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# SELECTED ASPECTS OF WELFARE REFORM

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Y 4. W 36:103-29

Selected Aspects of Welfare Reform...

## HEARING

BEFORE THE

### SUBCOMMITTEE ON SELECT REVENUE MEASURES

AND

### SUBCOMMITTEE ON HUMAN RESOURCES

OF THE

## COMMITTEE ON WAYS AND MEANS

## HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

MARCH 30, 1993

**Serial 103-29**

Printed for the use of the Committee on Ways and Means



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# SELECTED ASPECTS OF WELFARE REFORM

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TUESDAY, MARCH 30, 1993

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON WAYS AND MEANS,  
SUBCOMMITTEE ON SELECT REVENUE MEASURES  
AND SUBCOMMITTEE ON HUMAN RESOURCES,  
*Washington, D.C.*

The subcommittees met, pursuant to notice, at 10 a.m., in room 1100, Longworth House Office Building, Hon. Charles B. Rangel (chairman of the Subcommittee on Select Revenue Measures) and Hon. Robert T. Matsui (acting chairman of the Subcommittee on Human Resources) presiding.

[The press release announcing the hearing follows:]

FOR IMMEDIATE RELEASE  
TUESDAY, MARCH 16, 1993

PRESS RELEASE #2  
SUBCOMMITTEE ON SELECT REVENUE  
MEASURES  
COMMITTEE ON WAYS AND MEANS  
U.S. HOUSE OF REPRESENTATIVES  
1102 LONGWORTH HOUSE OFFICE BLDG.  
WASHINGTON, D.C. 20515  
TELEPHONE: (202) 225-9710

THE HONORABLE CHARLES B. RANGEL (D., N.Y.),  
CHAIRMAN, SUBCOMMITTEE ON SELECT REVENUE MEASURES,  
AND THE HONORABLE ROBERT T. MATSUI, (D., CALIF.),  
CHAIRMAN, SUBCOMMITTEE ON HUMAN RESOURCES,  
COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES,  
ANNOUNCE A PUBLIC HEARING  
ON SELECTED ASPECTS OF WELFARE REFORM

The Honorable Charles B. Rangel (D., N.Y.), Chairman, Subcommittee on Select Revenue Measures and the Honorable Robert T. Matsui, (D., Calif.), Chairman, Subcommittee on Human Resources, Committee on Ways and Means, U.S. House of Representatives, today announced that the Subcommittees will hold a joint public hearing on selected aspects of welfare reform on Tuesday, March 30, 1993, beginning at 10:00 a.m., in the Committee's main hearing room, 1100 Longworth House Office Building.

The Subcommittees will receive testimony from the Administration and public witnesses on the extent to which our current tax laws provide work incentives for low-income families and help create alternatives to welfare.

In announcing this hearing, Chairman Rangel stated: "In light of the budget proposals made by President Clinton, I believe it is appropriate for the Subcommittees to examine how effective our current tax laws have been in ensuring that all Americans have the opportunity to earn a decent living. The Subcommittees will review such provisions as the earned income tax credit (EITC), the targeted jobs tax credit (TJTC), and the employer-provided educational assistance exclusion to determine their efficacy in achieving that goal. In particular, the Subcommittees are interested in learning how to ensure that those entitled to these benefits, especially the EITC, receive them in a timely fashion. The Subcommittees will also examine proposals to target new labor and jobs-related incentives to distressed areas in the context of existing tax incentives and assistance programs."

Chairman Matsui further stated: "I strongly support President Clinton's goal of expanding the EITC to ensure that a family of four will not be forced to live below the poverty level if one parent works full time at a minimum wage job. I also support the President's proposals to make working pay for welfare recipients by rewarding work and breaking down the barriers to self-sufficiency. I look forward to working together on improving the EITC and the lives of millions of low-income children and their parents."

#### BACKGROUND

**Earned Income Tax Credit:** The Earned Income Tax Credit (EITC) is a refundable credit available to low-income working families with children. To qualify for the credit, a family must include at least one qualifying child, and the annual earnings of the family must be less than \$23,070. The credit, which is based on a percentage of the taxpayer's earned income, is completely phased out for income in excess of \$23,070 for the 1993 taxable year. The maximum credit for a qualifying family with one child for 1993 is \$1,435 and \$1,513 for a family with two or more children. A qualifying family may also qualify for the health care and/or the young child supplemental credit.

The Administration has proposed a major expansion of the EITC to an amount that is intended to lift poor working families out of poverty. In addition, its proposed changes are intended to offset the regressive effects of their proposed energy tax on families within certain income limits, including individuals without children. In considering whether to implement such a proposal, it will be important to examine closely not only the EITC, but other Federal programs and policies which affect the disposable incomes of low-income workers and their incentives to work.

(MORE)

Targeted Jobs Tax Credit: The targeted jobs tax credit (TJTC) is available to employers who hire and train certain individuals. The program generally targets individuals who are disadvantaged with respect to their ability to enter and compete in the workforce. The credit is generally computed as a percentage of the wages paid by the employer to the employee, for a specified period, up to a maximum amount. To qualify for the credit, the employer must meet certain requirements designed to ensure that the individual is employed for a minimum period and acquires skills the individual did not have before the qualified employment. The credit expired last year, but the Administration proposes to extend this benefit permanently. The President's proposal also contains a provision that would expand TJTC to cover apprenticeship programs. It is anticipated that this program would be targeted to high school students and would be structured as a work-study program.

Employer-Provided Educational Assistance: The employer-provided educational provision is a tax benefit which flows through the employer to the employee. It provides an annual exclusion from income of up to \$5,250 to the employee if the employer provides a nondiscriminatory plan under which the employee can pursue educational studies. The employer is allowed a deduction for a corresponding amount. This provision expired last year. The Administration proposes to extend this provision permanently.

#### DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD

Individuals and organizations interested in presenting oral testimony before the Subcommittees must submit their requests to be heard by telephone to Harriett Lawler, Diane Kirkland or Karen Ponzurick [(202) 225-1721] no later than Tuesday, March 23, 1993, to be followed by a formal written request to Janice A. Mays, Chief Counsel and Staff Director, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. The Subcommittee staff will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the Subcommittee on Select Revenue Measures [(202) 225-9710].

Persons and organizations having a common position are urged to make every effort to designate one spokesperson to represent them in order for the Subcommittees to hear as many points of view as possible. Time for oral presentations will be strictly limited with the understanding that a more detailed statement may be included in the printed record of the hearing (see formatting requirements below). This process will afford more time for Members to question witnesses. In addition, witnesses may be grouped as panelists with strict time limitations for each panelist.

In order to assure the most productive use of the limited amount of time available to question hearing witnesses, all witnesses scheduled to appear before the Subcommittees are required to submit 200 copies of their prepared statements to the Subcommittee on Select Revenue Measures office, room 1105 Longworth House Office Building, at least 24 hours in advance of their scheduled appearance. Failure to comply with this requirement may result in the witness being denied the opportunity to testify in person.

(MORE)

**WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE:**

Persons submitting written statements for the printed record of the hearing should submit at least six (6) copies by the close of business, Friday, April 30, 1993, to Janice A. Mays, Chief Counsel and Staff Director, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements for the record of the printed hearing wish to have their statements distributed to the press and the interested public, they may provide 100 additional copies for this purpose to the Subcommittee on Select Revenue Measures office, room 1105 Longworth House Office Building, before the hearing begins.

**FORMATTING REQUIREMENTS:**

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.
2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.
4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

\* \* \* \* \*



Chairman RANGEL. This morning we are going to have a joint hearing. The Subcommittee on Select Revenues and the Subcommittee on Human Resources will be looking into the welfare reform package. The President's commitment to welfare reform makes it appropriate that we look at the existing tax and nontax laws which are intended to provide working people with a decent living.

We will hear from a number of witnesses who will tell us whether such programs as the earned income tax credit, the targeted jobs tax credit, the employer-provided educational assistance, the child support enforcement, and other related programs are really effective in assisting individuals and families to get out of poverty.

In addition, we hope to learn specifically how we can improve these programs and to have them achieve their purpose more effectively.

We are especially interested in determining whether such benefits such as the EITC are reaching the individuals that we intended in a timely fashion.

It is my pleasure to have my friend and colleague and the cochair of this subcommittee, Bob Matsui. I now recognize him for his opening remarks.

Acting Chairman MATSUI. Thank you, Mr. Chairman. I will be reasonably brief. I would like to thank you cochairing this hearing with our subcommittee, and I appreciate the fact that we have a number of witnesses here who are very interested in welfare reform and also a number of people in the audience, because this issue is not timely yet. At the same time, it is one that all of us will face.

I have always contended that it is better to be a child born in 1950 than to be a child born in 1993. Just the other day, I was reading a story in The Washington Post Metro Section, and it talked about how children in various areas of this community have been hit with poverty, and with the fear of violent crime. It was noted in the articles that being born in the 1990s certainly was not as desirable as being born even as late as the 1960s.

We have a great deal ahead of us in terms of some of the major issues facing us: the EITC, as the chairman mentioned, but also in terms of the overall welfare reform package, the whole issue of child support enforcement, the issue of time limits, and certainly the infrastructure that we all know will be needed in order to make sure that welfare really works; that is, job training, education programs, job placement programs, but most importantly a job for all Americans.

And so we look forward to working with all the groups and certainly members of our committee and Mr. Rangel to make sure that whatever program we come up with ultimately leads from dependency to independence for those who are currently on welfare.

Thank you, Mr. Chairman.

Chairman RANGEL. Thank you. Mr. Hancock.

Mr. HANCOCK. Thank you, Mr. Chairman.

Today's hearing will give us an excellent opportunity to review several tax provisions which have helped to give the working poor a leg up toward achieving self-sufficiency.

Perhaps the most visible of these programs relates to the earned income tax credit. Created in 1975, it now affects nearly 14 million families. In February, the President proposed a \$27 billion expansion in the earned income tax credit program over the next 5 years. This recommendation follows on the heels of an \$18 billion increase in the 1990 Budget Act.

I am sure that all of us are anxious to know about the details of this proposal and how it will complement our committees' work on the welfare reform package.

I am also interested in hearing from our witnesses on two expired provisions of the tax law, the targeted jobs tax credit, and the exclusion for employer-provided education assistance. Based upon their numerous extensions, it is fair to conclude that the programs enjoy strong and bipartisan support. Nonetheless, we have a responsibility to review the effectiveness of these tax benefits in providing work and educational opportunities.

I would like to thank our witnesses for joining us today and sharing your comments and recommendations on how the Tax Code can enhance other Federal programs to assess low-income workers and their families.

Thank you, Mr. Chairman.

Chairman RANGEL. Mr. Santorum.

Mr. SANTORUM. Thank you, Mr. Chairman.

I just want to make a couple of comments on some concerns I have with the earned income tax credit. I know that it has enjoyed bipartisan support in the past, and I hope it continues to. I just want to voice some concerns, and hopefully the panels will be able to address whether expanding the EITC at this point is, in fact, justified, given what research we have, if any, that it is affecting the poor in our country in a positive fashion and in a substantial way, given the money that we are spending on the program. I would like to hear some comments about that.

And the other real concern I have is that the information I have received indicates that much less than 1 percent of all families that get the earned income tax credit get it in their monthly check. In other words, they get it in a lump sum at some point in time later on. And I would suspect that that is not a particularly effective way of moving people and encouraging people to work when they are not getting that consistent benefit every month in their paycheck. In fact, I am not too sure it is an incentive at all. I am also concerned that it is not making the kind of impact, as my chairman, Mr. Matsui, said, of moving people from dependency to independence.

So I hope we can examine those two issues in particular and hopefully try to address what I see as a real problem in verifying whether this EITC is, in fact, doing what it set out to accomplish.

Thank you, Mr. Chairman.

Chairman RANGEL. Thank you.

And now we are honored with the presence of the Honorable Jim Slattery, and we are awaiting your testimony.



**STATEMENT OF HON. JIM SLATTERY, A REPRESENTATIVE IN  
CONGRESS FROM THE STATE OF KANSAS**

Mr. SLATTERY. Thank you, Mr. Chairman.

First, let me commend you, Mr. Chairman, and the members of this committee for commencing your hearings on the broad issue of welfare reform, and certainly the earned income tax credit is a very integral part of this overall effort. We have long debated welfare reform, and hopefully this year, under your leadership, Mr. Chairman, this Congress and the administration will move forward with a real comprehensive plan to dramatically change our welfare programs in this country. Again, I see the earned income tax credit component as a very, very important part of this effort.

My testimony this morning, Mr. Chairman, is limited to a very small part of the earned income tax credit, and that is the way this program affects military dependents in this country.

To make a long story short, my legislation, H.R. 479, corrects a longstanding injustice against thousands of American service members who are forced to surrender their earned income tax credit when they are stationed overseas. Right now, if a family is stationed at Fort Riley, Kans., and if they are eligible for the earned income tax credit, if they receive orders to depart for Germany, when they go to Germany, they lose eligibility for their earned income tax credit.

My legislation does one simple thing. It says that those 25,000 families that are affected by this, that are in the military today, would not lose their earned income tax credit eligibility merely by virtue of the fact that their Government has ordered them overseas. Today 25,000 families that are ordered overseas lose their earned income tax credit when they leave this country. It involves about \$700 per family.

And again, it is a simple concept. H.R. 479 says: If you are eligible in this country, if you are in the military, you also will be eligible for the earned income tax credit when you are stationed overseas. It is a very simple concept. I will not take the committee's time in a lot of unnecessary verbose conversation about it this morning. But the bottom line is, I think, that this is a fundamental injustice in the existing law. It should be corrected.

This committee has looked favorably on this proposal twice in the past. As recently as 1992, with the Omnibus Revenue Act, this provision was included. Of course, the legislation was vetoed by the President. Prior to that, it was included in the 1991 tax bill that we passed. Unfortunately, it was removed in conference.

So this House has dealt twice with this legislation favorably in the past. Hopefully a third time is the charm, Mr. Chairman. And I would be happy to answer any questions you might have.

Chairman RANGEL. By unanimous consent, your prepared testimony will be entered into the record.

[The prepared statement follows:]

MEMBER:  
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 VETERANS' AFFAIRS  
 CHAIRMAN:  
 SUBCOMMITTEE ON  
 COMPENSATION,  
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**Congress of the United States**  
**House of Representatives**

JIM SLATTERY  
 SECOND DISTRICT, KANSAS

**STATEMENT OF**

**THE HONORABLE JIM SLATTERY**

**BEFORE THE**

**SELECT REVENUE MEASURES SUBCOMMITTEE**

**OF THE**

**HOUSE COMMITTEE ON WAYS AND MEANS**

**TUESDAY, MARCH 30, 1993**

Thank you, Mr. Chairman, for this opportunity to testify once again before the Select Revenue Measures Subcommittee regarding legislation, H.R. 479, I have reintroduced in the 103rd Congress to extend eligibility for the Earned Income Tax Credit (EITC) to military personnel and their families stationed overseas.

I appreciate your continuing interest in correcting this long-standing injustice against thousands of American servicemembers serving our nation around the world. I am hopeful that my colleagues in Congress and President Clinton will recognize the serious consequences of denying military personnel access to this credit and will act to correct this inequity as a component of expansion of eligibility for the EITC.

As you will hear in testimony this afternoon from the Non Commissioned Officers Association (NCOA) and the National Military Family Association (NMFA), enlisted personnel and their families count on the additional income they receive through the EITC. Loss of this credit when they are shipped overseas causes serious financial hardship for these low-income families, which typically have young children.

An estimated 25,000 low-income families, who are serving their country abroad, have been forced to forgo eligibility for this credit. The annual credit for these families with young children is typically more than \$700. Loss of this income causes financial hardship for these families, who already are living on a limited budget.

H.R. 479, which has the endorsement of the 26 organizations forming the Military Coalition, finally would end this inequity. This bill would ensure that all eligible military families, regardless of where they are stationed, would continue to receive an EITC.

I have introduced this legislation twice before, and each Congress has come closer to enacting it. The proposal was included in the House version of the 1990 Omnibus Budget Reconciliation Act, but was dropped in conference. The provision was included in the 1992 Omnibus Revenue Act, which was vetoed by President Bush. I hope the third time will be a charm.

I applaud President Clinton's commitment to reforming the EITC to ensure that a family of four, with one working parent, will not be forced to live below the poverty level, and I urge serious consideration of H.R. 479 as a component of this reform. We have shortchanged these patriotic American families for too long.

I appreciate this opportunity to discuss H.R. 479 and I would be pleased to respond to any questions you may have regarding this legislation.

Chairman RANGEL. It appears as though everybody—Bob Matsui, the staff, and I—agrees that this is an injustice to our people in the military.

Could you share with us again as to why the eligibility is excluded to those going overseas?

Mr. SLATTERY. Well, to the best of my knowledge, Mr. Chairman, it looks like the way this legislation was originally drafted, there was an oversight. People did not envision that people eligible for the earned income tax credit in this country would be stationed overseas. And so to be eligible, you have to be in the United States. That is the oversight, injustice, call it what you like, that this legislation is designed to correct.

Again, we are talking about 25,000 families, based on the best information we have. These families would be on average eligible for somewhere in the neighborhood of about a \$700 earned income tax credit, if their eligibility was not summarily eliminated when they were stationed overseas.

Chairman RANGEL. Mr. Matsui.

Acting Chairman MATSUI. Thank you, Mr. Chairman.

Jim, do you happen to know the revenue impact on this? It could not be much, if it is only 25,000 families at \$700.

Mr. SLATTERY. Well, again, this is a very rough estimate. We have not yet gotten the final fiscal impact of this. But if you take 25,000 times 700, you are talking about roughly \$17.5 million. That is a very rough estimate by me. It has not been crunched through the official number crunchers here. But we have tried to get that number. We have not yet gotten it. There are some assumptions that are being made, and they keep correcting them.

Acting Chairman MATSUI. As you and the chairman mentioned, this was in H.R. 11, and I think this is pretty much—

Mr. SLATTERY. That is correct.

Mr. ANDERSON [continuing]. Going to fly through, and so we appreciate your calling it to our attention. Thank you.

Mr. SLATTERY. Yes. I sure hope you will include it.

Chairman RANGEL. Mr. Hancock.

Mr. HANCOCK. Does this law apply to any American citizen living overseas, or is it limited? For instance, there are a lot of people that are living overseas that only have their Social Security. Now would they also be included, if, in fact, the law was changed?

Mr. SLATTERY. Well, you know, Mr. Hancock, as I was sitting here at the table this morning, I was asking myself that same question about perhaps other American families working for other agencies of the Federal Government under similar circumstances, perhaps being ordered or directed overseas, would they lose their eligibility also?

I assume they would. And if they do, I believe that should be corrected also. I do not believe you should lose your earned income tax eligibility merely by virtue of the fact that your Government has ordered you overseas, regardless of what agency of the Government that you work for.

Mr. HANCOCK. But you do not have any idea what the figures might be that this would—in other words, by changing this law, this might increase it to 200,000 people. We do not know. I mean—



Mr. SLATTERY. I do not know the other numbers. All I know is that with the military, we are looking at an estimated 25,000 families. We have repeatedly requested a fiscal impact of this legislation, and have not received it. I have just done a real rough analysis, and that is the 25,000 times an average of 700, and that gives you the \$17.5 million. That is probably a high-end number, I would guess.

Now if you expand this legislation to include other American families working for other agencies of the Federal Government, I do not know how many families you get into then. But I think if someone is working for the CIA or some other agency that is directing people overseas, the State Department, perhaps, then I think they should be eligible also.

But I do not believe that you are going to find the number of people there in those agencies that you do in the military.

Mr. HANCOCK. Well, I doubt very seriously if there are very many people working for other agencies that would be subject to the earned tax credit. I mean—

Mr. SLATTERY. I think you are right.

Mr. HANCOCK. This basically would only apply to the lower three grades in the military.

Mr. SLATTERY. That is correct.

Mr. HANCOCK. But I do have a little bit of a problem with people, by choice, who maybe go overseas on their Social Security and they retire—

Mr. SLATTERY. Yes.

Chairman RANGEL [continuing]. Of their own choice. I do have a little problem there.

Mr. SLATTERY. That is a different proposition.

Mr. HANCOCK. So I think it should be limited to the military, and I think that is your position.

Mr. SLATTERY. Yes, that is my position with this legislation. And again, let me reemphasize that if there are other agencies of the Federal Government that are directing their employees to go overseas for duty of whatever kind, and it may be the State Department or other agencies, then I think they should be treated the same as the military, if they are ordered by their Government, or directed by their Government, to go overseas.

That is a different proposition than the one that you just anticipated with people perhaps, you know, retiring and voluntarily going overseas for whatever reason. A different proposition.

Mr. HANCOCK. I understand. Thank you.

Mr. SLATTERY. Yes.

Chairman RANGEL. Is anyone seeking recognition? Mr. Jacobs.

Mr. JACOBS. Jim, these people lose their eligibility for the earned income tax credit. Do they gain anything by going overseas? Could you enlighten us about that? I mean is there any increased compensation, either in cash or kind, that might offset that.

