earned Income Tax Credit (EITC), the Child Tax Credit (CTC), and the Child and Dependent Care Credit are federally funded anti-poverty initiatives that help low-income individuals and families meet their basic needs. Households in poverty and those surviving on meager budgets can significantly benefit from these opportunities to increase their net income.

CLAIM YOUR CREDIT!

The Earned Income Tax Credit

Since its creation in 1975, the federal Earned Income Tax Credit has grown into the largest, federally funded, means-tested cash assistance program in the country. The EITC now brings more children out of poverty than any other government program. Working individuals and families who earn low or moderate incomes may be eligible to receive a rebate of all federal income taxes deducted from paychecks the previous year. Outreach programs by the IRS and other organizations have improved awareness of the program, but millions of EITC dollars still go unclaimed each year. In 2003, over 2 million Texans claimed over $4 billion through the Earned Income Tax Credit. However, the IRS estimates that more than 580,000 eligible Texans did not claim this credit and lost out on nearly $1.2 billion dollars.

Eligibility

The following taxpayers filing in 2005 are eligible to claim the EITC:

- Workers raising one "qualifying child" (see below) with a 2004 family income of less than $30,338 (or $31,338 for married couples) **are eligible for a credit up to $2,604**;
- Workers raising two or more qualifying children with a 2004 family income less than $34,458 (or $35,458 for married couples) **are eligible for a credit up to $4,300**; and
- Workers without a qualifying child who are between the ages of 25 and 64 on December 31, 2004, with a 2004 income below $11,490 (or $12,490 for married couples) **are eligible for a credit up to $382**.

Free Tax Filing Assistance

Low and moderate-income individuals and families are strongly encouraged to utilize free tax filing assistance. IRS data indicate that 72 percent of individuals filing for the EITC are utilizing commercial tax filing services. These services charge fees for tax preparation, electronic filing, and fees on "refund anticipation loans" (RALs) that can amount to as much as half of a taxpayer's total refund. Free Tax Filing Assistance sites in Texas:

- 211 – Information specialists link callers to free tax preparation and filing assistance.
- IRS VITA (Volunteer Income Tax Assistance) Info Line – 1-800-829-1040 -- Volunteers are trained by the IRS to provide help to low-and moderate-income taxpayers who request assistance.
- IRS *Free File* – http://www.irs.gov -- Available to qualifying low- and moderate-income taxpayers, Free File offers online tax preparation and electronic filing through a partnership between the IRS and a group of tax preparation companies.

In addition, the person claiming the credit must have a **valid** Social Security Number (SSN) that allows them to work, as well as a SSN for their spouse (if filing a joint return) and qualifying child (if they have children).

"**Qualifying children**" for the EITC include dependent children, grandchildren, great-grandchildren, stepchildren, adopted children, or foster children (if placed by a government authorized agency) who were under the age of 19 on December 31, 2004 (or under 24 if a full-time student), are U.S. citizens or legal immigrants, and lived in the worker's home for at least six months in 2004. Children of any age who were permanently and totally disabled during the year are also qualified.

Advance EITC Payments

Most workers receive their Earned Income Tax Credit as a traditional, single payment when they file their federal income tax returns. Workers also have the option to receive **advance EITC** payments. Under this option, the worker receives a portion of the credit in each paycheck. For example, a worker does not have to wait until 2006 to receive her EITC for income earned in 2005. The worker can receive the credit over the course of 2005 in regular installments in each paycheck. For low and moderate-income families, receiving a regular EITC payment can help them to pay rent, buy groceries, and meet other monthly expenses.

Workers who expect to qualify for advance EITC must expect:

- To have at least one qualifying child; and
- A 2005 income of less than $30,338 (or $31,338 for married couples).

Workers are **ineligible** for this credit if their only income is from self-employment, they get paid on a daily basis, or have no Social Security and Medicare taxes withheld from their pay.

Under Federal Law, **all employers** must provide advance EITC payments to eligible employees. (Employers are not, however, required to guarantee employees' eligibility). To claim the **advance EITC**, workers should complete the proper forms provided by their employers.

The Child Tax Credit

Many families who claim the EITC also are eligible for an additional tax credit—the Child Tax Credit (CTC). The Child Tax Credit is a federal tax credit for families who pay income tax and have one or more children under age 17. The CTC is intended to help working families with children improve their living conditions and enhance their economic well-being.

Eligibility

Taxpayers are eligible for the CTC, if they have a "qualifying child", and have a 2004 taxable earned income over $10,500. The person claiming the credit must have either a valid Social Security or Taxpayer Identification Number. For the purposes of the CTC, a "qualifying child" must meet **all** of the following criteria:

- Is under age 17 at the end of 2004;
- Is claimed as a dependent on the person's tax return;
- Is either a U.S. citizen or a legal immigrant who lives in the U.S. (must have either a valid Social Security or Taxpayer Identification Number); and
- Is a son, daughter, stepchild, adopted child, sibling, stepsibling, including their descendents (for example, a grandchild), or foster child that has been placed by a government authorized agency.