Mr. SLATTERY. They have housing allowances available, and in some instances, Mr. Jacobs, depending on where they are located overseas, a lot of these military personnel, especially, you know, the E-1s, E-2s, and E-3s that would be primarily affected by this, find that the housing allowances are inadequate to cover the hous-

ing costs where they are going. So, I mean, they are really hammered in both directions.

Mr. JACOBS. So your testimony is that the net of it is, they take a step backward just because—

Mr. SLATTERY. Absolutely.

Mr. JACOBS. Thank you very much.

Chairman RANGEL. Does anyone else seek recognition?

[No response.]

Chairman RANGEL. Well, I tell you, Jim, I am having staff also look into what impact the loss of food stamps would have on these very low-income individuals. I think one of the major problems is that we just do not like to think of our military people as living below the poverty line, which they really are. And thank you for once again bringing it to our attention.

Mr. SLATTERY. You are welcome.

Chairman RANGEL. And stick with us to make certain that it does not fall between the cracks, because it is my understanding that it will come up in the miscellaneous package.

Mr. SLATTERY. Right.

Chairman RANGEL. And Bob and I will be monitoring that with you.

Mr. SLATTERY. Well, I really appreciate your help, Mr. Chairman. And believe me, after 3 years of trying to get this minor little provision corrected that is so fundamentally flawed, I do not want to lose it in conference this year or lose it with a veto either, for that matter.

Thank you very much.

Chairman RANGEL. As a former foot soldier, I appreciate it.

OK. Our first panel is Sam Sessions, Office of Tax Policy, Department of the Treasury; Wendell Primus, Deputy Assistant Secretary for Human Service Policy, U.S. Department of Health and Human Services; Margaret Lullo, Deputy Assistant Commissioner, Taxpayer Services, and Robert Carver, Deputy Assistant Commissioner, Returns Processing, from the IRS.

We welcome all of you here, but especially Wendell Primus, who has been really such a great advocate for those who have few advocates in this room. We are really proud and look forward to the contribution that you will make for all of us over there at Health and Human Services.

And is this the first time that you are testifying in that capacity?

Mr. PRIMUS. Yes, Mr. Chairman.

Chairman RANGEL. Well, I am certain I speak for Republicans and Democrats alike in saying that we feel proud that those of us in the legislative branch were able to produce someone like you to serve in the executive branch. Welcome in your new capacity.

We will start off with Mr. Sessions.

I might say that, without objection, your written testimony will be put into the record, and you can testify as you feel most comfortable.

Mr. Sessions.

**STATEMENT OF SAMUEL Y. SESSIONS, DEPUTY ASSISTANT SECRETARY (TAX POLICY), U.S. DEPARTMENT OF THE TREASURY**

Mr. SESSIONS. Thank you, Mr. Chairman. My name is Sam Sessions and I am with the Department of the Treasury.

Chairman Rangel, Chairman Matsui, and members of the subcommittees, I am pleased to have this opportunity to present testimony today concerning elements of the President's welfare reform program. I will focus on three proposals that were included in the revenue component of the President's budget plan announced in February. These proposals are the expansion and simplification of the earned income tax credit, the EITC; the expansion and permanent extension of the targeted jobs tax credit, the TJTC; and the permanent extension of the exclusion from income of employer-provided educational assistance.

An important objective of all of these proposals is to provide individuals, especially those with low incomes, with incentives to work and to invest in their own human capital. As a consequence, these provisions—and, we think, particularly the expansion of the EITC and the extension of the targeted jobs tax credit—may help make work a more attractive alternative to welfare.

Other witnesses will comment today on other aspects of the President's agenda for welfare reform.

Let me start first with the EITC. The EITC is a refundable income tax credit available to a low-income individual who has a qualifying child, has earned income, and meets certain adjusted gross income thresholds. The EITC under current law has three components: a basic credit which is adjusted for family size, a supplemental young child credit for workers with children under the age of 1 year, and a supplemental credit for health insurance premiums. All of these credits phase in and phase out at certain income levels, and these income levels are adjusted for the cost of living.

A table summarizing the current law and the administration's proposals is attached to my testimony.

To give you some background about the structure of the EITC, all three of these credits are all computed in essentially the same way. Each credit is computed by multiplying an individual's earned income by a credit percentage. Under current law, for a family with one child, the basic credit percentage is 23 percent. That is multiplied times a maximum creditable amount of earned income, which for 1994 is projected to be \$7,990.

In all of my testimony, I am going to focus on 1994 dollars, both in describing current law—of course, this involves projections covering inflation—and in describing the administration's proposals, in order to facilitate comparison. Otherwise I would be jumping back and forth between different credit amounts for different years.

In any event, the maximum credit for 1994 for families with one child is about—projected to be about \$1,838. This credit is phased out once AGI reaches a certain threshold. Again, that is projected to be \$12,580. It is phased out by a phaseout percentage of 16.43 percent for adjusted gross income over \$12,580. That results in a complete phaseout of the credit once AGI reaches \$23,760, again in projected 1994 dollars.



For 1993, just for comparison, the phasein rate is 18.5 percent as opposed to 23 percent. The phaseout rate is 13.21 percent as opposed to 16.43 percent, and the phaseout range is very similar, \$12,200 to \$23,050.

Current law provides a somewhat larger credit for families with two or more children. The phasein rate for families with two or more children is 25 percent of the creditable amount of \$7,990 projected for 1994. The phaseout rate is somewhat higher also. It is 17.86 percent. And again, the phaseout range is the same, \$12,580 to \$23,760. My written testimony indicates the comparable amounts for 1993.

The current law provides two supplemental credits. A supplemental young child credit is a 5 percentage point credit, again multiplied by creditable earned income. The maximum then for 1994 with the \$7,990 maximum creditable earned income is around \$400. That supplemental young child credit is phased out at a rate of 3.57 percentage points. As I indicated, this credit is available to taxpayers who are eligible for the EITC, if they have a child who has not attained the age of 1 as of the close of the calendar year.

There is also a supplemental health insurance credit. That is a 6 percentage point credit, giving a maximum credit of \$479 for 1994. It phases out at a rate of 4.285 percent. This is a credit that is available for health insurance coverage of a qualifying child, and it is equal to the lesser of that maximum amount I just gave or the amount that is actually spent on health insurance.

That is a brief summary of current law. As my written testimony indicates, in 1991 around 14 percent of the population had income below the poverty level, despite the EITC and other programs. Five million individuals lived in households containing a full-time year-round worker and nevertheless were under the poverty level.

Reliance on the minimum wage alone is enough to bring only full-time single workers above the poverty level. A minimum wage job, food stamp benefits, and the EITC can lift a single parent with one or two children above the poverty level. But for larger families, even with those benefits and the minimum wage, the family's income falls below the poverty level.

The administration is committed to pulling more working families out of poverty, and that is one of the principal reasons for the EITC proposal.

In addition, there are considerable complexities in current law attributable to the supplemental credits, and the administration is interested in simplifying the credit to make sure that those who are eligible for it understand it and can compute it considerably more easily than they can at present.

I will now describe the administration's proposal. The proposal would expand the EITC and increase the EITC by an amount necessary to lift a four-person family out of poverty. This increase would take place over a 2-year period. The phasein and phaseout ranges would be adjusted to accomplish this, and they would continue to be adjusted for cost of living. Again, I will describe the proposal using 1994 dollars.

Under the administration's proposal, the basic credit, when fully phased in in 1995, for families with one child, would be 34.4 per-

cent of the first \$6,000 of earned income. This would give a maximum credit of \$2,062.

The beginning of the phaseout range would be lowered slightly to \$11,000, but the end of the phaseout range for families with one child would be the same as current law, which is projected to be \$23,760. The phaseout percentage would be 16.16 percent.

For families with two or more qualifying children, the credit percentage and the phaseout percentage also would be increased. The credit percentage would be increased to 39.7 percent of the first \$8,500 of earned income, and the phaseout percentage would be increased to 19.83 percent. The phaseout would begin at \$11,000, but for families with two or more children, the phaseout range would extend all the way to \$28,000, which is an increase of more than \$4,000 over current law.

The administration's proposal would replace both of the supplemental credits by the expansions of the basic credit described above, and this would mean that the supplemental young child credit and the supplemental health insurance credits would be repealed.

The administration's proposal would also for the first time extend to childless low-income workers an EITC benefit. To be eligible, the worker would have to be age 22 or older and could not be claimed as a dependent on another taxpayer's return.

The amount of this credit would be 7.65 percent of the first \$4,000 of earned income. It would be phased out between \$5,000 and \$9,000 of AGI, and the phaseout percentage would also be 7.65 percent.

When combined with other forms of Federal assistance to low-income workers, in particular the minimum wage and food stamps, the administration's proposed increase in the EITC would lift many families that have a full-time worker out of poverty. The poverty gap, the difference between the official poverty threshold and the sum of earnings, EITC amounts, and food stamp allotments would be eliminated for four-person families, and for larger families the poverty gap would be reduced.

As I indicated earlier, the supplemental young child and health insurance credits have been widely regarded as quite complicated, excessively complicated for the population to which the EITC is targeted. The replacement of those credits with the larger basic credit would be a major simplification, and health insurance will be dealt with more directly by the President's health care reform proposal which will be announced later this year.

Now turning to the targeted jobs credit, this credit is available to employers for hiring individuals from nine targeted groups who are economically disadvantaged, who receive payments under means-tested transfer programs or who are disabled. The credit is equal to 40 percent of the first \$6,000 of qualified first-year wages paid to a member of a targeted group, resulting in a maximum credit of \$2,400.

For economically disadvantaged summer youth employees, which is one of the nine categories, the credit is equal to 40 percent of the first \$3,000 of wages for a maximum credit of \$1,200.

The administration believes that the targeted jobs tax credit should be extended permanently. The administration believes that



in the current economic climate it is particularly important to provide job incentives, and it believes that it is important to equip young persons in these age categories with the skills that are needed to get better jobs over the course of their careers, their lives.

As a result, the administration would permanently extend the targeted jobs tax credit. This would apply to individuals who begin work after June 30, 1992. In addition, the targeted jobs tax credit would be expanded to include youth apprentices beginning work after December 31, 1993 in connection with qualified youth apprenticeship programs that are established and certified after that date.

A youth apprentice would be any individual aged 16 through 20 who is enrolled in a qualified youth apprenticeship program beginning in the 11th or 12th grade. A program would be considered to be a qualified youth apprenticeship program only if it was a planned program of job training designed to integrate academic instruction and work-based learning. There would be similar certification rules for the youth apprenticeship program for the years 1994 through 1998. A cap would be placed on the number of youth apprentices who could qualify for the credit, totaling 805,000 over that period.

Lastly, by the exclusion for employer-provided educational assistance. Under current law, the value of educational assistance provided by an employer is included in the employee's income and employment tax wages, unless the assistance would be deductible by the employee if the employee had incurred the cost directly.

For educational expenses to be deductible, education or training must either maintain or improve the employee's skills in the current job and must not qualify the employee for a new job. The costs of education that qualify or train the employee for a new job would not be deductible, and therefore absent the exclusion provided by section 127, those amounts would not be excludable. That is, they would be taxable to the employee.

The administration proposes to extend the section 127, the exclusion for employer-provided educational assistance for benefits provided after June 30, 1992. The administration believes that this exclusion encourages employers to provide, and employees to take advantage of, educational assistance, and it therefore increases the country's productivity. The exclusion also serves a simplification purpose in that within the \$5,250 limit, it makes it unnecessary for employers to have to distinguish between job-related expenses, which would be excludable without regard to 127, and employer-provided educational expenses.

That concludes my remarks, and I will be happy to respond to questions.

[The prepared statement and attachments follow:]

EMBARGOED UNTIL 10:00 A.M.  
March 30, 1993

STATEMENT OF  
SAMUEL Y. SESSIONS  
DEPUTY ASSISTANT SECRETARY  
(TAX POLICY)  
DEPARTMENT OF THE TREASURY  
BEFORE THE  
WAYS AND MEANS SUBCOMMITTEE ON SELECT REVENUE MEASURES  
AND THE  
WAYS AND MEANS SUBCOMMITTEE ON HUMAN RESOURCES  
U.S. HOUSE OF REPRESENTATIVES

Chairman Rangel, Chairman Matsui, and Members of the Subcommittees:

I am pleased to have this opportunity to present testimony today concerning elements of the President's welfare reform program. I will focus on three proposals that were included in the revenue component of the budget plan. These proposals are: (i) the expansion and simplification of the earned income tax credit (EITC), (ii) the expansion and permanent extension of the targeted jobs tax credit (TJTC), and (iii) the permanent extension of the exclusion from income of employer-provided educational assistance. An important objective of all of these proposals is to provide individuals, especially those with low incomes, with incentives to work and to invest in their human capital. As a consequence, these provisions -- particularly the expansion of the EITC and the extension of the TJTC -- may help make work a more attractive alternative to welfare. Other witnesses will comment today on other aspects of the President's agenda for welfare reform.

### EXPANDING AND SIMPLIFYING THE EITC

#### Current Law

The EITC is a refundable income tax credit available to a low-income individual who has a qualifying child, has earned income, and meets certain adjusted gross income (AGI) thresholds. The EITC has three components: (i) a basic credit (which is adjusted for family size), (ii) a supplemental young child credit for workers with a child under the age of one, and (iii) a supplemental credit for certain health insurance premium expenses covering qualified children. The basic credit and supplemental credits phase in and phase out at certain income levels. These income levels are adjusted for changes in the cost of living. A table summarizing the basic elements of the EITC under current law and the Administration's proposal is attached to my testimony.

#### Basic Credit

The basic credit is determined by multiplying an individual's earned income by a credit percentage. For a family with only one qualifying child, the credit percentage for 1994 is 23 percent. (The discussion of current law that follows focuses on 1994 in order to facilitate comparison with the Administration's proposal.) The basic credit amount increases as income increases, up to a maximum income threshold. For 1994, the income threshold is projected to be \$7,990. Therefore, if there is only one qualifying child, the maximum basic credit amount for 1994 is projected to be \$1,838 (23% of \$7,990).

The basic credit is reduced and eventually phases out once AGI (or, if greater, earned income) exceeds a certain phase-out threshold. For 1994, the phase-out threshold is projected to be \$12,580. The phase-out is accomplished by reducing the basic credit by a phase-out percentage. In 1994, for a family with only one qualifying child, the basic credit is reduced by an amount equal to 16.43 percent of the excess of AGI (or, if greater, earned

income) over \$12,580.

The basic credit is completely phased out and is no longer available to taxpayers with incomes above the end of the phase-out range. In 1994, this income level is projected to be \$23,760. The projected phase-out range of \$12,580 to \$23,760 is the same for the basic credit, the family size adjustment and the two supplemental credits.

The income thresholds for both the phase-in and phase-out ranges are adjusted for changes in the cost of living. In the foregoing discussion, I have indicated the inflation-adjusted income thresholds projected for 1994. For 1993, the basic EITC rate is 18.5 percent for a worker with one child. The corresponding phase-out rate is 13.21 percent. The phase-out range for 1993 starts at \$12,200 and ends at \$23,050.

#### Basic Credit with Family Size Adjustment

If there are two or more qualifying children, the basic credit percentage and phase-out percentage are increased. For 1994, the basic credit percentage for families with two or more children is increased to 25 percent. For 1994, this is projected to result in a maximum basic credit of \$1,998 (25% of \$7,990).

The phase-out percentage for families with two or more qualifying children is increased to 17.86 percent. As indicated above, this percentage is applied to phase out the credit over a projected income range of \$12,580 to \$23,760.

For 1993, the basic EITC rate is 19.5 percent for a worker with two or more children. The 1993 phase-out rate is 13.93 percent.

#### Supplemental Young Child Credit

The supplemental young child credit is available to an individual with a qualifying child who has not attained the age of one as of the close of the calendar year. This supplemental credit increases the basic credit by 5 percentage points. For 1994, the maximum supplemental young child is projected to be \$400 (5% of \$7,990) for qualifying taxpayers.<sup>1</sup>

Families receiving the supplemental young child credit are also subject to a higher phase-out percentage. The phase-out percentage for these families is 3.57 percentage points higher than it would otherwise be.

The supplemental young child credit and the child and dependent care tax credit may not be claimed for the same child.

#### Supplemental Health Insurance Credit

The supplemental health insurance credit is available for premiums paid to provide health insurance coverage of a qualifying child. This supplemental credit increases the basic credit by 6 percentage points, but the increased amount may not exceed the actual amount expended for such health insurance premiums. The amount of the expenses against which the credit is allowed are not deductible as medical expenses. For 1994, the maximum supplemental health insurance credit is projected to be \$479 (6% of \$7,990) for qualifying taxpayers.<sup>2</sup>

This supplemental credit also increases the phase-out percentage, in this case by 4.285

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<sup>1</sup> For 1993, the maximum supplemental young child credit is \$388 (5% of \$7,750).

<sup>2</sup> For 1993, the maximum supplemental health insurance credit is \$465 (6% of \$7,750).

percentage points.

### Reasons for Change

In 1991, 14.2 percent of the population had income below the poverty level. About 5 million individuals lived in households containing a full-time, year-round worker and yet were counted among the nation's poor. Many others worked during the year but were unable to earn sufficient amounts to escape poverty.

The Federal government assists low-income workers in a number of ways. Employers are required to pay at least the minimum wage. Through expenditures for job training and education, the Federal government promotes the long-term earning capacity of workers. The Federal government also directly supplements the earnings of low-income persons through the tax and transfer systems. Most low-income persons are eligible for food stamps, while those who both work and have children may be entitled to the EITC.

Reliance on the minimum wage alone results in income above the poverty level only for full-time, single workers. In combination, a minimum-wage job, food stamp benefits, and the EITC lift a single parent with one or two children above the poverty level. However, the income (including the EITC and food stamps) of a family of four with only one full-time, minimum wage worker falls below the official poverty threshold. The Administration is committed to pulling more working families out of poverty, while providing individuals who are currently outside of the workforce with greater incentives to work.

The effectiveness of the EITC is hindered by its complexity. A major source of that complexity is contained in the rules for determining eligibility for the two supplemental credits.

### The Administration's Proposal

The Administration's proposal would expand the EITC and increase the credit by the amount necessary to lift a four-person family out of poverty. The increase in the credit amount would take place over a two-year period and be completed by 1995. As under current law, the income thresholds for both the phase-in and phase-out ranges would be adjusted each year for changes in the cost-of-living. (To facilitate the comparison with current law, I will focus on our proposal as fully phased-in for 1995 and thereafter by reference to 1994 dollars.)

#### Basic Credit

Under the Administration's proposal, the basic credit when fully phased-in would be increased for families with one child to 34.4 percent of the first \$6,000 of earned income (in 1994 dollars). Therefore, where there is only one qualifying child, the maximum basic credit amount would be \$2,062 (34.4% of \$6,000).<sup>3</sup>

The basic credit would continue to be phased-out once AGI (or, if greater, earned income) exceeds a certain phase-out threshold. Under the Administration's proposal, the phase-out range for families with one child would begin at \$11,000, a lower level than current law, but would end at \$23,760, the same as projected under current law. The phase-out percentage would be 16.16 percent.

#### Basic Credit with Family Size Adjustment

For families with two or more qualifying children, the basic credit percentage and

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<sup>3</sup> For 1994, the Administration's proposal would increase the basic credit to 26.6 percent of the first \$7,750 of earned income.



phase-out percentage would also be increased under the Administration's proposal. When fully phased-in (in 1994 dollars), the basic credit percentage would be increased to 39.7 percent of the first \$8,500 of earned income. Filers with earnings between \$8,500 and \$11,000 would be entitled to the maximum credit of \$3,371 (39.7% of \$8,500).

The phase-out percentage would also be increased to 19.83 percent. As in the case of the credit for families with one child, the credit would be phased out starting at \$11,000. However, the phase-out range for families with two or more children would extend to \$28,000, an increase of \$4,240 over current law.<sup>4</sup>

#### Supplemental Young Child Credit

Under the Administration's proposal, the supplemental young child credit would be replaced with the increase in the basic credit described above.

#### Supplemental Health Insurance Credit

Under the Administration's proposal, the supplemental health insurance credit would also be replaced with the increase in the basic credit described above. In addition, as is well known, the Administration is in the process of developing a comprehensive health care proposal.

#### Credit for Childless Workers

Under the Administration's proposal, the EITC would be extended for the first time to low-income workers who do not have children. Qualifying workers must be age 22 or older and may not be claimed as a dependent on another taxpayer's return. For these workers, the basic credit would be 7.65 percent of their first \$4,000 of earned income. In 1994, the phase-out range for these workers would be between \$5,000 and \$9,000 of AGI (or, if greater, earned income). The phase-out percentage would also be 7.65 percent.

#### Effects of Proposal

When combined with other forms of federal assistance to low-income workers (in particular, the minimum wage and food stamps), the proposed increase in EITC would lift many families containing a full-time worker out of poverty. For example, the "poverty gap" -- the difference between the official poverty threshold and the sum of earnings (after the employee share of social security taxes), EITC amounts, and food stamp allotments -- would be eliminated for four-person families. For larger families the poverty gap would be reduced.