Child and Dependent Care Credit

Affording quality child care is a significant problem for many low and moderate-income families. The Child and Dependent Care Credit can considerably offset dependent care expenses for working families who pay federal income tax. The credit is available to families who, in order to work or to look for work, have to pay for child care for dependents under age 13. The credit is also available to families who pay for care of a spouse or dependent of any age who is physically or mentally incapable of self-care.

Depending on household income, the credit for 2003 can be as much as $1,050 for one qualifying child or dependent, and as much as $2,100 for two or more children or dependents.

Unlike the EITC and CTC, this credit is "non-refundable," which means it is used to reduce or eliminate income tax owed, but workers are not issued a true refund for this credit as they may be for the EITC and CTC. However, the Child and Dependent Care Credit **can** result in a larger refund of over-withheld income tax.

Eligibility

Families that paid for child care, or care for a disabled spouse or dependent family member over 13, and paid federal income taxes in 2004 can receive this credit. The person claiming the credit must have either a valid Social Security or Taxpayer Identification Number.

- **Children in child care** must be under the age of 13, have lived in the household in 2004, and be claimed as a dependent on the taxpayer's 2004 tax return.
- **Dependents who received care** must have lived in the household in 2004, be physically or mentally incapable of self-care, and have been claimed as a dependent on the 2004 tax return.
- **Children** and **Dependents** must be either U.S. citizens or legal immigrants and have a valid Social Security or Taxpayer Identification Number.

Families Can Claim All Three Tax Credits

A family may be eligible for all three credits—the Earned Income Tax Credit, the Child Tax Credit, and the Child and Dependent Care Credit. Claiming all three credits qualifies the participant for even more money from the IRS.

Immigrants and Tax Credits

Legal immigrants, such as green card holders, refugees, and other immigrants legally authorized to work are eligible for the EITC. Undocumented workers may apply for the CTC and the Child and Dependent Care Credit provided their children are citizens or legal immigrants. In general, a valid Social Security[1] or Taxpayer Identification Number **is** needed for the person(s) applying for the credit, as well as for any child or dependent claimed for the credit. EITC filers **<u>must</u>** have a Social Security Number for themselves, their spouse (if filing a joint return), and any qualifying children. For more information about immigrants' eligibility for these tax credits, contact the National Immigration Law Center at 213-639-3900 or www.nilc.org.

Important points for immigrants:

- Applying for these tax credits will **not** affect the person's immigration status or the immigration status of any family members.
- Applying for these tax credits will **not** affect an immigrant's ability to become a legal permanent resident ("green card" holder), naturalize as a U.S. citizen, or sponsor relatives to enter the country.
- An immigrant who receives these tax credits will **not** be considered a "public charge." The EITC, the CTC, and the Child and Dependent Care Credit are **earned** benefits, not public assistance. Receiving these benefits is not considered evidence of government dependency.
- "Sponsored" immigrants who receive these tax credits do **not** have to worry that their sponsor will be asked to repay these benefits. [2]

Impact on Other Public Benefits

For families that are receiving federal benefits, it is important to understand how the refundable tax credits might affect their continued eligibility for those programs. In Texas, the three tax credits are **not** counted as **income** when determining eligibility for any federal program benefits, such as TANF, Medicaid, Food Stamps, SSI, or public housing. This means that when a worker who uses (or whose family member uses) a federal benefit receives a tax credit and **spends** the money immediately, the receipt of the credit will have **no effect** that person's eligibility for public benefits.

However, when a worker wants to **save** the tax credit in a savings or checking account, these savings **may** in some cases affect a person's eligibility to receive public benefits. This is because a person's cash and savings—known as **"assets"** or **"resources"—are** considered when determining that person's eligibility for certain public benefits. **Because in many cases benefits will *<u>not</u>* be affected, workers whose families use public benefits should not automatically be discouraged from claiming the EITC or other tax**

[1] Social Security numbers issued to U.S. citizens **<u>and</u>** Social Security numbers issued to non-citizens who have permission to work legally in the United States are both acceptable.

[2] Most legal immigrants come to the United States on a family-based visa. The majority of legal immigrants are required to have a "sponsor," an immediate family member—either a U.S. citizen or a permanent resident—who agrees to support them.

credits. A description of the rules related to tax credits and public benefits follows.

Assets/Resources

Whether a tax credit is counted as a resource or asset varies by type of tax credit, and also from program to program. The amount of resources a person may have and still be eligible for benefits also varies by program; therefore receipt of either the EITC or CTC could make a person ineligible for certain benefits, but not others. The table below shows how credits are treated as assets/resources in several programs.