The increase in the rate of the EITC, together with lowering the earnings level at which the maximum credit is reached, would provide a larger credit to low-income families in the current-law phase-in ranges. This combination would provide low-income families, particularly those outside of the workforce, a greater incentive to work.

In addition, the increase in the EITC, together with the Administration's proposals to expand food stamps and to provide low-income home energy assistance, will help offset the impact of the energy tax on millions of low-income families.

The repeal of the supplemental young child and health insurance credits would relieve low-income filers of significant filing and computational burdens. The Administration also is in the process of developing a health care proposal that will address the health care needs of low-income families in a more comprehensive manner.

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<sup>4</sup> Under the Administration's proposal, for 1994 the credit rate would be increased to 31.6 percent of the first \$8,500 of earned income, and the phase-out percentage would be 15.8 percent. The phase-out range would extend from \$11,000 to \$28,000.

**PERMANENT EXTENSION, AND EXPANSION TO INCLUDE  
YOUTH APPRENTICESHIP, OF THE TJTC**

Current Law

The targeted jobs tax credit is available to employers on an elective basis for hiring individuals from nine targeted groups. The targeted groups consist of individuals who are economically disadvantaged, recipients of payments under means-tested transfer programs, or disabled.

The credit generally is equal to 40 percent of the first \$6,000 of qualified first-year wages paid to a member of a targeted group. Thus, the maximum credit generally is \$2,400 per individual. With respect to economically disadvantaged summer youth employees, however, the credit is equal to 40 percent of up to \$3,000 of wages, for a maximum credit of \$1,200.

The credit is not available for wages paid to a targeted group member unless the individual either (1) is employed by the employer for at least 90 days (14 days in the case of economically disadvantaged summer youth employees), or (2) has completed at least 120 hours of work performed for the employer (20 hours in the case of economically disadvantaged summer youth employees). The employer's deduction for wages must be reduced by the amount of the credit claimed. The credit expired on June 30, 1992.

Reasons for Change

The targeted jobs tax credit is intended to encourage employers to hire workers who otherwise may be unable to find employment and to subsidize training costs. Job creation incentives are required in the current economic climate. In addition, a significant number of youth in the United States lack the necessary skills to meet requirements for entry level positions and, therefore, are unprepared to make the transition from school to the workforce.

The Administration's Proposal

The proposal would permanently extend the targeted jobs tax credit. The provision is effective for individuals who begin work for the employer after June 30, 1992. In addition, the targeted jobs tax credit would be expanded to include youth apprentices beginning work after December 31, 1993, in connection with qualified youth apprenticeship programs certified after that date. The certification would be made by a local educational agency or other designated local agency.

A youth apprentice would be any individual aged 16 through 20 who was enrolled in a qualified youth apprenticeship program beginning in the eleventh or twelfth grade. A program would be considered to be a qualified youth apprenticeship program only if it is a planned program of structured job training designed to integrate academic instruction provided by an educational institution and work-based learning.

Before a youth apprentice began work, the employer would have to receive or request a certification from the local educational agency or other designated local agency that the individual was enrolled in a qualified youth apprenticeship program. In addition, the employer would have to receive periodic written assurances that the youth apprentice was making satisfactory progress in completing the program.

Because the youth apprenticeship program is designed for part-time workers, the credit would equal 40 percent of up to \$3,000 of first-year wages, for a maximum credit of \$1,200. In addition, the number of apprentices that employers could take into account in computing the credit would be subject to an annual cap. From 1994 through 1998, 805,000 youth apprentices could be taken into account in computing the credit (i.e., 125,000 in 1994;

140,000 in 1995; 160,000 in 1996; 180,000 in 1997; and 200,000 in 1998).

## **MAKING THE EXCLUSION FOR EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE PERMANENT**

### **Current Law**

Under current law, the value of employer-provided educational assistance is included in an employee's income and employment tax wages unless the cost of the assistance would qualify as a deductible expense of the employee if the employee had incurred the expense directly. Education costs incurred by an employee are generally deductible if they maintain or improve the employee's skills in his or her current job and do not qualify the employee for a new trade or business. Thus, for example, the cost of retraining for a new job is generally not deductible. As a result, such retraining is generally taxable to the employee when paid for by his or her employer.

Under prior law, amounts paid by an employer with respect to an employee under an educational assistance program were excluded from the employee's gross income and employment tax wages to the extent that the value of the assistance did not exceed \$5,250 per year, regardless of whether the expense would otherwise have been deductible. Such programs were subject to nondiscrimination rules to ensure that the assistance was not provided primarily to higher-paid employees. The educational assistance exclusion expired for benefits provided after June 30, 1992.

### **Reasons for Change**

The exclusion encourages employers to provide, and employees to take advantage of, educational assistance and thereby increases the country's productivity. In addition, the absence of the exclusion imposes significant administrative burdens on employers, workers, and the IRS by forcing them to distinguish between job-related expenses (which are excludable from gross income under current law when paid by the employer) and other employer-provided educational expenses.

The absence of the exclusion may have a relatively greater effect on lower-income and lower-skilled individuals. As noted above, without the exclusion the value of employer-provided educational assistance is excludable from gross income and employment-tax wages only if the education directly relates to the employee's current job and does not qualify the employee for a different trade or business. Higher-income, higher-skilled individuals may more easily satisfy these requirements because of the breadth of their prior training and current job responsibilities.

### **The Administration's Proposal**

The proposal would permanently extend the general exclusion for employer-provided educational assistance. The provision is effective for benefits provided after June 30, 1992.

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This concludes my prepared remarks. I would be pleased to respond to your questions.

Chairman RANGEL. Thank you. We will wait for the whole panel. Mr. Primus.

**STATEMENT OF WENDELL E. PRIMUS, DEPUTY ASSISTANT SECRETARY FOR HUMAN SERVICES POLICY, U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES**

Mr. PRIMUS. Mr. Chairman, members of the subcommittees, thank you for this opportunity to discuss the effects of current tax laws on work incentives and poverty, as well as strategies to create alternatives to welfare.

It was a privilege to serve for 15 years on the staff of this committee. I have enormous respect for this committee and its staff, and it is an honor for me to be back so soon testifying on behalf of the Clinton administration.

Thank you for your kind remarks when you introduced this panel, and I would now like to summarize my written testimony.

Mr. Chairman, you have demonstrated a real commitment to helping low-income working people. You were the first to recognize and hold hearings on the impact of Federal tax policy on the working poor. The hearings you held in 1984 began the process of strengthening Government policy to ameliorate the effects of poverty.

At that time, a two-parent family of four with poverty-level earnings paid almost \$1,100, \$1,075 to be precise, or 10 percent of their income in Federal income and employee Social Security taxes. In total, poverty-level families had their incomes lowered by almost \$2 billion because of Federal taxes.

Through your efforts and on a bipartisan basis, today, 1993, this same family pays no taxes. The Social Security tax is completely offset by the earned income tax credit, and the family pays no other Federal income taxes.

As a result of changes to tax and welfare policy developed by this committee, the recent recession produced a much smaller increase in poverty than was produced in the recession in the early 1980s. According to a recent study released by the Human Resources Subcommittee, between 1979 and 1983, poverty increased by 12 million persons. Part of the problem was the recession. But unfortunately, changes in Government policy accounted for 5 to 5.5 million of the 12 million increase. Tax policy changes alone between 1979 and 1983 accounted for over 1 million of this increase.

Contrast that to the recession of 1989 to 1991. In that recession, poverty overall rose by 3 million persons. In this case, Government policy was beneficial, for it prevented another 1 million individuals from becoming poor.

In 1982, Government tax and welfare policies removed 3 million people in single-parent families from the ranks of the poor, while in 1991 Government policy removed 4.1 million people from poverty in these kind of families. In other words, Government tax and welfare policy worked better during the last recession.

However, State budgetary pressures are resulting in many unpleasant decisions. For example, in 1992, nine States have cut nominal AFDC benefits.

More needs to be done. Many poor people are working, but they are still poor. Roughly 6 million poor people live in families with



a full-time, full-year worker. Several times that number lived in families in which someone works part of the year. The reality is that, for millions of Americans, work simply does not pay.

We need to make work pay. There is no better profamily policy than helping the working poor. These are families at the economic brink, families working hard at some of the most unpleasant jobs in this country. They often lack medical protection. They are vulnerable to even a comparatively modest financial or medical emergency. They are under real stress. And such families surely must be at real risk of splitting apart because of the pressures they face.

Can we talk of family values when two-parent working families go unprotected from poverty and medical uncertainty? Can we say we believe in work when we fail to reward those people who try to choose work over welfare?

Today more children live in poverty than at any time since 1965. There is a growing body of literature that poverty, by itself, is detrimental to child development. We, as a society, can no longer tolerate over one-fifth of our children, almost one-half of black children and one-quarter of children under age 6, in poverty.

A starting place would be to make work extremely attractive, and the President is committed to doing just that.

Part of the answer involves ensuring that every family has medical protection, whether they work or not. That will come with health care reform.

The expansion in the earned income tax credit is another critical part, as was explained in the earlier testimony.

As members of this committee well know, an expanded EITC is a pay raise for the working poor. No money goes to families without workers. When the administration's proposal is fully implemented, a two-parent family of four with poverty-level earnings will receive a Federal tax supplement to their earnings of 9 percent. Recall that this same family back in 1984 when you first had those hearings had a debit of 10 percent. This is a total tax change of 19 percent expressed as a percentage of earnings.

The expansion sends the right message to those who are not working, but who want to work, and it sends the right message to those on welfare seeking a way off. Helping poor working families through the EITC expansion enhances their ability to be independent, and it supports their dignity. It leaves choice, coupled with real money, in their hands. Best of all, they do not have to suffer the welfare system with its bureaucratic hassles, complicated application forms, and perverse incentives.

The EITC should be a supplement to work, received in the worker's paycheck as current law provides, and we must strive to find ways to implement it even more effectively.

The proposed expansion in the EITC will substantially increase the antipoverty effectiveness of Government policy. In 1984, Federal taxes increased the number of poor people by over 1.7 million as shown in table 3. In 1994, if the President's EITC proposal is enacted and fully implemented, over 2 million people will be removed from poverty, even if no more people go to work, and we expect to move more people to work. This is a change of nearly 4 million individuals or over 1.5 percent of the population.

Instead of Federal taxes taking \$1 billion from poor families with children, as it did in 1984, wages will be supplemented by \$3 billion.

I would now like to discuss the larger context within which these reforms are contained. Everyone believes in work and family and independence and responsibility, and everyone is frustrated with the current system. But the question is how to embrace and reinforce these values.

The welfare system is not the answer. AFDC benefits have been declining for years, over 40 percent since 1970, but caseloads have risen dramatically anyway. In 1992, almost 4.8 million families received AFDC each month, and Federal expenditures were \$12.2 billion. Caseloads are up 28 percent since 1988. These increases are partly, but certainly not entirely, due to the recent recession. Clearly something is not working.

The President's call for welfare reform comes from a recognition that welfare for many Americans has meant isolation, stigma, and humiliation. The call to end welfare as we know it is not a call to stop aiding low-income families. The President wants to change the role of Government from one of stepping in to provide support when parents are unable or unwilling to do so to one where Government supports the parents in their proper leadership role of nurturing and supporting their children. The President seeks to give people a real alternative to welfare, a genuine opportunity to regain control of their lives, by giving people the support they need to achieve real independence.

But in exchange, he expects them to meet their responsibilities. As part of this overall effort, President Clinton has enunciated four central elements in his reforms.

**Make work pay.** The President has repeatedly stressed his belief in this proposition, and he has proved his commitment in the budget by dramatically expanding the EITC and the targeted jobs tax credit.

**Health reform** will ensure that all people, especially working people, can count on health coverage, and child care will be a critical element as well.

**Dramatically improved child support enforcement.** The current system is a disgrace. The obvious starting point for supporting children is to look for support from both parents. The fact that only one-third of single parents currently received any court-ordered child support sends the worst possible signal about parental roles and responsibilities.

**Better training and support.** The Family Support Act of 1988 started a process of improved employment and training services, but many States, as you well know, have been unable to use all of the available Federal funds. Making the JOBS program more effective will be a key feature that the administration's Welfare Reform Task Force will examine.

**Transition people to work.** The ultimate goal of this administration is to make welfare truly transitional for those who are healthy and able to work. If we make it feasible for single mothers to support themselves and nurture their families, then we can and should expect people to take advantage of opportunities and move to market work.

Taken together, these steps will create an end to welfare as we know it. These are not isolated, uncoordinated proposals. Rather they form a coherent whole which must be considered together as a package.

Making welfare more time-limited for those who are healthy and employable is not the whole plan. Unless work pays, unless both parents are expected to help support their children, unless strong employment training and support programs exist, time limits will not achieve their purpose.

But if we truly offer an alternative to work, if people really can support themselves, if people who play by the rules do not lose the game, then welfare really can be transformed.

It is time to be bold. The real hope is to replace, rather than reform, welfare. That requires making independence and self-support genuinely feasible. The President calls on Government to support, rather than supplant, the efforts of parents. He asks that we reinforce work.

For 12 years, we have talked about the dignity of work, while wages were falling and incentives to work eroded. The new budget seeks to reverse the decades of slow growth. In the long run, a strong and growing economy and a talented and motivated work force is the best prowork, profamily policy there is. The welfare reform effort will be a critical part of the effort, for it seeks to give back dignity, independence, control, and responsibility to those at the economic bottom of our society. It signals a real commitment to the future of families and children.

[The prepared statement and attachments follow:]

**STATEMENT OF WENDELL E. PRIMUS**  
**Deputy Assistant Secretary for Human Services Policy**  
**U.S. Department of Health and Human Services**

Mr. Chairmen, Members of the Subcommittee, thank you for this opportunity to discuss the effects of current tax laws on work incentives and poverty as well as strategies to create alternatives to welfare. My name is Wendell Primus and I am the Deputy Assistant Secretary for Human Services Policy in the Office of the Assistant Secretary for Planning and Evaluation, Department of Health and Human Services. It was a privilege to serve for 15 years on the staff of this Committee. I have enormous respect for this Committee and its staff, and it is an honor for me to be back so soon testifying on behalf of the Clinton Administration. I look forward to working with you.

INTRODUCTION

Mr. Chairmen, you have demonstrated a real commitment to helping low-income working people. The hearings you held in 1984 began the process of strengthening government policy to ameliorate the effects of poverty. At that time, a two-parent family of four with poverty level earnings paid almost \$1,100 or 10 percent of their income in federal income and employee Social Security taxes. In total, poverty level families had their incomes lowered by almost 2 billion dollars because of federal taxes. Through your efforts and on a bipartisan basis, today -- 1993 -- this same family pays no taxes. The Social Security tax is completely offset by the earned income tax credit and the family pays no federal income taxes.

As a result of changes to tax and welfare policy developed by these Subcommittees and the full Committee, the recent recession produced a much smaller increase in poverty than was produced in the recession in the early 1980s. According to a study released by the Human Resources Subcommittee, between 1979 and 1983, poverty increased by 12 million persons. Part of the problem was the recession. But unfortunately, changes in government policy accounted for 5 million of the 12 million increase. Tax policy changes alone between 1979 and 1983 accounted for over 1 million of this increase. Government policies almost doubled the effect of the recession -- without the policies poverty would have risen by 6 million (see Table 1).

Contrast that to the recession of 1989-1991. In that recession, poverty overall rose by 3 million persons, while poverty before tax and transfer income are added rose by almost 6 million. In this case government policy was beneficial for it prevented another 1 million people from becoming poor. Government policy, especially tax policy, now is doing far more to protect people who fall victim to the economic pressures of recession.

It is instructive to consider what happened to the especially vulnerable group of single-parent families. In 1982, government tax and welfare policies removed 3.0 million people in single-parent families from the ranks of the poor, while in 1991, government tax and welfare policy removed 4.1 million people from poverty. In other words, government tax and welfare policy worked better during the latest recession (see Table 2).

However, 1992 data is beginning to portray a setback. Even as the recession ends, state budgetary pressures are resulting in many unpleasant decisions. For example, according to Congressional Research Service data, in 1992, 9 states cut nominal AFDC benefits. Typically, zero, one, or two states reduce benefits in a given year.

I commend the Chairmen and Members of the Subcommittees, as well as the Members of the full Committee, for their achievements in this area. But more needs to be done.



MAKING WORK PAY

Many poor people are working, but they are still poor. Roughly 6 million poor people live in families with a full-year, full-time worker. Several times that number live in families in which someone works part of the year. The reality is that for millions of Americans work simply does not pay.

We need to make work pay. There is no better pro-family policy than helping the working poor, for the bulk of these 6 million persons are in families with two parents. These are families at the economic brink, families working hard at some of the most unpleasant jobs in this country. They often lack medical protection. They are vulnerable to even a comparatively modest financial or medical emergency. They are under real stress. And such families surely must be at real risk of splitting apart because of the pressures they face.

But the failure to support work not only has implications for two parent families; it also helps to create welfare dependency. For in most states, unless a single parent can get a full-time job paying at least \$6 to \$7 per hour with full health benefits, find inexpensive day care, and arrange transportation, that parent is economically better off on welfare. It is not that welfare pays so much, rather work pays so little.

Can we talk of family values when two parent working families go unprotected from poverty and medical uncertainty? Can we say we believe in work when we fail to reward those people who try to choose work over welfare?

Today more children (14.3 million) live in poverty than at any time since 1965. There is a growing body of literature that poverty by itself is detrimental to child development. We as a society can no longer tolerate over a fifth of our children, almost one-half of black children and one-quarter of children under age six in poverty.

EXPANDED EITC

A starting place would be to make work extremely attractive. And the President is committed to doing just that. Part of the answer involves ensuring that every family has medical protection whether they work or not. That will come with health care reform. The expansion in the Earned Income Tax Credit (EITC) is another critical part.

As members of this Committee well know, an expanded EITC is a pay raise for the working poor. No money goes to families without workers. When the Administration's proposal is fully implemented, a two-parent family of four with poverty level earnings will receive a federal tax supplement to their earnings of 9 percent. Recall that this same family in 1984 had a debit of 10 percent. This is a total tax change of 19 percent expressed as a percentage of earnings.

The expansion sends the right message to those who are not working, but who want to work more. And it sends the right message to those on welfare seeking a way off. Helping poor working families through the EITC expansion enhances their ability to be independent and supports their dignity -- it leaves choice, coupled with real money, in their hands. Best of all, they do not have to suffer the welfare system with its bureaucratic hassles, complicated application forms, and perverse incentives. The EITC should be a supplement to work received in the worker's paycheck as current law provides, and we must strive to find ways to implement it even more effectively.

Compared to having no EITC at all, the proposed EITC would amount to a 40 percent higher return from working. Compared to current law, a two parent family with two children and one full-time minimum wage worker will get \$1,000 more per year. In effect, this budget raises the pay for such a person by 13 percent over what the situation was previously.

Single parents considering work instead of welfare will see a similar increase. For example, a woman with two children in Pennsylvania earning \$10,000 a year now has only \$2,000 more income than a welfare mother with no earnings. Under the Clinton proposed increase, this family will have an additional \$1,300, or \$3,300 more than the non-working welfare mother. The return to work for this family has increased by 65 percent.

More generally, the proposed expansion in the EITC will substantially increase the anti-poverty effectiveness of government tax and welfare policy. In 1984, if cash and near-cash means-tested transfers are counted, Federal taxes including the EITC, increased the number of poor people by over 1.7 million (see Table 3). In 1994, if the President's EITC proposal is enacted, over 2 million people will be removed from poverty even if no more people go to work. And we expect to move more people to work.

As shown in Table 3, instead of Federal taxes taking \$1 billion dollars from poor families with children as it did in 1984, wages will be supplemented by \$3 billion.

But expansions to the EITC and the Targeted Jobs Tax Credit (TJTC), as well as an extension to employer-provided educational assistance are only part of the picture. Since your Subcommittees, and indeed the full Committee, have such a crucial role to play in accomplishing the President's program, I would like to discuss the larger context within which these reforms are contained.

#### LARGER CONTEXT

Everyone believes in work and family and independence and responsibility. And everyone is frustrated with the current system. But the question is how to embrace and reinforce these values?

The welfare system is not the answer: AFDC benefits have been declining for years, over 40 percent since 1970, but caseloads and costs have risen dramatically anyway. In 1992, about 4.8 million families received AFDC each month and Federal expenditures were \$12.2 billion. Caseloads are up 28% since 1988. These increases are partly, but certainly not entirely, due to the recent recession. Clearly something is not working.

President Clinton has called for an end to welfare as we know it. He asks not for welfare tinkering, but to replace the current system. He argues that to restore dignity and hope and independence, we must find a way to make it practical for people to support themselves, to move people off welfare. Many of the reform efforts to date have sought to change rules for people on welfare, rather than to move them off welfare.

The President's call for welfare reform comes from a recognition that welfare for many Americans has meant isolation, stigma, and humiliation. It has meant being stuck in a system that everyone dislikes. The call to end welfare as we know it is not a call to stop aiding low-income families. The President wants to change the role of government from one of stepping in to provide support when parents are unable or unwilling to do so, to one where government supports the parents in their proper leadership role of nurturing and supporting their children. The President seeks

to give people a real alternative to welfare, a genuine opportunity to regain control of their lives by giving people the support they need to achieve real independence. But in exchange, he expects them to meet their responsibilities.

As part of this overall effort, President Clinton has enunciated four central elements in his reforms.

- o Make Work Pay -- As I discussed before, the critical starting point for helping people to leave welfare is to ensure that people who work are not poor. Work must be much more attractive than welfare. The President has repeatedly stressed his belief in this proposition and he proved his commitment in the budget by dramatically expanding the EITC and the TJTC. In addition, health reform will ensure that all people, especially working people, can count on health coverage. And child care will be a critical element as well.
- o Dramatically Improved Child Support Enforcement -- Current child support enforcement is a disgrace. The obvious starting point for supporting children is to look for support from both parents. The fact that only one-third of single parents currently receive any court-ordered child support sends the worst possible signal about parental roles and responsibilities. There are many changes that can be made ranging from paternity establishment in the hospital to a central clearinghouse for all collections as well as a much greater role for the Federal government.
- o Better Training and Support -- The Family Support Act of 1988 started a process of improved employment and training services. But many states have been unable to use all available Federal funds (because of an inability to find the State match money). Making the JOBS program more effective will be a key feature that the Administration's welfare reform task force will examine. The changes to employer-provided educational assistance mesh nicely with this goal.
- o Transition People to Work -- The ultimate goal of this Administration is to make welfare truly transitional for those who are healthy and able to work. If we make it feasible for single mothers to support themselves and nurture their families, then we can and should expect people to take advantage of opportunities and move to market work. If, after two years, they are unable to find a job on their own, then providing some form of public work seems appropriate.

Taken together these steps will create an end to welfare as we know it. These are not isolated, uncoordinated proposals; rather they form a coherent whole which must be considered together as a package.

Making welfare more time-limited for those who are healthy and employable is not the whole plan. Unless work pays, unless both parents are expected to help support their children, unless strong employment, training, and support programs exist, time-limits won't achieve their purpose. But if we truly offer an alternative to work, if people really can support themselves, if people who play by the rules do not lose the game, then welfare really can be transformed.

For many years until the Family Support Act of 1988, Federal welfare policy relied exclusively on state efforts to reform welfare. These efforts continue today. At their best, state initiatives have been important innovations that helped other states find a vision of reform. We must continue such innovation. Still, many state innovations have actually involved

relatively modest changes in the nature of welfare -- sometimes more symbolic than anything.

It is time to be bolder. The real hope is to replace, rather than reform, welfare. That requires making independence and self-support genuinely feasible. The President calls on government to support rather than supplant the efforts of parents. He asks that we reinforce work. For 12 years we've talked about the dignity of work while wages were falling and incentives to work eroded. The new budget seeks to reverse the decades of slow growth. The President calls for renewed investment in the education and development of our children. As a study released last week underscored, poverty is seriously damaging many of our children.

In the long run, a strong and growing economy and a talented and motivated work force is the best pro-work, pro-family policy there is. The welfare reform effort will be a critical part of the effort, for it seeks to give back dignity, independence, control, and responsibility to those at the economic bottom of our society. It signals a real commitment to the future of families and children.



**TABLE 1. SOURCES OF INCREASE IN THE POVERTY POPULATION FOR THE ENTIRE POPULATION (in thousands)**

Increased Number of After-Transfer Poor Due to:	1979-89	1979-83	1989-91
Population, Demographic and Market Income	3,248	6,048	3,759
Transfer Program Changes	2,931	4,349	-119
Federal Tax Policy Changes	547	1,311	-812
Net increase	6,726	11,708	2,829

Note: The definition of poverty includes the value of all cash transfers, plus the value of food stamps, housing programs, and school lunches and subtracts Federal income taxes and the employee portion of Federal payroll taxes. See the Committee print for additional details.

Source: Table 31, p. 141, Sources of the Increases in Poverty, Work Effort, and Income Distribution Data, January 26, 1993, Subcommittee on Human Resource of the Committee on Ways and Means, Committee Print WMCP: 103-2.

**TABLE 2. ANTIPOVERTY EFFECTIVENESS OF GOVERNMENTAL POLICY FOR INDIVIDUALS IN SINGLE-PARENT FAMILIES WITH CHILDREN**

Number of Poor Individuals: (thousands)	1982	1991
Cash Income Before Transfers	13,594	16,387
After Social Insurance, Cash and Near-Cash (Food and Housing Benefits)	10,312	12,452
After Federal Taxes	10,611	12,263
Total Number of Individuals Removed from Poverty	2,983	4,124

Source: 1992 Green Book and table 45, p. 86, Sources of the Increases in Poverty, Work Effort, and Income Distribution Data, January 26, 1993, Subcommittee on Human Resource of the Committee on Ways and Means, Committee Print WMCP: 103-2.

TABLE 3. EFFECT OF FEDERAL TAXES, INCLUDING EITC,  
ON INDIVIDUALS IN FAMILIES WITH CHILDREN UNDER 18

	1984	1991	1994 <sup>1</sup>	With Clinton EITC Proposal <sup>2</sup>
<b>Number of People in Poverty (thousands)</b>				
Cash plus food and housing	22,405	21,080	21,080	21,080
Less Federal taxes	24,194	21,090	20,377	18,956
Effect of Federal taxes including EITC	+1,789	+10	-703	-2,124
<b>Poverty Gap (millions of dollars)</b>				
Cash plus food and housing	\$20,564	\$25,329	\$25,329	\$25,329
Less Federal taxes	\$21,397	\$24,719	\$23,779	\$22,287
Effect of Federal taxes including EITC	+\$833	+\$610	-\$1,550	-\$3,042

Source: Special tabulations of the Congressional Budget Office

1. Estimated using 1991 income levels but with 1994 EITC parameters.
2. Estimated using 1991 income levels with Clinton EITC proposal fully implemented.

Chairman RANGEL. Thank you, Mr. Primus.  
Ms. Lullo.

**STATEMENT OF MARGARET J. LULLO, DEPUTY ASSISTANT COMMISSIONER, TAXPAYER SERVICES, INTERNAL REVENUE SERVICE, ACCOMPANIED BY ROBERT J. CARVER, DEPUTY ASSISTANT COMMISSIONER, RETURNS PROCESSING**

Ms. LULLO. Mr. Chairman and members of the subcommittees, my name is Margaret Lullo. I am the Deputy Assistant Commissioner for Taxpayer Services with the Internal Revenue Service.

I appreciate the invitation to represent the Internal Revenue Service before your subcommittees to discuss the earned income tax credit and various other tax incentives.

As indicated previously, Robert Carver, the Deputy Assistant Commissioner for Return Processing, is with me today.

My testimony today is intended to supplement that of the Department of the Treasury and will concentrate on IRS's administration of these provisions.

The Internal Revenue Service is responsible for educating the public on the benefits provided to taxpayers through the tax system, as well as on the rules pertaining to their tax obligations. We use a variety of media to convey the information needed for taxpayers to benefit from and comply with our tax laws.

Today I will focus on the current administration of the earned income tax credit for low-income taxpayers in my summary of my written statement.

For tax year 1992, qualified low-income workers are entitled to claim a refundable earned income credit of up to \$1,324 if they live with one qualifying child. If two or more qualifying children live with them, the maximum credit can be as much as \$1,384.

The earned income credit generally begins to phase out once the income reaches \$11,850, and for tax year 1992, the credit is completely phased out at incomes of \$22,370 or more.

A qualifying child is a child who meets a relationship test, a residency test, and an age test. The credit is based on earned income, which includes all wages, salaries, tips, and other employee compensation, and net earnings from self-employment.

Earned income, for purposes of the earned income credit, also includes nontaxable compensation such as the basic quarters and subsistence allowances for the military and clergy, the value of meals and lodging furnished for the convenience of the employer, and excludable employer-provided dependent care benefits.

In addition to the basic earned income credit, there are two components of the earned income credit. One is the young child credit, which is available to taxpayers with qualifying children under the age of 1 year. For 1992, the maximum amount for this component was \$376. If a taxpayer claims the young child credit, the taxpayer may not also claim other dependent care benefits for that child.

A third component of the earned income credit is the health insurance credit to taxpayers who provide health insurance coverage for their qualifying children. The maximum amount for 1992 for this component was \$451. If a taxpayer claims this credit, the taxpayer may not also deduct this amount as an itemized medical ex-

pense deduction or as a health insurance deduction if they are self-employed.

There are two ways to claim the basic credit. Taxpayers may get the credit when they file their tax returns or as an advance credit that is paid by their employers as part of their regular salary. Most taxpayers choose to get the earned income credit when they file their returns. In order to do this, taxpayers must file a form 1040 or form 1040A with a schedule EIC. They may fully compute their own credit or supply the Internal Revenue Service with basic information, and we will calculate the credit for them.

Taxpayers who appear to qualify for the credit, but do not claim it on their tax return, will receive a notice containing the schedule EIC, explaining their potential eligibility for the credit. When the taxpayer responds with the schedule EIC, IRS will determine the correct amount of the credit. When claiming the credit, taxpayers must provide the Social Security number of the qualifying child if the child is 1 year or older.

Employees may also elect to receive the basic earned income credit in advance payments from their employers during the year along with their regular pay, instead of as a lump sum refund or tax credit upon filing their returns. To get the credit in advance, an employee must complete a form W-5, Earned Income Credit Advance Payment Certificate, and submit it to his or her employer. If advance EIC payments are received, the taxpayer must file a form 1040 or 1040A with the schedule EIC to claim additional components of the credit and to report the amount received throughout the year.

In 1990, Congress simplified the eligibility rules for claiming the earned income credit and in the conference report required taxpayers to file a form to claim the credit. However, new rules for the young child credit and health insurance credits added complexity to the law. Because of the interdependency rules in determining whether to claim the young child credit, taxpayers may have to compute their credit on both form 2441, Child and Dependent Care Expenses, and on schedule Earned Income Credit in order to determine which provides the greater benefit.

Also, in claiming the health insurance credit, taxpayers must reduce any medical expense deduction by the amount of the credit claimed.

These additional earned income credit components, which were added for the first time for tax year 1991, can result in errors by taxpayers. Any errors can delay IRS processing and therefore any refund that includes these credits. Undue complications may also discourage taxpayers from claiming credits which are intended for them.

I would like to talk to you briefly about some of our outreach efforts. I believe each of you should have received a booklet that contains examples of some of the informational materials which we distribute to the media to publicize the credit, materials we use in our outreach seminars, and items we issue to employers, so that they can give notification to their employees.

Over the past few years, IRS has taken a number of actions to ensure that qualifying taxpayers received earned income credits that are intended for them. We have conducted educational pro-



grams to alert taxpayers to the availability of the earned income credit and the advance earned income credit. We have designed both traditional media releases and nontraditional promotional efforts. We have also entered into cooperative ventures with outside organizations that are interested in protecting the welfare of children.

We are very proud of our outreach efforts in this area. We believe that we have been successful in reaching a high proportion of taxpayers who are eligible for this tax benefit.

For instance, a 1991 Simmons Market Research Bureau study that was conducted for IRS to help us identify market segments to target our publicity efforts estimated that the number of households earning less than \$20,000 with 1 or more children was approximately 16 million. In tax year 1990, 12.5 million returns were filed claiming \$7.5 billion in earned income credit. And in tax year 1991, the number of returns claiming earned income credit was almost 14 million for a total of \$11.2 billion.

We believe that a large portion of the difference in the number of low-income households potentially eligible for the credit based on income and the number that actually claim the credit may be because the definition of income used in the study included income from sources other than earned income, such as welfare, unemployment, Social Security payments, alimony, and child support payments. To qualify for the credit, taxpayers must have earned income.

Also we realize that some individuals in the study, who may not otherwise be required to file a return, do not realize that they are entitled to the earned income credit.

Some specific examples of our publicity and outreach efforts are including the earned income schedule EIC in every 1040 and 1040A tax package. This gets the information into the hands of every American who receives a tax package.

Publication 596, which is on the earned income credit, has been completely revised both in content and format. The language has been simplified and color graphics added to help explain the new rules. The publication has been distributed as part of our outreach efforts. It is printed in both English and Spanish.

Public Affairs Officers and Taxpayer Education Coordinators in each of our 63 Internal Revenue Service districts across the country have been given publicity materials, including media and nonmedia kits, posters, factsheets, brochures, a consumer videotape, and television and radio public service announcements. We also developed a special envelope notice, or "stuffer," which was included in paychecks, bank statements, and utility bills across the country.

An independent aspect of our earned income credit publicity is the information campaign being developed by the Center for Budget and Policy Priorities for the 13,000-member service organizations. We are coordinating with them and providing 20,000 earned income credit posters for use by their members. This year our publicity includes instructions for claiming the advance earned income credit. All of our information includes information on the advance earned income credit.

IRS field personnel have been and continue to conduct outreach sessions, train volunteer income tax assisters, or VITA volunteers,



to meet with the media and to work with local organizations to disseminate the information and materials that we develop. The goal is to reach all individuals who are potentially eligible for the earned income credit.

The training provided to volunteer assisters, as well as our own assisters, includes information on the earned income credit and the advance earned income credit.

In considering any changes to the earned income tax credit or other tax provisions, IRS urges the Congress to simplify the rules to the extent possible. It is extremely important to both taxpayers and to the fairness of the tax system that taxpayers be able to understand and voluntarily fulfill their tax obligations. If the rules can be simplified, both taxpayers and the IRS will make fewer errors, and the costs and burdens of the tax system will be reduced.

Taxpayers and practitioners alike have expressed frustration with computing the two additional components of the earned income credit. Our figures for tax year 1991 show that there were 105,000 returns where the young child credit was computed erroneously and 75,000 returns with errors attributable to the health insurance credit.

The proposed repeal of the health insurance credit and the supplemental young child credit would simplify the schedule EIC and would reduce taxpayer error rates. The repeal would also eliminate errors on tax returns which stem from the limitations between these additional credits and other deductions or credits permitted elsewhere on the tax return. Such simplification will ease the burden of taxpayers who are most in need of the credit.

Finally, I would like to make one last point. We at the Internal Revenue Service strongly believe that the introduction of the schedule EIC has significantly reduced the number of errors made by taxpayers in computing the credit.

For example, in tax year 1990, the error rate was 7.3 percent without the schedule. With the introduction of the schedule in tax year 1991, the error rate declined to 5.6 percent, even though changes were made to the eligibility requirements for the EIC. Preliminary figures for 1992 indicate that the error rate is down to 3 percent.

In addition, the schedule is important because it helps taxpayers accurately compute the credit and gives IRS information that is not otherwise available from the tax returns, such as nontaxable earned income. We believe the schedule helps taxpayers and the IRS accurately compute and verify the credit.

In conclusion, I would like to thank the subcommittees for this opportunity to discuss the current rules for the earned income tax credit and other tax incentives. We believe the proposals made by the Department of the Treasury to simplify the rules and to increase the basic amount of the earned income credit will help low-income families who are entitled to this credit.

We look forward to working with the department and with you and your staffs as you consider these proposals.

[The prepared statement follows:]

STATEMENT OF  
MARGARET J. LULLO  
DEPUTY ASSISTANT COMMISSIONER (TAXPAYER SERVICES)  
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BEFORE THE  
SUBCOMMITTEES ON  
SELECT REVENUE MEASURES AND HUMAN RESOURCES  
COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES

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Mr. Chairmen and Members of the Subcommittees:

I appreciate the invitation to represent the Internal Revenue Service before the Subcommittees to discuss the earned income tax credit and various other tax incentives. With me is Robert J. Carver, the Deputy Assistant Commissioner of Returns Processing. My testimony today is intended to supplement that of the Department of the Treasury and will concentrate on the IRS' administration of these provisions.

The Internal Revenue Service is responsible for educating the public on the benefits provided to taxpayers through the tax system, as well as on the rules pertaining to their tax obligations. We use a variety of media to convey the information needed by taxpayers to benefit from and to comply with our tax laws. Today I will focus on the current administration of the earned income tax credit for low-income taxpayers and will also briefly touch on the targeted jobs tax credit and the educational assistance credit provided through the tax system.

### EARNED INCOME CREDIT

#### The Basic Credit

For Tax Year 1992, qualified low-income workers are entitled to claim a refundable earned income credit (EIC) of up to \$1324 if they live with one qualifying child. If two or more qualifying children live with them, the maximum credit can be as much as \$1384. The EIC generally begins to phase out once income reaches \$11,850. For Tax Year 1992, the credit is completely phased out at incomes of \$22,370 or more.

A qualifying child is a child who meets a relationship test, a residency test, and an age test. The credit is based on earned income, which includes all wages, salaries, tips, other employee compensation, and net earnings from self-employment. Earned income for purposes of the EIC also includes --

- nontaxable compensation such as the basic quarters and subsistence allowances for the military,
- parsonage allowances,
- the value of meals and lodging furnished for the convenience of the employer,
- excludable employer-provided dependent care benefits,
- voluntary salary deferrals such as 401(k) plans, and
- voluntary salary reductions such as under a cafeteria plan.

#### The Young Child Credit

In addition to the basic EIC, there are two other components of the EIC. One is the young child credit which is available to taxpayers with qualifying children under the age of one year. For 1992 the maximum amount is \$376. If a taxpayer claims the young child credit, that taxpayer may not also claim the dependent care tax credit or the dependent care exclusion for that child.

### The Health Insurance Component

A third component of the EIC is a health insurance credit available to taxpayers who provide health insurance coverage for their qualifying children. The maximum amount for 1992 is \$451. If a taxpayer claims this credit, the taxpayer cannot also deduct this amount as an itemized medical expense deduction or as a health insurance deduction if they are self-employed.

### Claiming the Credit

There are two ways to claim the basic credit: Taxpayers may get the credit when they file their tax returns or as an advance credit that is paid by their employers as part of their regular salary. Most taxpayers choose to get the earned income credit when they file their returns. In order to do this, taxpayers must file a Form 1040 or Form 1040A with a Schedule EIC. They may fully compute their credit or supply IRS with basic information, and IRS will calculate the credit for them. Taxpayers who appear to qualify for the credit, but do not claim it on their tax return, receive a notice containing a Schedule EIC explaining their potential eligibility for the credit. When the taxpayer responds with the Schedule EIC, IRS will determine the correct amount of credit. When claiming the credit, taxpayers must provide the social security number of the qualifying child if the child is one year or older.

Employees may elect to receive the basic EIC in advance payments from their employers during the year along with their regular pay, instead of as a lump sum refund or tax credit upon filing their individual income tax returns. To get the credit in advance, an employee must complete a Form W-5, Earned Income Credit Advance Payment Certificate, and submit it to the employer. If advance EIC payments are received, a taxpayer must file Form 1040 or 1040A with the Schedule EIC to claim the credit and report the amount received throughout the year.

Only the basic credit is available in advance payments. Therefore, advance payments of the other two components (the young child credit and the health insurance credit) and the credit for more than one child are not available.

If employers pay any amounts of advance earned income credit to their employees, they reduce the amounts of employment taxes otherwise due for that payroll period by the amounts advanced during that period.

## **EARNED INCOME CREDIT COMPLEXITIES**

In 1990 Congress simplified the eligibility rules for claiming the EIC and required taxpayers to file a form to claim the credit. However, new rules for the young child and health insurance credits added complexity. Because of the interdependency rules in determining whether to claim the young child credit, taxpayers may have to compute their credit on both Form 2441, Child and Dependent Care Expenses, and on Schedule EIC in order to determine which provides the greater benefit. Similarly, in claiming the health insurance credit, taxpayers must refigure any medical expense deduction.

These additional EIC credits, which were added for the first time for Tax Year 1991, can result in errors by taxpayers. Any errors can delay IRS processing and, therefore, any refund that includes these credits. Undue complications may also discourage taxpayers from claiming credits intended for them.

## **IRS OUTREACH EFFORTS TO EDUCATE THE PUBLIC**

Over the past few years IRS has taken a number of actions to ensure that qualifying taxpayers receive the earned income credits intended for them. We have conducted educational programs to alert taxpayers to the availability of the EIC and the Advance EIC. We have designed both traditional media releases and non-traditional promotional

efforts. We have also entered into cooperative ventures with outside organizations that are interested in protecting the welfare of children. IRS is very proud of its outreach efforts in this area. We believe that we have been successful in reaching a high proportion of taxpayers who are eligible for this tax benefit. For instance, a 1991 Simmons Market Research Bureau study estimated that the number of households earning less than \$20,000 with one or more children was 16 million. In Tax Year 1991, 12.5 million returns were filed claiming \$7.5 billion for the EIC and in Tax Year 1992, the number of returns claiming EIC was almost 14 million for a total of \$11.2 billion. We believe that a large portion of the difference in the number of low-income households potentially eligible for the credit (based on income) and the number that actually claimed the credit was because the definition of income used in the study included income from sources other than earned income such as welfare, unemployment, social security payments, alimony, and child support payments. However, we also know that some individuals in the study may not otherwise be required to file or do not know they are entitled to claim the earned income credit.