Program	EITC	Child Tax Credit
Texas Medicaid, Food Stamps, TANF, and CHIP	1) If the household is not already receiving the public benefit when they receive the EITC lump-sum payment, the EITC payment is not counted as a resource the month of receipt, or in the following month. *However, starting in the third month after the EITC payment is received, any unspent EITC funds* ***would*** *be counted as a resource, which could cause some families to lose eligibility for the benefit at that point.* 2) If the household is already receiving the benefit when they receive the EITC payment, the EITC payment is not counted as a resource the month of receipt, or in the following 11 months **for those programs the household currently receives**. ***Exception:*** *If the household loses eligibility for the benefits for more than 30 days during the 12 months described above, any unspent portion of the EITC payment will be counted as a resource when the household re-enrolls.*	Child Tax Credit is not counted as a resource the month of receipt, or in the following month.
SSI	EITC is not counted as a resource for nine months following the month of receipt. (*Starting in the 10th month after the EITC payment is received, any unspent EITC funds* ***would*** *be counted as a resource.)*	CTC is not counted as a resource for nine months following the month of receipt. (*Starting in the 10th month after the EITC payment is received, any unspent EITC funds* ***would*** *be counted as a resource.)*
Public housing	Federally subsidized housing programs do **not** have resource limits. However, household **income** does affect eligibility for public housing and the amount of rental assistance a household receives, and interest earned on resources is counted towards household income. If a household's resources exceed $5,000, the higher of the following is counted towards the household's income: (a) the actual interest or other income earned on the resources or (b) the amount of resources multiplied by the current passbook savings rate. In any event, the actual impact of a household's resources on the amount of rental assistance it receives is extremely modest.	
Veterans' Benefits	The EITC does count as a resource, but the VA's resource limit is so high ($80,000, not counting home and motor vehicle), that saving EITC refunds is not likely to affect eligibility.	
Reminder: EITC or CTC tax credit payments are treated differently from **tax refund checks** of over-withheld income tax. Simple withholding refunds are **always** subject to being counted as an asset/resource.		

Example:

A household is already receiving Food Stamps in March 2005. On March 15, 2005, the household receives an EITC payment. The EITC payment does not count as a resource for March or the next 11 months. If the household saves the funds for the entire 12 months, those funds will be counted as a resource at the next recertification for Food Stamps after the 12 months expire. At this point, if the household's total assets including the saved EITC **exceed** the amount allowed for Food Stamps recipients, then the household would lose its eligibility for these benefits.

Exception: If the family deposits its EITC refund in an ***Individual Development Account*** these savings are **not** counted as a resource when determining eligibility for any benefit. Read on for information about IDAs.

Individual Development Accounts Can Allow Families to Save for Major Goals.

An IDA is an account similar to a savings account that enables an individual to save earned income for a "qualifying purpose." IDAs are often matched dollar-for-dollar with funds from private citizens or corporations, banks, communities, or charitable organizations. The matching funds are inaccessible to the worker and may only be used to pay for one of the qualifying purposes.

In Texas, the TANF, Medicaid, SSI, Food Stamp, and CHIP programs **exclude** from resources **any funds from earned income (including EITC payments) deposited in a TANF IDA or Assets for Independence Act** (**AFIA**) **IDA**. The qualifying purposes for these IDAs include paying for a college education, purchasing a home, or starting a business. Also excluded from resources are any matching funds deposited in the account as well as any accrued interest.

Visit our web site at www.cppp.org for a fact sheet on IDAs.

In summary:

- If a worker spends his/her tax credit(s), then receipt of the credit will **not** affect that person's eligibility for public benefits.
- Persons who deposit their tax credit(s) in a savings or checking account need to be aware that these savings could potentially affect their family's eligibility for certain public benefits, depending on the total amount of resources they have.
- For families wishing to save money (for example, saving for a home down payment) the IDA offers a way to pursue that goal without losing critical benefits like TANF, Medicaid, CHIP, or Food Stamps.

For more information

- Download our flyer "How Resources are Treated in Federal Public Benefit Programs in Texas," at www.cppp.org.
- For more information about the EITC and to download an outreach toolkit, visit the Center on Budget and Policy Priorities web site at http://www.cbpp.org/EITC2005/index.html
- Use the IRS' "EITC Assistant" at http://www.irs.gov/individuals/article/0,,id=130102,00.html to find out if you're eligible.
- An EITC outreach toolkit designed for employers is available on the Corporate Voices for Working Families' web sit at http://www.cvworkingfamilies.org/toolkits/eitc/
- For more information about the Child Tax Credit, visit the IRS at http://www.irs.gov/taxtopics/tc606.html.
- For more information about the Child and Dependent Care Tax Credit, visit the IRS at http://www.irs.gov/newsroom/article/0,,id=106189,00.html