In addition to the extensive public media campaign to alert taxpayers to the earned income credit, we place a strong emphasis on EIC in our IRS training material that is used to train our own tax assistants as well as our volunteers in the VITA program. VITA is a program, staffed by volunteers, that is designed to help low-income, elderly, non-English speaking and other taxpayers who may have particular problems filing their returns. Both our public and our internal materials emphasize the availability of this credit to those individuals who are not otherwise required to file an income tax return. In addition, we let taxpayers know that, if they give us the basic information, IRS will compute the EIC for them. Our experience indicates the error rates are lower when IRS computes the credit for taxpayers. However most taxpayers seem to prefer to compute their credits in order to anticipate the amount of their refunds.

Publicity materials that IRS developed for distribution to the public include drop-in ads, posters, brochures, notices, grocery bag and milk carton display ads, and the VITA taxpayer envelope. These envelopes are specially printed to help taxpayers determine whether they are eligible to claim EIC and provide a handy repository for their records. Most of our publications, posters, and brochures are printed in English and Spanish.

Specific examples of our efforts include:

Tax Packages -- perhaps the most important thing we are doing is including Schedule EIC in every Form 1040 and 1040A tax package. This gets the form and information into the hands of every American who receives a tax package. Any changes in the EIC are highlighted on the package covers and in the "changes" section of the instructions.

Publication 596, Earned Income Credit -- the publication has been completely revised, both in content and in format. The language has been simplified and color graphics added to help explain the new rules. The publication has been distributed as part of our outreach efforts. Publication 596 is printed in English and Spanish.

Publicity Campaign -- Public Affairs Officers and Taxpayer Education Coordinators in each of the IRS' 63 districts across the country have been given publicity materials including media and non-media kits, posters, fact sheets, brochures, a consumer video tape, and television and radio public service announcements. An independent aspect of EIC publicity is the information campaign being developed by the Center for Budget and Policy Priorities for their 13,000 member service organizations. We are coordinating with them and providing 20,000 EIC posters for use by their members. This year our publicity includes instructions for claiming the Advance EIC.

Outreach -- IRS field personnel have been and continue to conduct outreach sessions, train VITA volunteers, meet with the media, and work with local organizations to disseminate the information and materials we develop. The goal is



to reach all individuals who are potentially eligible for the Earned Income Credit. The VITA provides return preparation assistance, at sites sponsored by community groups, to low-income, elderly, and non-English speaking taxpayers. The training provided to the volunteer assistants includes the EIC and the Advance EIC. During 1992, over 1.5 million taxpayers were assisted through VITA.

### **TARGETED JOBS CREDIT AND EDUCATIONAL ASSISTANCE PROGRAMS**

I want to briefly touch on the targeted jobs tax credit and the employer-provided educational assistance program. The targeted jobs tax credit is designed to provide incentives to businesses to hire economically disadvantaged workers. This credit is generally equal to 40 percent of the first \$6000 of first year wages paid to each qualified worker, up to a maximum of \$2400. For economically disadvantaged summer employees, the maximum credit is \$1200. In Tax Year 1991, 85,000 employers claimed credits for hiring certified employees. According to Department of Labor statistics, the number of workers certified for Tax Year 1991 was 428,000.

The educational assistance program allows employers to pay up to \$5250 of educational expenses which the worker may exclude from income. One of its purposes was to provide employees with opportunities for upward mobility through education. The educational assistance must be provided under a written nondiscriminatory plan. Because amounts received by employees for educational assistance are not required to be itemized on either the Forms W-2 or on individual tax returns, we have no way of determining how many employees benefit from this provision.

Both the targeted jobs tax credit and the educational assistance program expired as of June 30, 1992. If the provisions are retroactively extended we expect that some taxpayers will have to file amended returns. For those taxpayers who will be due a refund if the legislation is extended retroactively, IRS will make every effort to facilitate these claims for refund.

### **SIMPLIFICATION**

In considering any changes to the earned income tax credit or other tax provisions, IRS urges the Congress to simplify the rules to the extent possible. It is extremely important to both taxpayers and to the fairness of the system that taxpayers be able to understand and voluntarily fulfill their tax obligations. If the tax rules can be simplified, both taxpayers and IRS will make fewer errors and the costs and burdens of the tax system will be reduced.

Taxpayers and practitioners alike have expressed frustration with computing the two additional components of the EIC. Our figures for Tax Year 1991 show that there were 105,000 returns where the young child credit was computed incorrectly and 75,000 returns with errors attributable to the health insurance credit. The proposed repeal of the health insurance credit and the supplemental young child credit would simplify the Schedule EIC and would reduce taxpayer error rates. The repeal would also eliminate errors on tax returns which stem from the limitations between these additional credits and other deductions or credits permitted elsewhere on the tax return. Such a simplification will ease the burden of taxpayers who are most in need of the credit.

Finally, I would like to make one last point. We at the IRS strongly believe that the introduction of the Schedule EIC has significantly reduced the number of errors made by taxpayers in computing the credit. For example, in Tax Year 1990, the error rate was 7.3 percent without the Schedule. In Tax Year 1991, the error rate declined to 5.6 percent even with the changes to the EIC credit. Preliminary figures for the 1992 Tax Year indicate that the error rate is down to 3 percent.

In addition, the Schedule is important because it helps the taxpayer accurately



compute the credit and gives IRS information that is not otherwise available from the return, such as nontaxable earned income. We believe this Schedule helps taxpayers and the IRS accurately compute and verify the credit.

#### CONCLUSION

In conclusion, I would like to thank the Subcommittees for this opportunity to discuss the current tax rules for EIC and various other tax incentives. We believe the proposals made by the Department of Treasury to simplify the rules and to increase the basic amount of the EIC will help low income families who are entitled to this credit. We look forward to working with the Department and with you and your staff as you consider these proposals.

Chairman RANGEL. Thank you, Ms. Lullo.

Mr. Carver, are you making any separate contribution?

Mr. CARVER. No, Mr. Chairman, I am not. I am just here to help answer how it is going at the present time.

Chairman RANGEL. Thank you.

Ms. Lullo, you are saying that you believe that we are reaching 14 million of the potential 16 million taxpayers that are eligible for EITC, and with some simplification that we are proposing, that we could reach even more?

Ms. LULLO. Yes.

Chairman RANGEL. With your outreach program?

Ms. LULLO. Yes. What I was saying, with the study that was done to help us target our publicity, they estimated that there were 16 million households with income under the threshold amount with children living in them.

What we are saying is that the \$16 million estimate does not isolate those taxpayers necessarily that are eligible for the earned income credit, because they may—for instance, their income may be under that amount, but it could be, for instance, all from public assistance, in which case they would not be eligible for the earned income credit. But we feel like we have been very successful in our outreach efforts in increasing the numbers of taxpayers who know they are entitled to the credit and file for it.

Chairman RANGEL. Did you do any research as to whether or not these low-income people would prefer to have the EITC on a weekly, or however they get paid basis, rather than at the end of the tax year?

Mr. CARVER. May I answer that, Mr. Chairman?

We have done some research at the local level, and we are finding, as she said in her statement, that most people prefer the lump sum. Let me just give you a couple of numbers.

So far this year, up through the end of February, we have had about 16,000 taxpayers involved in the advance earned income credit, with about 5.5 million people filing for the lump sum. So our efforts—we have advertised it; we have advertised it better this year than we have prior years. But it seems to us at this point that the preference is for the lump sum payment.

Chairman RANGEL. With the advance payment, is the employer in a position to not only advise the worker, but to fill out or assist in filling out the form, so that when they enter the employment contract, they know what their options are? Is that a part of the educational process?

Ms. LULLO. Yes, sir. And in your packet, you probably will find—I do not know if we have all of the information—but we have a notice that goes to the employer telling them that they are required to notify employees, even if they do not have withholding, that they may be eligible for the earned income credit, and all of the brochures that we have developed talk about the advance earned income credit as well. And then in addition to that, there is a publication that they can give to their employees that explains the credit and how to claim the advance credit.

Chairman RANGEL. OK. We may want to work with you to monitor this, but we certainly appreciate the fact that you know what

the problems are and you are working to try to make it easier for the beneficiaries to receive the credit.

Mr. Primus, this may not be the right forum to discuss this with you, but you were so eloquent in saying that in order to deal with the problems of the poor that we really have to have a comprehensive approach to the problem and certainly in giving assistance to the working poor and education and health services as a part of all of that.

I do not have my notes for the question, but one of the questions I have is: When we talk about the increased number of children entering poverty, there has to be some connection between the number of teenage parents that we have that are in poverty to begin with, and there also has to be some connection with their families being unemployed, the availability of drugs and alcohol, and as the President moves forward with these investments in people and job training and education, there has to be a large number of people that just fall outside of all of this thinking; that is, as relates to the proposal in front of us. As a matter of fact, there has to be millions of people who are of working age that are in jail.

What made me think of this is that we are moving forward in the international arena to provide a billion dollars for the rebuilding of Haiti. And you may have read in today's papers that a large number of people that are going to be the recipients of this are a bunch of bums who are in the Army, that are illiterate, not trained to do anything, they run around with guns, they hold up people, but because it is a small country they cannot throw them in jail, so they are reaching out to these people to have them rebuild Haiti.

These would normally be our rejects. Because you are a part of discussions beyond what is in front of this committee, all I am asking now: Are these people being considered at all for any type of attention, because they are costing us dearly in terms of the deficit?

Mr. PRIMUS. Let me respond in the following way, Mr. Chairman.

In terms of your general remarks, I mean, we are going to look at a lot of these things as part of the Welfare Reform Task Group, and there are other things in the budget that address some of the issues you have raised.

For example, over 5 years, there is almost \$3 billion in new discretionary funds that were proposed for drug treatment programs through the Public Health Service. And as you know, the President made a decision to take something that was called family support and parenting and change it into a capped entitlement program. With those moneys, plus this Public Health Service money, priority will be given to women and children, including those involved or at risk of involvement with the child welfare system.

I have not been privy to the precise—the last question you asked, but I could provide it for the record. I do not know the administration's policy on the last thing you asked about.

Chairman RANGEL. More than that, if you could contact me to see whether or not we could put together a legislative task force to work with those people. We cannot afford to ignore this large segment of our population. And whether it is this committee or another committee, if we are talking about America moving forward, then we should at least deal with all of those that we are able to

touch in order to move forward. And knowing you as well as I do, I am certain that you would want to do that.

Now, Mr. Sessions, my last question to you is that with the earned income tax credit, in addition to just moving people who are working out of poverty, a lot is made of the fact that it is supposed to cushion the energy tax.

Now there are a lot of people who are not working, who are old, who are retired, who do not have kids—and I know there is some minor provision in the EITC for them—but when you are discussing policy, are there any other considerations for those people who may not be reached with EITC, who are the poor folks who are going to get hit with the energy tax?

Mr. SESSIONS. Well, as you mentioned, the EITC would be expanded to cover childless workers not covered by current law.

Chairman RANGEL. Yes.

Mr. SESSIONS. In addition, the administration's budget plan includes an expansion of the food stamp program. I think the amount is about \$1.7 billion when fully phased in in 1997, which is the time that the energy tax will be fully phased in, and also an expansion of the LIHEAP program by about \$1 billion. So both of those programs would be available to people who do not necessarily qualify for the earned income tax credit.

Chairman RANGEL. OK. Mr. Matsui.

Acting Chairman MATSUI. Thank you, Mr. Chairman.

What I would like to ask, Mrs. Lullo, is: You know, one of the things that I find is that—I think it was 1983, if I am not mistaken, we had a hearing on SSI disability benefits, and we had somebody from the Social Security Administration come to our subcommittee who gave us a packet of information, and it was very well done, very similar to what I see here. And then as we really got into it, we found out that the package or the brochures were only given to senior citizen groups in various communities, and it was only like eight communities out of all the communities in the United States, and so it was not what I would have called a real outreach program. It was more a showy thing. And I understand that you are really trying. Can you tell me how many thousands of these were prepared?

Ms. LULLO. I am sorry. I do not know the number. We can get that for you.

[The following information was subsequently received:]

The type and numbers of EIC publicity material distributed to the public this year (as of April 15, 1993) follow:

	English	Spanish
Notice 962, EIC stuffer .....	2,448,000	318,000
Publication 1495, EIC Poster .....	165,418	52,443
Publication 1620, EIC Folder .....	37,200	.....
Publication 1621, EIC Drop-in Ads .....	3,800	550
Publication 1622, EIC Brochure .....	1,405,343	789,000
Publication 1695, EIC Envelope .....	3,000	.....

In addition, approximately 6 million copies of Publication 1325, "Employers—Required Notice to Employees of a Possible Federal Tax Refund Due to the Earned Income Credit (EIC)," were mailed to employers during the third quarter of calendar year 1992.



Acting Chairman MATSUI. Mr. Carver, do you know the number of these documents that were prepared for groups? How is this packet being distributed?

Mr. CARVER. We can give you some numbers. The smaller ones are included in the mailout of the tax forms we send to all employers. That is about 6 million employers every quarter that we mail that out to. That stuffer appears in there about the advance credit and the information for taxpayers.

Acting Chairman MATSUI. So this one, 6 million go out every quarter to employers?

Mr. CARVER. Yes. Annually to that same group, we send the poster, the large one there, that one you have in your hand, that goes out.

Acting Chairman MATSUI. Who does this poster go to?

Mr. CARVER. To the employers.

Acting Chairman MATSUI. Employers as well.

Mr. CARVER. And then we also hand it out to some of the groups that you mentioned before that we contact.

Acting Chairman MATSUI. Now like this "Good News: Working Families Earned Income Credit," this goes out to—how many of these go out annually or quarterly?

Mr. CARVER. I do not have an answer for that.

Acting Chairman MATSUI. Do we have an answer to that?

Ms. LULLO. I do not know the exact number, but the other items that you find in here that are actually publications go out to all of our Public Affairs Officers, Taxpayer Education Coordinators, and to private groups to be handed out during outreach seminars, to be mailed out.

Acting Chairman MATSUI. Well, could I ask you about these seminars? Who goes to these seminars? Is it employers or employees? [The following was subsequently received:]

Through the Community Outreach Tax Education (Outreach) Program, seminars addressing the Earned Income Credit (EIC) have been conducted in all districts. Meetings in which this credit is promoted are held with the following types of groups of taxpayers, tax professionals, and organizations:

- State and local welfare agencies
- Child care providers
- Anti-poverty groups
- Parents Without Partners
- Town meetings attended by representatives from state, federal, and local agencies
- State correctional institutions
- Church associations
- Community associations established for immigrants, such as Koreans, Vietnamese, and Spanish
- Migrant workers
- Health and Human Services agencies such as Head Start and Aid for Dependent Children
- United Way agencies
- Department of Agriculture County Extension Service
- Job Service offices
- State Employment offices
- State Education Association Conference
- Hospital employees
- State University Tax Conference
- Women's organizations such as Women in Business, Displaced Homemakers, and Women's Resource Center
- Refugee Resettlement Programs
- Military bases
- Parent Teachers Association (PTA)



Ms. LULLO. Well, there are probably cases where each goes. Our seminars are set up in the District Offices, and they are based on the needs that the District Taxpayer Education Coordinators and Public Affairs Officers have determined, and they do that in conjunction with organizations in the local district offices. So each district will be handled differently, depending on the needs.

Acting Chairman MATSUI. I guess one of the problems I have—and let me say this—I think you all have been doing a better job. I was trying to recall an article I had read either last year or 1991 in which there was a GAO report in which it said only about 60 to 65 percent of the people who are eligible actually collect their benefits, not the 14 million out of 16 million that you are currently referring to. And I think it was about 11 million as opposed to 15 or 16 million people who were eligible at that time.

Now this was a 1991 study, I believe, and so it is a year and a half old, so I do not want to hold you to that. But it just seems to me that we have a lot of work to do.

And I think these are fine, but I do not think they get out to the people, generally speaking. I do not think you have the resources to be able to hit the kind of population that you want to hit, and I think there are probably more than you are saying, and you just have rough numbers anyway. I mean, you do not have data that is—I mean, what is your data based upon?

Ms. LULLO. I am sorry?

Acting Chairman MATSUI. Your data, your 16 million eligible recipients and 14 million that are receiving this earned income credit? How did you arrive at that figure?

Ms. LULLO. Well, the 16 million is an estimate, and that came from the research study that we used in trying to target our publicity efforts. The 14 million is based on information that we have as far as people who claim the credit.

Acting Chairman MATSUI. So you are telling me that the 16 million is—so that number is based upon your publicity effort; it is not based upon any—

Ms. LULLO. Well, it was a research study trying to identify households that had income at the threshold or below that had children in the home.

Acting Chairman MATSUI. See, I think one of the problems is that you are relying on information—you are relying on people to take advantage of a right in a very anecdotal way, and so you may hit, you may miss, and it may be relevant, and it may not be relevant.

I do not think that is enough. I mean, if only 80 percent of the taxpayers filed their returns, I think we would be really howling right now. And so if only 80 percent are receiving benefits, I think we should really be upset over that. I do not think it is anything to be proud of. We have to get 90 percent, 95 percent, and maybe 100 percent. We will never get that, but we have to do the best we can.

Now I am thinking that a better way of doing this—and I think Mr. Rangel referred to this—is maybe put an obligation on the employer. I mean, maybe we have to do this in a way that a filing occurs on the moment that person applies for the job and is hired and files that W-4 form, maybe that has to be put into the equa-

tion, and the employer is probably the only one who knows what this person makes, and make that an obligation of the employer. That way we know that we will not even have this kind of hearing, and we will not need all this stuff, because it will be an obligation.

And I do not know what it is going to require. I mean, maybe employers will complain because it is more paperwork. But at the same time, we are talking about a lot of valuable benefits, particularly since we are going to increase these benefits.

I mean, we hear that now a family will, when it is fully phased in, will receive \$3,300, and I do not think we should rely upon somebody losing \$3,300 a year in refundable credit just on the basis of anecdotal information.

And so I think we have got to go beyond this kind of stuff. And, you know, I know you are going to have a new Commissioner soon, and I really look forward to working with Commissioner Richardson, because I think she will be tremendous for all of us. I know she is committed to this.

And so it would be my hope that over time you are going to come up with something more than just this anecdotal information. I do not think you are going to reach the people by doing it this way.

Do you have an observation on that?

Ms. LULLO. Well, just a couple of clarifications. First, the 16 million that I mentioned earlier, not all of those people are known to be eligible for the earned income credit, because they may have incomes that are under the threshold amount, but it may not be earned income, in which case they would not be eligible for the credit.

The other thing is that we do send out notices to employers telling them that they are required to notify taxpayers, especially those who have no withholding, that they may be eligible for this credit and that they can get it in the advance form.

My understanding currently is that there is not a statutory requirement at this point in time for the employer to notify employees.

Acting Chairman MATSUI. That is probably something that we will want to work on with you. I think it makes some sense.

But, you know, I will tell you how anecdotal this is. You get a GAO report that says about 10 million are taking it. You say 14. And then Mr. Primus' own Blue Book it says 13 million—I mean, Green Book, excuse me, Green Book says 13. And, again, you know, what is the difference between 10, 13, and 14 million? Well, it is. It is a big difference, particularly if we are talking about \$3,300 worth of valuable benefits.

So let me move over, if I may, to Mr. Sessions and Mr. Primus, and I will be very brief, because I know other members have questions.

In terms of the credit, we have now a single individual who will be eligible for a credit up to \$306 a year. If this committee and the administration embarks upon a very significant major child support enforcement operation this year or next year in terms of the welfare reform package, is there any reason we should think about allowing the noncustodial wage earner to receive a benefit, the earned income credit, based upon family size if, in fact, we can set

up this mechanism where it really works and where we get every absent father to start paying his benefits for having children?

Mr. PRIMUS. Mr. Chairman, I think that is a very interesting idea and one that looks like it has considerable merit, so that it encourages the fathers who are not living with their children, but nevertheless are working, to pay child support to their children, and we will definitely take a look at that idea in the context of welfare reform.

Acting Chairman MATSUI. Yes, I would like that done. And then also, I guess, you have to still deal with the marriage penalty problem as well, right, because that makes it worse. Or does it? I guess it would make it worse. And so is that something that you could also look at?

Mr. SESSIONS. The marriage penalty? Were you referring earlier to the EITC for childless workers or for the—

Acting Chairman MATSUI. Well, the first one for childless workers, which will be in the proposal.

Mr. SESSIONS. Right.

Acting Chairman MATSUI. But what about those workers, noncustodial fathers, who are single at this time and who have children, now would that person—because we are really going to come down on them. I mean, we are hoping that we are going to make that person feel the same obligation that the custodial mother feels for that child. Perhaps that person should be considered for an earned income credit based upon family size and children as well. And that is what I think I asked Mr. Primus and you to look at.

Mr. SESSIONS. OK.

Acting Chairman MATSUI. Thank you, Mr. Chairman. I have no further questions.

Chairman RANGEL. Thank you. Mr. Santorum.

Mr. SANTORUM. Thank you. I would just like to follow up on that point, because I think we could be getting ourselves into a real kettle of fish here. My understanding right now is, if a couple is married, their maximum benefit is \$1,500; is that correct? But if they were not, if they were not married because of the marriage penalty, they would get a \$2,000 maximum benefit, and together it would be \$4,000; is that my understanding; is that correct?

Mr. SESSIONS. The EITC is not necessarily tied to marital status. It is a function of whether or not you have children. A marriage penalty or bonus can result when a couple—

Mr. SANTORUM. Right.

Mr. SESSIONS. Right.

Mr. SANTORUM. But there is a marriage penalty.

Mr. SESSIONS. There are marriage penalties and also potential marriage bonuses. By extending the phaseout range to \$28,000, we create a marriage bonus in some cases.

Mr. SANTORUM. The point I was trying to make is, if we extend the EITC to noncustodial parents, we, in fact, not only have a marriage penalty, but we have a bonus for people who divorce, because both parents would then be able to claim a tax credit under that idea, correct? I mean, that is what is being offered.

Mr. SESSIONS. The credit is only available if the child lives with the parents.



Mr. SANTORUM. I understand that. But what Mr. Matsui was asking was, if you gave the tax credit to noncustodial parents, would you not be setting up a situation where it would be much more advantageous to you as a parent not to live there?

Mr. SESSIONS. Well, Mr. Matsui has asked us to look into this proposal, but it is not part of our proposal at the moment—

Mr. SANTORUM. I understand. I am asking the question in response to his question.

Wendell, do you want to give it a whack?

Mr. PRIMUS. Well, one, I said we would explore it. I did not say that this was the administration's policy.

Second—

Mr. SANTORUM. I am not suggesting that you did say that. I am asking the question.

Mr. PRIMUS. It seems to me on first blush that that would lower the marriage penalty. I mean, that idea would lower the marriage penalty. And it seems to me that, again, if the noncustodial—if you made it a condition that the noncustodial parent has to pay support in order to receive it, some of the adverse impact that you are concerned about may be alleviated.

Mr. SANTORUM. Well, explain to me how it would lower the marriage penalty. You would have two parents not living in the same household receiving the earned income tax credit, correct, as opposed to, if they lived in the same household, they would receive a much reduced earned income tax credit?

Mr. PRIMUS. This is a very complicated question when you get into marriage penalties, and I would want to sit in the quiet of my office and think about it. I mean, there are examples, as Sam indicated, where the current law creates an incentive for marriage. I mean, it depends upon the example you pick.

If you have the mother and children without earnings, potentially marrying or having—marrying a male with earnings, in those situations, the EITC—it is an opposite of the penalty; it creates a bonus, if you will.

There are other examples that you can create where it does look like there is a marriage penalty. And so the question is: Which examples are the most prevalent, and which one are we the most concerned about?

Mr. SANTORUM. OK. A question for Ms. Lullo, and I want to follow up again on what Mr. Matsui was saying, because I think he made a good point on this 16 million and 14 million receiving it.

How many of the people get the earned income tax credit who do not apply for it, but who are caught in your computer system?

Mr. CARVER. I would like to answer that, if I may. I have some numbers for our current period through the end of February, and out of the 5.5 million that have filed for it so far, there were 277,000 people who filed just to get their earned income credit. There were 270,000 brand new filers that have not filed returns with us before with no tax liability. So that is about 500,000 there, people who have filed with no tax liability just to get the earned income credit.

Of the 5.5 million, in 4.5 million the earned income credit exceeded the tax liability. So for the great majority of them, the earned income credit was in excess of the tax liability.

Mr. SANTORUM. Are you done?

Mr. CARVER. Did I not answer your question? I am not sure I did.

Mr. SANTORUM. No.

Mr. CARVER. I am sorry. Did you want to know how many notices we have mailed to people?

Mr. SANTORUM. No. The question I have is: How many returns do you catch with your own internal computer system of people who did not file for the earned income tax credit? You said, well, these people are obviously eligible for it, and then sent a check.

Mr. CARVER. We have mailed out about 100,000 of those this year so far, up through the end of February. We do not have the statistics for this week. But we have mailed out about 100,000 notices.

Mr. SANTORUM. So you say that 500,000 people out of the 5 million have applied, and another 100,000 did not apply, but you caught them and sent them out?

Mr. CARVER. That is correct.

[The following was subsequently received:]

In tax year 1991, approximately 14 million individuals received the EIC. This total includes approximately 500,000 cases where the IRS identified returns where the individual appeared to be eligible for the credit (based on information contained on the tax return). For these 500,000 individuals, IRS calculated and issued the basic EIC and provided an appropriate notice to the taxpayer. In tax year 1992, through the end of February 1993, approximately 5 million individuals claimed the EIC. The IRS identified an additional 100,000 cases where the individual appeared to be eligible for the credit. IRS mailed a notice (and a schedule EIC) to these individuals encouraging the filing for credit.

Mr. SANTORUM. OK. And is that standard? I mean, is that 5-to-1 ratio pretty standard? I guess the question I have is: If you are catching these 100,000 people, why are you not catching all 2 million eligibles who don't receive the EIC? I mean, what is the discrepancy here? Is your computer set up or is your system set up to catch everyone who makes the mistake and does not claim for the credit, number one?

And number two, are you in the process of trying to get your computers to the point where you can catch all of these eligible people?

Mr. CARVER. There are two answers. For the people who file a return, our system does catch it if they do not claim the credit and it looks like to us they are eligible; we will catch those.

The question is really the ones who are not filing, who do not file a return with us. And the reason we track the new filers this year, it is an initiative of the service in total, but our outreach efforts—this is where we will see the results, are the people who have never filed before, who are now filing just to get the earned income credit.

So we do measure that when we—

Mr. SANTORUM. So the problem that Mr. Matsui was talking about—maybe I did not understand it—was the problem of getting people to file returns, not necessarily getting people who are filing returns to claim the credit. The problem is not claiming the credit here. So the information here—I might be wrong—but the information here is nice, but it really does not matter whether they go out and claim this credit or not. What we need them to do is file the return.



Mr. CARVER. That is the best guarantee that we will catch it. But this effort—

Mr. SANTORUM. But did you not just tell me that you will catch it if they file a return?

Mr. CARVER. Yes. Yes, we will.

Mr. SANTORUM. So what we need them to do is to file the return.

Mr. CARVER. Yes.

Mr. SANTORUM. The question I have is: Why do we need this?

Mr. CARVER. The opportunity between—and we are not sure that that 16 million is a good figure, but we really do feel that we are getting the most that we can possibly get. The 16 million was based on census data, and, as Ms. Lullo said, it has nonincome—

Mr. SANTORUM. The question is: Why do we need to go out and promote the earned income tax credit when really all we need to do is go out and promote people to file returns?

Mr. CARVER. If the 16 million were good and we are getting 14 million, we are looking at this being the opportunity to reach those other 2 million.

Mr. SANTORUM. To file.

Mr. CARVER. Yes.

Ms. LULLO. In addition to that, I think the reason that we need the publicity is that there are a lot of taxpayers who otherwise would not be required to file a tax return, but they are eligible for the credit, so we need to get the word to them as well that you are eligible for this earned income credit, even though you have no other liability to file a tax return.

Mr. SANTORUM. Thank you. I have one more quick question. Wendell, you can try this.

What evidence do you have that the earned income tax credit works? Now we have increased it the last few years, and now we are talking about increasing it again this year. Do you have any sort of empirical data that the earned income tax credit motivates people to work or motivates them to work longer for more money to sustain their families?

Mr. PRIMUS. Let me make a couple of comments that are relevant to that question.

One is, Americans are a very hard-working society. If you look at the data that was released in the subcommittee print a couple week ago, it clearly shows that Americans are working harder in 1989 than they were in 1979. Labor force participation rates are at an all-time high.

Second, I have listened closely to what members on your side of the aisle have said and to your staff for the last 15 years. And I think the problem that you have been most concerned about is the issue of nonwork, and based on a lot of economic theory and evidence, this credit clearly encourages people who are not working to get into the labor force. There is no dispute about that.

The third is that because the phaseout rate is increased by 2 percentage points, some would argue that that diminishes work effort. Well, one, there is a question of whether they can really change their work hours.

Two, there is a question of whether they know that that phaseout did increase 2 percent.

And third, let's assume they have all of that, and these are two-parent families, and they decide to spend a little less time in the labor force and more time with their children at home, is that necessarily a bad outcome? I mean, these are people now who are clearly in the labor force earning \$15,000, \$16,000, \$17,000.

Mr. SANTORUM. I guess on that last point, it might not necessarily be a bad thing. But I think people earning \$25,000 and \$30,000 and \$40,000 would like to have that same comfort level of having Government support for them not to work.

But if you could put in the record any empirical studies that you have that indicate—that support your contentions, it would be much appreciated.

Chairman RANGEL. The record is open for Mr. Grandy to introduce questions to the panel in the record.

The chair recognizes Mr. Jacobs.

[No response.]

Chairman RANGEL. Mr. Cardin.

[No response.]

Chairman RANGEL. Mr. Hancock.

[No response.]

Chairman RANGEL. Mr. Payne.

Mr. PAYNE. Thank you very much, Mr. Chairman.

I would like to just pursue this notion a little bit further about the implementation of the EITC and something specifically, Ms. Lullo, that you mentioned in your testimony.

You said that the supplemental credits, the young child and health insurance credits, had proven to be complex, and consequently there were quite a number of errors as a result of that.

The question I have is: Will the proposal by the administration correct that problem, or are you suggesting that we should do some additional things in order to change the complexity of that particular element?

Ms. LULLO. We feel that the proposal of the Treasury Department, which indicates that they would do away with the health insurance credit and the young child credit, would substantially simplify the earned income tax credit.

Mr. PAYNE. OK. I appreciate that. I was not sure of the answer and whether that was part of the administration's proposal.

The second area, and one that you did not touch on, but it is my understanding that when the targeted jobs tax credit was originally enacted that the Department of the Treasury was charged also with the responsibility of publicizing that program. Is that something that falls under your purview, and if so, what kind of publicity does the department provide for potential employers?

Ms. LULLO. Well, yes, it would fall under our purview. At this point in time we are not doing any publicity because the credit ended as of June 30, 1992.

But if it were reinstated, we would go through some of the same types of things, that we would try to identify those employers and get the word out to them. We could do that in the mailings that we send out to them with their quarterly tax returns, and we would, in fact, try to publicize the credit. And in addition to that, we would take some extra efforts to make sure that they knew, for

instance, if it were extended retroactively what they would need to do, because some employers would be affected by that.

In addition, the exclusion for employer-provided educational assistance, if reenacted retroactively, would affect individual taxpayers. Some taxpayers would have paid income tax that they probably would not have needed to, and we would have to deal with them getting refunds if they had paid tax on benefits that became taxable after June 30, if it were reinstated retroactively.

Mr. PAYNE. Do you think you were doing enough before it expired, so that employers understood the program and its availability?

Ms. LULLO. I think my answer to that would have to be yes. We think about 85,000 employers were claiming the targeted jobs credit, and I believe the figure that had been certified for employees that qualified for that was around 500,000 employees, and that would have been, of course, last year.

Oh, in addition to that, what we did when the credit expired was to make sure that this was made known in all of the publications that employers or employees that might qualify, that might be a qualifying employee for that credit, were aware of it. We would use those same publications, then, to reach the public that needed to know about the fact that the credit was in effect again.

Mr. PAYNE. Well, it's my own experience that in my district, it seemed that there were many potential employers who did not seem to be familiar with the program. And it occurred to me as you were talking about the earned income tax credit that many of the same people who get that information, the employers, are exactly the same people who would be most interested in the targeted jobs tax credit program. Perhaps there might be a way to combine those two as you mail information, one piece of information about the earned income tax credit, at the same time they might also get information about the targeted jobs tax credit, and I think it would be maybe an effective way and an efficient way of providing that kind of information.

Ms. LULLO. That certainly makes a lot of sense, yes.

Mr. PAYNE. Thanks. And I yield back the balance of my time.

Chairman RANGEL. A good idea. Mr. Hoagland.

Mr. HOAGLAND. Mr. Chairman, I would like to take advantage of the presence of our colleague, Mr. Sessions, here who works in tax policy in Treasury, and if I might ask a couple of questions about certain aspects of the administration proposal, if that is permissible, Mr. Chairman?

And do you mind, Mr. Sessions, if I ask you a couple of questions about two subjects? First, the temporary incremental tax credit and also the disparity, the problem that Mr. Matsui has outlined on numerous occasions, between the capital gains rate and the ordinary income rate, if the President's proposal is to be adopted.

But first let me ask you about the temporary incremental income, the temporary incremental tax credit for companies that make investments.

I visited with companies in Nebraska and corporate managers in Nebraska and elsewhere who have indicated that it really will not affect any of their investment decisions, that this temporary 2-year incremental tax credit would provide revenues. They would be



pleased to accept the money, but that they do not plan that way. They do not make year-to-year business investment decisions based on that.

I am hearing from—another criticism I am hearing is that it would be very difficult to administer, that the corporations would have to hire lawyers and accountants to help them prepare the forms, that IRS would have a very complicated job processing the forms. People have called it an administrative nightmare.

The third problem is that Mr. Reischauer testified about 2½ weeks ago before this committee that the price tag was in the range of \$12 billion. You know, that is about three-quarters of the stimulus package that we are having so much difficulty with in the Senate.

We know how painful it is to find \$12 billion in cuts or in revenue increases. And I just wondered what Treasury's view is toward the efficacy of that proposal and how wedded the Department is to that?

Mr. SESSIONS. Well, there have been a number of studies of incremental investment tax credits which indicate that they do, in fact, provide incentives for investment, particularly in equipment.

As far as the \$12 billion figure that Mr. Reischauer named, I do not know if he was speaking of the temporary credit only or the permanent flat credit. In any event, as I said, there have been studies indicating that it does provide incentives.

In addition, for longer term investments, the credit would be based upon progress payments that occur within the 2-year period. The provision is intended to be a stimulus provision. Since it is designed to reward only investment above the taxpayer's marginal investment, we think that it will provide a stimulus for investments on the margin. It expires after 2 years because that is consistent with the stimulus purpose.

In terms of administrability, we are in the process of developing the specific rules. We are going to try to make it as simple as possible. The fact that it is temporary makes it possible to dispense with a number of rules that a permanent incremental credit would require. So we think it will be simpler than a permanent credit, that is, a permanent incremental credit.

In addition, there would be, as you know, a flat credit available for smaller businesses, which would entirely dispense with the complications that result from making the credit incremental.

So on the whole, the administration still thinks that it is a good idea, supports the provision, and hopes that this committee will also.

Mr. HOAGLAND. A couple of additional criticisms I have heard—and by the way, I am just speaking about the incremental credit for corporations of over \$5 million; that was costed out by CBO at \$12 billion; I think there is a lot more support for the permanent credit for companies of under \$5 million—additional criticisms that I have heard have to do with the uneven application of the credit.

Companies that were good corporate citizens the last 3 years and made substantial investments in plant and equipment to help the economy along would not be able to avail themselves of it in some instances because their 3-year prior average would be too high.



The recapture, the rather harsh recapture, provisions have come under some criticism.

CBO, in an internal memo, indicated that 40 percent of the benefit would go overseas; 40 percent of the \$12 billion would benefit importers.

I just wonder if there is not a better way of spending that \$12 billion? But do you have any additional response that you would like to make?

Mr. SESSIONS. Well, I will respond to the comments that you made.

In terms of your first point about the uneven application of the credit, we have incorporated a number of features that are designed to deal with that. One is that taxpayers would be allowed to elect between a 3- and a 5-year period for determining their historical base. Five years is a fairly long period of time, so that for the larger businesses that would be eligible for the credit, we believe that that will capture their historical averages, at least in the great majority of cases.

In addition, rather than allowing the credit only for investments over the historical base, we allow the credit for investments over a percentage of the historical base. It is 70 percent in the first year and 80 percent in the second year.

The recapture is also at an 80 percent rate, so you would have to drop down—this refers to the second point you made—you would have to drop significantly below your historical average to be subject to recapture. This is simply a rule that is designed to prevent taxpayers from bunching investment in 1 year, effectively having 2 years' investment in 1 year and therefore getting well above their base, and drop significantly in the next year. We think that the 80 percent rule is a fair way of dealing with that.

The figure that you gave about CBO and the portion of the credit that goes overseas, I am not familiar with that and would have to get back to you on that.

Mr. HOAGLAND. OK. Let me shift your focus, if I can, to this issue that Mr. Matsui—may I, Mr. Chairman? Let me inquire just briefly on one question on this additional issue that Mr. Matsui has raised on a number of occasions.

And that is, by broadening the disparity between capital gains tax rates and individual income tax rates, why corporations have the incentive, then, to pay compensation in the form of items that would be taxed at the capital gains rate, and we are turning to the shell games that we had before the Tax Reform Act was passed.

I wonder if all of you are thinking about that in Treasury and trying to figure out a way of overcoming that problem with a proposal and if you have any ideas you could give us today?

Mr. SESSIONS. Well, first of all, the differential would still be a great deal smaller than it has been in the past. We had a 30 percentage point differential in the middle of the 1980s. This would be an 11.6 percentage point differential and only for a fairly small number of taxpayers.

In addition, one of the incentives that taxpayers have even under a flat-rate system is to take capital gains rather than ordinary income because of deferral, and that is a significant advantage regardless of the actual rates. We do not think that the difference be-

tween 39.6 and 28 is a huge swing. At least it certainly does not return to the levels that we had before the 1986 Tax Reform Act.

Despite these points, we are working on ways to try to ensure that conversion opportunities are limited to the greatest extent possible. I cannot share those at the moment, because we are still in the process of working those out.

Mr. HOAGLAND. Well, good. Well, thank you, Mr. Chairman. Thank you, Mr. Sessions.

Chairman RANGEL. Mr. Kopetski.

Mr. KOPETSKI. Thank you, Mr. Chairman. I have some brilliant, incisive questions, but in the interest of time, I will yield back my time.

Chairman RANGEL. Let me thank this panel. Let me just ask Mr. Primus if you can run in your computer to see how many of the 2 million people that are incarcerated would be eligible for some type of employment. These bums are in jail; they are not working. And it seems to me that they are a heavy load on the deficit, and we might think of putting them to work, if you can get some idea as to their age group and how many we are talking about.

Thank you very much for your testimony.

The next panel—I am sorry; I did not notice you, Mr. Grandy. I thought you had gone.

Mr. GRANDY. Mr. Chairman, you did not notice me, because I was not here. I appreciate your sense of timing, though.

Gentlemen, I am sorry that I had to leave. I thought I had an appointment, and they were not on congressional time, so I missed them.

But I did want to, particularly with you, Mr. Sessions, explore some things on page 7 of your proposal about the targeted jobs tax credit. And I might say, I had hoped that someone from the Department of Labor would be here to talk a little bit about apprentice programs and work-based learning and lifelong learning, because I know that is of tremendous concern to the Secretary and to Mr. McLarty, the President's Chief of Staff and others that I have dealt with.

But I assume that has more to do with staffing problems in the Department of Labor than a lack of interest in this particular concept.

Mr. SESSIONS. The Treasury was invited to attend, and I showed up. As far as invitations to other agencies, I do not know what the decision was.

Mr. GRANDY. Well, I would have to assume that somewhere down the line the Department of Labor will be—

Mr. SESSIONS. They certainly are involved in this proposal.

Mr. GRANDY. But let me talk to you, Mr. Sessions, about the proposal on the targeted jobs tax credit expansion, because this looks, at least on its face, very similar to a proposal that I put in last year, which I am happy to say Mr. Rangel is a cosponsor of, called the Leading Employers Into Apprenticeship Partnership Act. And it looks, based on what you are doing here, like you want to do exactly the same thing, foster apprenticeships at the local level.

But let me ask you this: If you want to do that, why are you limiting this proposal to people between the ages of 16 and 20, when we know that so many of our nontraditional workers and potential

aspirants to the workplace are older. Some, as Mr. Rangel said, may be coming out of prison, may be coming out of drug rehab, may be coming from a foreign country.

Is there any particular reason that this proposal is just limited to youth? Are you narrowly trying to redirect the targeted jobs tax credit here? And do you have another proposal down the line that would perhaps be more inclusive of nontraditional workers?

Mr. SESSIONS. There is no other proposal that I am familiar with. The decision, I think, in part relates to the fact that there is an opportunity to establish programs involving high schools and other academic institutions that may be somewhat more ready to establish these programs than the programs that deal with the kinds of individuals that you are describing.

Certainly we would be willing to look at expanding the program. There is obviously a revenue consideration that you have to deal with in expanding it beyond this.

Mr. GRANDY. Well, look, I mean, we are not talking about something that we want to do on the cheap, if we do it at all. I base this around the high school concept as well. But in my particular State, we have a rather strong network of community colleges which are now taking things like the Carl Perkins Act, which had a technology preparation provision which allows people in high school to begin to get some vocational credit while they are in high school, and expand that concept. As a result, a lot of the apprenticeships, if you want to call them that—and I want to use a generic definition of apprenticeship here—are now being funneled through the high schools into the community colleges. It is a partnership at the local level which is beginning to work rather well.

I would have to assume the administration would be amenable to those kinds of work-based learning crucibles.

Mr. SESSIONS. From the standpoint of the Treasury Department, certainly we would. As you mentioned, the Labor Department is involved in this. I would expect that they would also be interested in this.

Mr. GRANDY. However, in your proposal you talk exclusively about the targeted jobs tax credit. So we are talking about a wage credit here.

My question would be: You obviously use a wage credit to displace or replace an employer's contribution to wages. In many of these cases, you are going to have students and nontraditional students who are not capable of earning a wage until they go through some kind of an apprentice program. That was the idea behind my bill, which was like a tax credit, an R&D credit, for in this case human capital, which employers would be able to take off their taxes.

Is that something that comports with your notion on underwriting the costs of apprenticeship programs?

Mr. SESSIONS. In part, it was a decision to use an existing mechanism, not to add another structure to the code.

Mr. GRANDY. Yes.

Mr. SESSIONS. Something that employers are familiar with and may, in fact, be taking advantage of with respect to other groups that are eligible for the targeted jobs tax credit.



Mr. GRANDY. But the problem with the targeted jobs tax credit, at least from the employers I have dealt with, is that it does not really get as deeply into the systemic educational problems that you have in trying to get these people up and operational in the workplace.

In other words, by the time they are to the place where they can qualify for the wage credit, the targeted jobs tax credit in this case, they have had to have a certain amount of learning, and it is that learning that, at least in my experience, needs to be underwritten. That was the purpose behind introducing this act.

I am not trying to replace what you are doing here. I am just wondering if that should not be part and parcel of a greater concept that does involve the business and the educational community at the local level in a kind of synergy partnership that moves kids out of school or back into school and into the workplace hopefully seamlessly.

Mr. SESSIONS. Well, as I said, the Treasury would be willing to look at that proposal.

In terms of the qualifications of the target populations to hold a job, the targeted jobs tax credit as a wage supplement obviously is for employers who have made a decision that the employee can provide some valuable service to the employer at the time; therefore, you are getting some efficiencies by asking the employer and the tax system to share a part of the burden.

If you were to extend a credit to a group where the employer does not believe that the employee can provide any services that are worth even the minimum wage, you would have to have a more generous credit, and maybe it would be somewhat less efficient.

Mr. GRANDY. Well, the idea behind this—and I will not get into the details in it, because I will probably respond in writing—but it is similar to the R&D tax credit in that it is a 20 percent credit for the cost of education, which is administered by a tax-exempt organization of which the employer is a key component, but it is not exclusively the employer's domain. Labor would be involved, the community, educators, perhaps even parents and students.

I will not explore this now, but I would just say that I think I see a lot here in your proposal that I like, but I find myself saying: I wish there was a little bit more to embrace and that more of the concepts that have been talked about, certainly by the Secretary of Labor, had been included.

Mr. Chairman, I would like to submit one question for the record regarding the EITC and some of the things that Mr. Santorum alluded to in his testimony.

Chairman RANGEL. Without objection.

Mr. GRANDY. Thank you, gentlemen.

[The questions submitted by Grandy and the answers follow:]



Questions Submitted For The Record  
Committee on Ways and Means,  
Subcommittees on Human Resources and Select Revenues  
March 30, 1993  
By Representative Fred Grandy

#### EMPLOYER PROVIDED EDUCATION ASSISTANCE

I have a few questions for you regarding how the Administration would like to see the employer provided education assistance provision be made retroactive.

First, do you have any idea what percent of businesses have filed incorrect W2 forms for their employees -- meaning they did not report and withhold taxes in the last six months of 1992 on education benefits? How many businesses or what percent did withhold on education benefits?

I support the President's proposal to retroactively extend to June 1992 Section 127, employer provided education assistance benefits. Given that some employers did follow the law and did report and withhold on education benefits, what is the least painful manner in which to change the law and not penalize those taxpayers who did follow the law? I believe it would be to allow them to not file amended returns for 1992 and instead to rebate the overwithholding on the 1993 return. Once Congress does change the law, the employer can change the employee's withholding for a few weeks or months and thereby rebate the overwithholding immediately to the employee.

Finally, it has been said that much of the education benefits provided under section 127 could really be classified as normal and ordinary business expenses and would thus be eligible for a regular business deduction under section 168. Has the Administration got any information on how much of the education provided to employees under section 127 could actually be reclassified as a business expense?

## Attachment B.

## Responses to Representative Grandy's Questions for the Record

**QUESTION:** Does IRS have any idea of the number of employers that treated the educational expenses incurred in the latter half of 1992 incorrectly for tax purposes (meaning it was not included in income) and the number that treated the expenses correctly?

**ANSWER:** We do not have information on the number of employers that treated employee educational assistance program expenses incurred on or after July 1, 1992 (when the exclusion expired under current law) properly or improperly. Only through examination of returns would errors in this area be identified. This type of examination, which would not cover all filers, does not take place for quite some time after the filing of the tax return by the employer.

**QUESTION:** What does IRS believe would be the least painful (for the employers who treated the educational expenses correctly) manner of handling this provision retroactively?

**ANSWER:** Should this deduction be extended retroactively by the Congress (as provided in the vetoed H. R. 11), the effect would be transparent to employers' income taxes. However, employers would be required to issue amended W-2 forms for their employees and employees would be required to file amended returns. It is currently impossible to grant a credit for prior year activities on a current year return. If filers were permitted to make adjustments on the 1993 returns, as proposed by Mr. Grandy, that would affect the calculation of their Adjusted Gross Income (AGI) which in turn would impact the eligibility of taxpayers for a wide variety of credits and deductions on the 1993 returns.

**QUESTION:** Does IRS have any information on the amount or the percentage of the educational expenses provided by employers that could actually be reclassified as an ordinary and necessary business expense under section 168?

**ANSWER:** We do not have the information requested. (Section 168 in the question does not relate to ordinary and necessary business expense; section 162 is the correct citation.)

Chairman RANGEL. We thank the panel, and we will invite the next panel to come up: the General Accounting Office, Jennie Stathis, Director of Tax Policy and Administration; our old friend, Jim Wetzler, Commissioner of the New York State Department of Taxation and Finance; Tom Hines, Executive Deputy Commissioner, New York State Department of Labor.

Now at the request of Mr. Santorum, there is a professor here that wanted to get on this panel because of a time problem.

Is Dr. Gary Burtless here?

Well, if he is not, then we will move forward with this panel.

All right. Dr. Burtless is here, and as a courtesy to Mr. Santorum, we will put him on the Government panel.

As most of you know, we are running behind time here in this hearing. So without objection, your testimony will be entered into the record, and it would be very, very helpful to the committee if you could highlight your testimony and try to keep your oral testimony to the minimum, and we will start with Ms. Jennie Stathis of the General Accounting Office.

**STATEMENT OF JENNIE S. STATHIS, DIRECTOR, TAX POLICY AND ADMINISTRATION ISSUES, GENERAL GOVERNMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE**

Mr. STATHIS. Thank you, Mr. Chairman. I am pleased to be here today. On my left is Dr. Tom McCool, our economist who is responsible for a lot of the work that we are discussing today. We have five major points.

The first one is that the target population for the earned income credit is working families with children. Accordingly, most low-income households do not qualify for the credit. For those 18 percent reached, the credit works. It offsets payroll taxes, increases progressivity of the tax system, and provides a positive work incentive to the lowest income group with only a slight disincentive to other recipients.

The credit has been the source of more taxpayer mistakes than any other individual income tax provision. IRS introduced a complex schedule in an attempt to prevent ineligible taxpayers from receiving the credit, but gives the credit even when the schedule lacks most information. Despite simplification efforts, the earned income credit remains fairly complex, primarily because of the supplemental credits, but also because families must meet one test to claim a dependent and another to claim a child who qualifies for the credit.

Most employers and credit recipients are unaware that the credit is available in advance payments. Advance payments did not appeal to many of those who were aware of the option.

I would just highlight a few things in my statement, Mr. Chairman. On page 4, we have a figure that shows the design of the credit and features the three groups: the lowest income earners whose credit is phased in; the middle group whose credit is a flat amount; and the highest income recipients whose credit is phased out.

In 1988, more than half of all the recipients had incomes in that phaseout range, and the remainder were split between the other two portions.

One stated goal of the earned income credit is to offset payroll taxes. We compared the credit received by households in 1988 with their payroll taxes. The credit offset almost all of the employee's share of payroll taxes and is projected to offset 178 percent by 1994.

We also examined how the credit affected combined payroll and Federal income tax burdens. In 1988, recipients who were in the lowest income range had their Federal tax burden reduced from over 14 percent to about 1 percent due to the credit. Recipients in the phaseout range saw their tax rate reduced from about 14 to 8 percent.

One way of considering the incentive effects of the credit is to examine how it affects marginal tax rates. Those rates were also reduced. While the incentives generated by marginal tax rates and changes in those rates are clearly important, whether and how much people are likely to react to those incentives are also important. Our measures indicate that recipients in the lowest income range probably increased their hours worked about 4 percent in response to the credit. Workers in the middle range or the phaseout range probably reduced their hours worked slightly by 3 to 4 percent.

Because there are many more workers in the latter two categories than in the first, the net effect on all recipients was probably a 2 percent reduction in hours worked.

For many years, the credit has been a major administrative concern for IRS. Changes in 1990 both simplified and complicated the credit for taxpayers and IRS. The law eliminated a major obstacle in determining eligibility. It replaced the complicated head-of-household support test with a simpler test. On the other hand, it created additional complexity by adding two supplemental credits. IRS compounded that complexity by introducing a complicated schedule that taxpayers had to submit to get the credit.

The primary reason for the schedule was to give IRS assurance that the credit would be given only to eligible taxpayers. However, the procedures IRS established can still allow ineligible taxpayers to receive the credit.

While there are changes IRS can make to ensure better compliance with existing law, both compliance and administration could be eased with some legislative changes. Either eliminating the supplemental credits or eliminating the interactions would make it easier to administer without any additional information other than what is normally on a tax return.

A second complexity is the different test now in law for claiming exemptions for children and for qualifying children for the credit. Congress could make the job of IRS and the taxpayer easier by making those rules conform. One way of doing that would be to simplify the personal exemption determination by substituting a residency test for the more complex support test.

The advance payment option allows workers who are qualified for the credit to receive it as part of their paychecks. We found that very few workers were taking advantage of that option. Less than one-half of a percent of eligible workers received the advance payment in 1989. From our analysis, it appeared that the main reasons for this low rate were that many eligible workers were not



aware of the option, and many others preferred to receive the credit as a lump-sum amount.

That concludes the basic points in my statement.

[The prepared statement follows:]

**STATEMENT OF JENNIE S. STATHIS, DIRECTOR  
TAX POLICY AND ADMINISTRATION ISSUES  
U.S. GENERAL ACCOUNTING OFFICE**

Messrs. Chairmen and Members of the Subcommittees:

We are pleased to be here to discuss the earned income tax credit as a wage supplement and its effect on work incentives. The credit was established in 1975 and expanded in 1990 to increase the progressivity of the federal tax system and to enhance work incentives for low-wage workers.

Today, I want to make five major points:

- The target population for the earned income credit is working families with children. Accordingly, most low-income households do not qualify for the credit.
- For those 18 percent reached, the credit works. It offsets payroll taxes, increases progressivity of the tax system, and provides a positive work incentive to the lowest income group with only a slight disincentive to other recipients.
- The credit has been the source of more taxpayer mistakes than any other individual income tax provision. IRS introduced a complex schedule in an attempt to prevent ineligible taxpayers from receiving the credit but gives the credit even when the schedule lacks most information.
- Despite simplification efforts, the earned income credit remains fairly complex, primarily because of the supplemental credits but also because families must meet one test to claim a dependent and another to claim a child who qualifies for the credit.
- Most employers and credit recipients are unaware that the earned income credit is available in advance payments. Advance payments did not appeal to many of those who were aware of the option.

Our testimony today is based on three GAO efforts. One is an ongoing review of the earned income tax credit requested by Senator Bill Bradley. The second is a recently issued report to the Chairman of the Senate Finance Committee, TAX ADMINISTRATION: Erroneous Dependent and Filing Status Claims(GAO/GGD-93-60, Mar. 19, 1993). The third is a report EARNED INCOME TAX CREDIT: Advance Payment Option is Not Widely Known or Understood by the Public(GAO/GGD-92-26, Feb. 19, 1992), which was mandated in the Omnibus Budget Reconciliation Act of 1990.

DESIGN OF THE CREDIT

The earned income tax credit is a refundable tax credit available to low-income workers with a qualifying child. The benefits are based primarily on earnings, although total income can affect the amount of the credit.

Congress created the credit in 1975 with two stated long-term objectives: (1) to offset the impact of Social Security taxes on low-income individuals; and (2) to encourage these same individuals to seek employment, rather than depend on welfare benefits.

In 1990, as part of the Omnibus Budget Reconciliation Act (OBRA), Congress substantially expanded the credit, making the basic credit more generous and adding provisions that give larger credit amounts to households (1) with more than one child, (2) with a child less than 1 year old, or (3) that pay for health insurance covering a dependent child. OBRA also relaxed and simplified the credit's qualifying criteria.

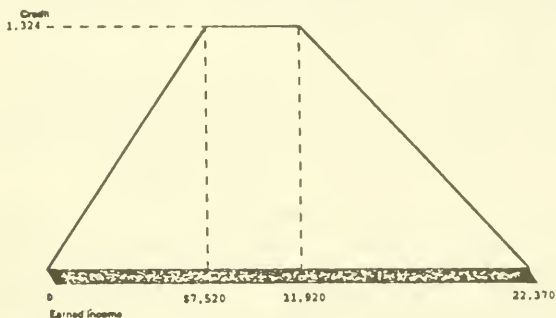
The credit's structure divides recipients into three groups: lowest income earners whose credit is "phased in," a middle group

of low-income earners whose credit is a flat amount, and the highest income recipients whose credit is "phased out." In 1992, the ranges were as follows:

- Qualifying workers with incomes less than \$7,520 received the full credit rate or wage supplement (17.6 percent of earnings for families with one child and 18.4 percent with more than one child).
- Workers whose income ranged between \$7,520 and \$11,920 received the maximum credit amount of \$1,324 with one child and \$1,384 with more than one child.
- Workers whose earnings were greater than \$11,920 saw the credit reduced by 12.57 cents (or 13.21 cents if more than one child) for each additional dollar earned until earnings reached \$22,370, at which point the credit was completely phased-out.

Figure 1: Structure of Basic Earned Income Tax Credit, 1992

(Amounts in dollars)



The supplemental credits add 5 percentage points to the credit rate for a child under 1 year old and 6 percentage points for payment of the health insurance premiums of a dependent child.

As part of OBRA, the credit rate is scheduled to rise to 23 percent for one child and 25 percent for more than one child in 1994. The phase-out rates will also rise to 16.43 percent and 17.86 percent in 1994.

SIZE OF CREDIT HAS INCREASED SUBSTANTIALLY,  
BUT MANY LOW-INCOME FILERS DO NOT QUALIFY

Between 1988 and 1990, the average credit amount was about \$600 in 1991 dollars. As a result of the OBRA changes, the average amount increased to over \$800 in 1991 and is projected to rise to over \$1,000 by 1994. The average credit amount as a proportion of adjusted gross incomes rose similarly. This effective credit rate was 5.3 percent in 1988 and 6.7 percent in 1991. On the basis of our analysis, we project that it will rise to over 9 percent by 1994.

Our analysis of 1988 recipients showed that slightly over half were above the poverty line with the remainder below that line. Those below the poverty line generally received above average amounts of credit, about \$700, compared to those above the poverty line, whose average credit was about \$500 in 1988.

More than half of the credit recipients had incomes in the phase-out range. The remainder of the recipients were split between those with incomes in the middle range where the credit was constant, and those in the lowest income range.

Only families with children are eligible to receive the credit. As a result, about 18 percent of taxpayers whose adjusted gross income (AGI) was below the eligibility cutoff received the credit in 1988. Single filers became eligible for the credit in 1991, so the proportion of credit recipients may be higher today.

CREDIT INCREASES PROGRESSIVITY OF TAX SYSTEM  
ALTHOUGH IT MAY SLIGHTLY REDUCE HOURS WORKED

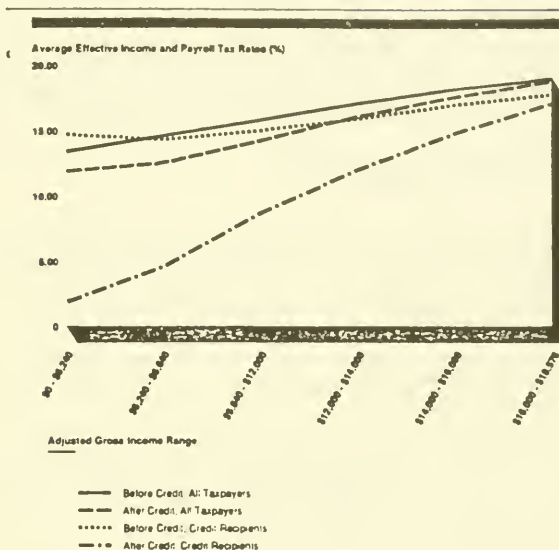
One stated goal of the earned income credit is to offset payroll taxes. We compared the credit received by households in 1988 with their payroll taxes. The credit offset almost all of the employee's share of payroll taxes and is projected to offset 178 percent by 1994.

- For those in the lowest income group, the credit more than offset the employee's share of the payroll tax in 1988. In addition, the credit offset 86 percent of the combined employee and employer payroll taxes. Our calculations show that in 1991 the credit more than offset all payroll taxes for these lowest income workers.
- For qualifying workers with higher incomes (those in the flat and phase-out ranges), the credit offsets a decreasing portion of payroll taxes as earnings increase. On average, the credit offset 89 percent of the combined employee and employer payroll taxes for those in the flat range in 1991 and 28 percent for those in the phase-out range.

We also examined how the credit affected combined payroll and federal income tax burdens. In 1988, credit recipients who were in the lowest income range had their federal tax burden reduced from over 14 percent to about 1 percent due to the credit. Recipients in the beginning of the phase-out range (AGI from \$9,840 to \$12,000) saw their effective tax rate reduced from about 14 percent to about 8 percent. A similar analysis of all taxpayers in these income ranges showed a much smaller effect--primarily because such a large proportion of them were not eligible for the earned income credit for reasons other than income level. For example, for all taxpayers in the lowest income range, the credit reduced the effective tax rate from about 13 percent to about 12 percent. All taxpayers in the AGI range of \$9,840 to \$12,000 had an effective tax rate of over 15 percent before the credit and about 14 percent after the credit was included.



Figure 2: Average Effective Income and Payroll Tax Rates, Before and After Earned Income Tax Credit, 1988



### Incentive Effects

One way of considering the incentive effects of the credit is to examine how the credit affects marginal tax rates.<sup>1</sup> Marginal tax rates (counting employees' payroll taxes and federal income taxes) were a negative 6.49 percent for households in the lowest income range (less than \$6,240 in 1988). This negative tax or effective wage subsidy may act as an incentive to work or to work more hours, if possible.

As workers' incomes increased and they moved into the range of incomes in which the credit was constant, marginal tax rates jumped to 7.51 percent, reflecting payroll taxes. Marginal tax rates jumped again (to 17.51 percent) as workers moved into the phase-out range of the credit (adjusted gross income above \$9,840 in 1988), because the phase-out acted as an effective tax rate of 10 percent on earnings. As an effective tax on wages, the phase-out may reduce the incentive to work. The last jump comes when the worker moved to an income level at which the 15 percent personal income tax rate became effective (\$12,800 in 1988).

While the incentives generated by marginal tax rates and changes in those rates are clearly important, whether and how much people are likely to react to those incentives are also important. We used estimates of labor supply response from the negative income tax experiments of the early 1970s to measure the effect of these incentives on hours worked by credit recipients. Such estimates, from a different time and context, must be used cautiously and

<sup>1</sup>A marginal tax rate is the increase in taxes that results from a 1-dollar increase in income.

could overstate the contemporary response to the credit. But we believe they are the best available evidence of the labor supply response of low-income workers.

Our measures indicate that credit recipients in the lowest income range probably increased their hours worked about 4 percent in response to the credit. Workers in the middle range or the phase-out range of the credit probably reduced their hours worked slightly--by 3 to 4 percent. Because there are many more workers in the latter two categories than in the first category, the net effect on all recipients was probably a 2-percent reduction in hours worked.

SOME PROBLEMS ADMINISTERING THE CREDIT  
HAVE BEEN RESOLVED BUT OTHERS REMAIN

For many years, the earned income credit has been a major administrative concern for IRS: it is the source of more taxpayer mistakes than any other individual income tax provision. For tax year 1988, an estimated one-third of those who received the credit were not entitled to it. The most frequent source of error was filers claiming the wrong filing status; this was usually head of household, because single filers with children were not eligible for the credit before 1991. IRS was always faced with the dilemma of denying the credit to potentially eligible taxpayers or granting it to ineligible filers, primarily because it did not have enough information to make accurate qualification determinations.

Paradoxically, OBRA both simplified and complicated the credit for taxpayers and the IRS. On the one hand, OBRA eliminated some of the major obstacles for taxpayers in determining their eligibility and for IRS in administering the eligibility requirements for the basic credit by replacing the complicated head of household support test with simpler tests based on relationship, residence, and age of the child.

On the other hand, OBRA created some additional complexity for IRS and taxpayers by adding two supplemental credits (health insurance and young child) to the basic credit. Congress had always been concerned that all those eligible for the credit were not receiving it. With the introduction of the new credits this concern increased. In response, IRS substantially increased its outreach efforts, publicizing the credit through seminars and distributing brochures and handouts at meetings of those concerned with potentially eligible clientele. IRS also tried to get information directly to those who might be eligible through news releases, fact sheets, posters, and radio and TV advertisements. IRS has also subsequently modified the notice it sends to nonfilers to let them know that filing a return may be to their advantage because they may be eligible for the credit.

While IRS' outreach efforts improved, in our view IRS compounded some of the new complexities for taxpayers by introducing a complicated schedule that taxpayers had to submit to get the credit. The schedule has four parts and a number of cautionary notes to warn taxpayers about the interactions. We are concerned that some potential recipients may be intimidated by the form. In IRS' view, the primary reason for the schedule was to give them assurance that the credit would be given only to eligible taxpayers. However, the procedures IRS established to process the schedule can still allow ineligible taxpayers to receive the credit.

If a taxpayer submits the Schedule EIC but omits important information, IRS often gives the credit anyway. Submitting the schedule with any information at all often seems to be enough, from IRS' perspective, to allow a taxpayer to qualify. For example, taxpayers can submit a schedule without providing such information as the child's year of birth, Social Security number,

relationship, and number of months lived with taxpayer and still get the credit, even though this information is essential if IRS is to make proper credit determinations.

We believe that IRS should modify the income tax return to capture the data needed to determine basic credit eligibility. For example, IRS could modify the dependent information segment of the tax return to accommodate the differences between a qualifying child and dependent, thus reducing the need for a separate schedule. (See attachment) If the health insurance credit is maintained, space would be needed on the return to write in the health insurance premium. Such modifications to the return, along with clearer tax return instructions, would likely reduce the number of erroneous credit payments.

IRS could establish a program to detect taxpayers who erroneously claim children for earned income credit purposes. This could be done by matching the Social Security number for the child against other IRS records to determine if the child meets the age requirements, was claimed by another taxpayer, or received income. If IRS matched Social Security numbers to detect nonqualified children or W-2 information to check income eligibility, the benefits of such programs would be limited because, under current technology, these matches would have to be done well after the credit has already been paid. IRS' Tax Systems Modernization program may allow IRS to match W-2 information contemporaneously with the incoming tax return. With such a technique, IRS will be better able to ensure that the credit goes to eligible and only to eligible recipients.

#### SOME ADMINISTRATIVE AND COMPLIANCE PROBLEMS CAN BE ELIMINATED BY LEGISLATIVE CHANGES

While there are changes IRS can make to ensure better compliance with existing law, both compliance and administration could be eased with some legislative changes. One significant change would eliminate the interactions introduced by the 1990 law. Another would do away with the current distinctions between a qualifying child and a dependent.

Some of the most complicated features of the OBRA changes are the interactions between the new supplemental credits and preexisting provisions of the tax code. For example, taxpayers who take the young child supplemental credit are not allowed to exclude employer-provided dependent care expenses. Alternatively, taxpayers who claim the health insurance credit must reduce any health insurance premium deduction. These interactions affect a very small number of taxpayers, but providing for them on a schedule or a tax return is complicated and can be confusing to taxpayers.

Either eliminating the supplemental credits or eliminating the interactions would make it easier to administer the credit without any additional information other than what is normally on a tax return.

A second complexity is the different tests now in law for claiming exemptions for children and for qualifying children for the credit. Congress could make the job of IRS and the taxpayer easier by making these rules conform. One way of doing this would be to simplify the personal exemption determination by substituting a residency test for the more complex support test. If this change were enacted and the exemption section on the tax return modified to include the child's age, IRS could readily determine if taxpayers are eligible for the basic credit without the need for a separate schedule.

Most of IRS' problems with administering the credit have come about because IRS does not have enough information on the tax return to make an accurate eligibility determination. If either

more information is put on the return or the qualifying information is limited to items that can be included on a return, many problems would go away.

ADVANCE PAYMENT MECHANISM LITTLE USED  
AND NONCOMPLIANCE A POTENTIAL PROBLEM

The advance payment option allows workers who are qualified for the credit to receive it as part of their paychecks rather than wait until they file tax returns. Employees who wish the advance payment must fill out a Form W-5 and submit it to their employers. The employer pays the worker the proper wage supplement and credits that amount against employment taxes owed.

We found that very few workers were taking advantage of the advance payment option; less than 0.5 percent of eligible workers received the advance payment in 1989. From our analysis, it appeared that the main reasons for this low rate were that (1) many eligible workers were not aware of the option and (2) many others preferred to receive the credit as a lump-sum amount.

With some justification, IRS appears concerned about the advance payment option. Because the money is paid out before IRS receives a tax return, advance payments pose a potential noncompliance problem. Using IRS data, we estimated that about 40 percent of those people who may have received an advance payment did not file a tax return. We examined a sample of returns with usable W-2s attached. Of these, only about half reported the receipt of advance payments. Since some of those who did not report receiving the advance payment appeared eligible for the credit, they may have received it a second time. We also found that more than a third of those who filed returns were not eligible for the credit.

Because of the time lag between filing and matching W-2s with tax returns, along with the low incomes of the individuals involved, it is unlikely that IRS would recapture much money even if it pursued people who underreported income or did not file a return. Contemporaneous document matching would also help IRS administer the advance payment by preventing overpayments of the credit to eligible individuals.

CONCLUSIONS

In general, the earned income tax credit appears to have achieved its policy goals, although for a limited clientele. Low-income workers with children have a lower, and in some cases a negative, tax burden as a result of the credit. The credit appears to provide positive work incentives for the lowest income workers and negative work incentives for near-poor workers. The net effect may be a small reduction in work effort.

In recent years, IRS' administration has been made easier in some ways and more difficult in others. While we do not believe the earned income schedule is necessary, certain legislative changes could make it completely redundant. We believe that Congress should at least eliminate the interactions in the supplemental credits if not the supplemental credits themselves. We also believe that Congress should conform the rules for claiming a dependent with the rules for claiming a qualifying child for earned income credit purposes.

Potential recipients and IRS would then be able to determine earned income credit eligibility from the tax return itself. This would help assure that all those qualified, but only those qualified, receive the credit.

This concludes my statement. We welcome any questions that you may have.



**Addendum:**

We would like to respond to IRS' claim that introducing the Schedule EIC substantially reduced the error rate associated with the credit. The most revealing piece of evidence that this claim may be spurious is that the error rate, so far this year, is only about 3 percent. In fact, at this time last year, the error rate was also about 3 percent. An important reason for this low error rate is that a large portion of the returns filed early are filed electronically. Electronically filed returns have a much lower error rate than paper returns. We believe the increase in electronically filed returns between the 1991 filing season (tax year 1990) and the last two filing seasons accounted for some part of the reduced error rate associated with the credit that IRS attributes to the schedule.

In addition, reduced errors in determining filing status and qualifying children may be more related to simplifications made in the law than to the introduction of the Schedule. If IRS wants to demonstrate the efficacy of the schedule, it needs to do a more careful analysis than simply comparing overall error rates before and after introduction of the schedule.

Mr. KOPETSKI [presiding]. Thank you very much for your testimony, and especially your brevity as well.

We have from New York State Department of Taxation and Finance Mr. Wetzler. Welcome to the committee. And if you could summarize your testimony in about 5 minutes as well, we certainly would appreciate it.

**STATEMENT OF JAMES W. WETZLER, COMMISSIONER, NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE**

Mr. WETZLER. Thank you. I will summarize my statement and perhaps react to the administration's proposal, which I heard for the first time this morning.

Three types of changes to the earned income credit are needed. First of all, it needs to be increased by at least as much as is needed to offset the costs of new energy taxes on families with children; second, it needs to be simplified; and third, its impact on work incentives needs to be improved. Let me talk about the last two of these, simplification and work incentives.

Like so many Government programs, the earned income credit, as it has gotten bigger over the years, has been asked to achieve a wider array of social goals. It now encourages beneficiaries to buy health insurance and to stay at home to care for their infant children. As a result, the credit has become much, much more complicated, and eligible people face much more difficulty in claiming it. Simply put, the present rules are incomprehensible to many of the beneficiaries, and to the extent beneficiaries must use a paid preparer to use the credit, obviously the assistance is diluted.

When the earned income credit was enacted in 1975, its principal goal was to offset payroll taxes for low-income parents, and it was quite simple by present-day standards. In 1978, the credit was simplified further so that taxpayers or the Internal Revenue Service could compute the credit from elements already present on the individual income tax returns. That is important because that meant that if taxpayers failed to claim the credit themselves, the IRS could claim it for them as part of the routine processing of income tax returns. As late as 1990, the instructions for the credit were only two pages long.

In 1990, Congress abandoned the idea of a simple earned income credit. It differentiated the credit by family size and added additional credits for infants whose parents did not incur significant child care costs and for health insurance. It also broke the link between earned income credit eligibility and computation and the other elements on the tax return. As a result, today the credit requires a separate schedule that has seven pages of instructions. The complexification of the credit has gone too far, and Congress should seriously consider returning to the original concept of a simple credit.

The special credit for infants should be repealed, and I was pleased to see the administration proposal to do that. The health insurance credit ought to be repealed on the assumption that in health care reform, you are going to deal with the problem of providing health care to this population; and if that is done, you can repeal that credit.

The existing differentiation by family size, which today is only \$77, should either be increased to a meaningful amount or should be repealed, because unless the differentiation is meaningful, the additional complexity is not worth the small amount of additional credit you get for the larger families.

Now, I notice the administration proposal creates a very significant differentiation by family size, and I think that is certainly one appropriate way to go.

In addition, as suggested, I believe, by the GAO, you ought to seriously consider relinking the eligibility and the computation of the credit to elements already present on the tax return, so that the IRS can compute the credit for taxpayers who don't claim it as part of the math error program in the processing of their tax returns.

These simplifications will make it easier for States and other interested groups to conduct outreach efforts and will make it unnecessary for beneficiaries to hire paid preparers to claim the credit.

Now, let me next talk about work incentives. What makes the earned income credit unique in our income maintenance system is that it is designed to encourage work. Because the credit is a percentage of the first \$7,750 of earned income, it encourages people to earn at least that amount of income. Indeed, in this income range, the credit more than compensates for the burden of payroll taxes.

However, the credit is phased out at higher income levels, and thus for taxpayers whose income is within the phaseout range, the credit acts as a deterrent to earning additional income.

When you consider the phaseout of the earned income credit plus Federal income taxes, State income taxes, and payroll taxes, the cumulative effect of all these items on the incentive to earn additional income can get quite high. Indeed, the implicit tax can be over 50 percent in certain cases.

It is important as you reform the credit not to steepen that phaseout range in order to aggravate this problem of people within the phaseout range having a very high effective tax on their additional income. The temptation is to pour money down to people below the poverty level and then make that back by phasing the credit out quickly, and that really needs to be resisted, because otherwise you would have a very adverse impact on work incentives for people in that phaseout range when you add in State income taxes, local income taxes, Federal income taxes, the payroll tax, and so on and so forth.

I noticed that the administration's proposal does continue to phase out the earned income credit relatively modestly, and I think it deals with work incentives in an appropriate way.

One last point: The administration proposes to extend the credit to childless couples and single persons. It is attractive, of course, to provide tax relief to low-income singles and childless couples to offset the burden of energy taxes on them. But in my opinion, providing greater relief and greater work incentives to people with children is a higher priority. Much of the benefit from providing the credit to single persons and childless couples will go to students and people with nontaxable income sources like Social Security. And so I think you ought to consider that proposal quite carefully.

The upcoming revenue bill will give the committee an opportunity to simplify the credit and to improve its impact on work incentives. It will also provide a temptation to create further complexity and weaken work incentives, and I encourage the committee to take advantage of the opportunity and to resist the temptation.

[The prepared statement follows:]



STATEMENT OF JAMES W. WETZLER  
NEW YORK STATE COMMISSIONER OF TAXATION AND FINANCE  
BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS  
SUBCOMMITTEES ON SELECT REVENUE MEASURES AND HUMAN RESOURCES  
ON SELECTED ASPECTS OF WELFARE REFORM

March 30, 1993

I appreciate the opportunity to testify about the earned income tax credit. From its modest beginnings in 1975 as a means of providing assistance to low-income working parents to offset the burden of payroll taxes, the earned income credit has grown into a significant part of our income maintenance system. President Clinton's proposal to expand the credit by about 50 percent will give Congress an opportunity to reassess the role of the credit and whether, as currently structured, it is adequately performing that role.

Three types of changes to the credit are needed: (1) It should be increased by at least as much as is needed to offset the costs of new energy taxes on families with children, (2) it should be simplified, and (3) its impact on work incentives should be improved. The first item will obviously depend on budgetary considerations. Let me discuss the second and third of these changes.

#### Simplification

Like so many government programs, the credit, as it has gotten bigger, has been asked to achieve a wider array of social goals. For example, it now encourages beneficiaries to buy health insurance and to stay at home to care for infant children. As a result, the credit has become much more complicated, so that eligible persons face much more difficulty claiming it. The present rules are incomprehensible to a large number of potential beneficiaries. To the extent beneficiaries must use paid return preparers, the assistance provided by the credit is diluted. An important goal of this Committee should be to simplify the credit, which inevitably will mean making choices about just which social goals the credit should be designed to serve.

Structured primarily as an offset to payroll taxes for low-income parents, the original earned income credit was quite simple by present-day standards. In 1978, the credit was further simplified so that taxpayers or the Internal Revenue Service could compute it from elements already present on the individual income tax return -- earned income, filing status, dependency exemptions, and adjusted gross income. If taxpayers failed to claim the credit, the Internal Revenue Service could grant it to them as part of the ordinary processing of income tax returns. As late as 1990, the instructions for the credit were less than two pages long.

In 1990, Congress abandoned the concept of a simple earned income credit. It differentiated the credit by family size and added additional credits for infants whose parents do not incur significant child care costs and for health insurance. Congress also broke the link between the determination of eligibility for and computation of the credit and the other elements of the tax computation. Today, the earned income credit requires a separate schedule on the tax return, the instructions for which are seven pages long. This complexification of the credit has gone too far, and Congress should seriously consider returning to the original concept of a simple credit.

The special credit for infants should be repealed. At a minimum, the requirement that the taxpayer choose between the infant credit and the child care credit should be eliminated. The health insurance credit should be repealed on the assumption that Congress will address this concern in its health care reform bill. (The revenue from repeal could be reserved to fund health care reform.) The existing differentiation of the credit by family size, which is only \$77 in 1993, should either be repealed or made sufficiently meaningful to warrant the complexity it creates. The eligibility for, and the computation of, the credit should be relinked to elements of the tax computation, so that the IRS can determine

taxpayers' eligibility and compute their credits from the tax return without the need for a separate schedule and seven pages of instructions.

These simplifications will make it easier for states and interested groups to conduct outreach efforts for eligible beneficiaries. They will make it unnecessary for beneficiaries to hire paid preparers to claim the credit.

#### Work incentives

What makes the earned income credit special in our income maintenance system is that it is uniquely designed to encourage work. Because the credit (in 1993) is a percentage of the first \$7,750 of earned income, it encourages people to earn at least that amount of income. Indeed, in this income range, the credit more than compensates for the burden of payroll taxes. However, the credit is phased out at higher income levels, and thus, for taxpayers whose income is within the phaseout range, between \$12,200 and \$23,070 of income, the credit acts as a deterrent to earning additional income because the phaseout of the credit acts as an additional tax on incremental income. For a taxpayer eligible for all three existing credits, the implicit tax in the phaseout range can be almost 22 percent, and will exceed 25 percent next year.

As it reforms the earned income credit, the Committee should consider the impact of the credit phaseout on work incentives for persons whose income is in the phaseout range. When one considers the impact of ordinary federal income taxes (15 percent in this range), state and local income taxes (as much as 7 percent in New York City), the payroll tax (15.4 percent) and the loss of earned income credit benefits as income rises, the cumulative marginal tax rate can get very high if the earned income credit is phased out too rapidly. Today, one sees effective marginal tax rates exceeding 50 percent for some earned income credit beneficiaries.

President Clinton has promised that a family with one full-time worker earning the minimum wage will receive an earned income credit sufficient to lift its income to the official poverty level, or to almost \$15,000 for a family of four. The Administration has not yet presented a specific proposal to achieve this goal, and I am skeptical that it can be readily achieved within the \$6 billion per year budget constraint for the earned income credit component of the Administration's tax program. The temptation will be to make the credit more generous for persons below the poverty level and to make up the costs of this generosity by phasing out the credit more rapidly. This would further weaken work incentives for taxpayers in the phaseout range. There will also be a temptation to add further complexity to the credit to make it more precisely reflect the campaign promise. I would caution the Committee about making a fetish over this particular campaign promise to the extent that it conflicts with the goals of simplification and work incentives.

A widely leaked draft version of the Clinton program proposed extending the credit to childless couples and single persons, although these ideas were not included in the published summary of the Administration's revenue proposals. While it is attractive to provide relief to low-income single persons and childless couples to offset the burden of energy taxes on them, providing greater relief and greater work incentives to persons with children is a higher priority. Much of the benefit from providing the credit to single persons and childless couples would go to students and persons with nontaxable income sources like social security.

#### Conclusion

The upcoming revenue bill will give the Committee an opportunity to simplify the earned income credit and improve its impact on work incentives. It will also provide a temptation to create further complexity and weaken work incentives. I encourage the Committee to take advantage of this opportunity and resist the temptation.

Acting Chairman MATSUI [presiding]. Thank you, Mr. Wetzler. Mr. Hines.

**STATEMENT OF THOMAS HINES, EXECUTIVE DEPUTY COMMISSIONER, NEW YORK STATE DEPARTMENT OF LABOR**

Mr. HINES. Good afternoon, Chairman Matsui, members of the committee. I would like to speak today about the effectiveness of the targeted job tax credit program in New York State. I have submitted written testimony. I am going to summarize it briefly and respond to questions as necessary.

Before I begin, I would like to thank the members of all the committees for their historical support in making TJTC one of the most valuable avenues of moving people off public assistance rolls and on to the tax rolls. In 1992 alone, approximately 24,000 New Yorkers found employment through participation in the TJTC program.

Since the program began in 1979, more than 400,000 TJTC participants were hired by employers who realized tax credit savings of more than half a billion dollars. Since the program expired at the end of June of last year, we have received tens of thousands of applications from individuals and over 50,000 letters of inquiry from employers who wish to participate in the program when it is reinstated.

We believe TJTC works. It has made a real difference in the lives of hundreds of thousands of economically disadvantaged men and women who have faced real or perceived barriers to employment. These people are now working, supporting their families, and paying taxes instead of collecting public assistance. At the same time, employers are saving millions of dollars in the form of tax credits while they are gaining valuable and trained employees.

These savings to the taxpayers are very tangible. We estimate in 1992 alone the U.S. taxpayers saved up to \$26.8 million when TJTC participants in New York State stopped collecting AFDC assistance and began earning wages.

In New York State, we estimate that an additional savings of approximately \$9.3 million occurred when thousands of TJTC participants went off Home Relief and went on to payrolls.

We like to think of TJTC and other job stimulation tools as our most effective way of controlling social service expenditures. In addition to public assistance savings, individual States realize savings in prison expenditures when ex-offenders are given a chance to get a meaningful job through the TJTC program. In New York, we estimate the annual cost of housing one prisoner to be \$40,000. In 1992, 1,600 ex-offenders participated in this program.

If TJTC keeps only 10 percent of these individuals from committing new crimes and going back to prison, the savings alone is \$6.5 million a year.

Beyond tax savings, more millions are being pumped into the economy as TJTC recipients eventually can afford, perhaps for the first time in their lives, to pay for such items as housing, goods and services, and additional education.

The multiplier effect as described by leading economists indicates that for every dollar in wages a TJTC recipient earns, \$3 flow through the economy. That means that of the estimated \$3.5 billion of payroll New York participants have earned since 1979, approxi-

mately \$10 billion has been added to the State and national economies.

Another targeted group greatly benefited by participation in TJTC is our youth. The program actually opens the doors that would ordinarily be shut tight during a recession of the kind we are currently experiencing. The unemployment rate for youth aged 16 to 19 is a staggering 22 percent. These young people represent only 7 percent of the population, but they represent 10 percent of those who are unemployed. Placing youth in TJTC programs encourages employers to have a look at these young people who could become valuable employees.

As Congress considers reinstatement of the program, I urge you to give careful consideration to reopening eligibility of the program to 23- and 24-year-olds. Many of these young people are just completing their education or getting out of the military at this age. They should have every opportunity to find viable employment so they can become contributing members of the community.

I also urge Congress to consider the issue of eligibility for veterans. I strongly support the removal of the specific Vietnam-era veterans category and ask that you extend TJTC eligibility to all disadvantaged veterans. In New York, approximately 10 percent of people currently unemployed and receiving benefits are veterans.

As Congress moves to restore this program, it is imperative that you also make available adequate funds to support the administration of the program. Applicant screening, eligibility determination, completion of forms, receiving and filing certificate requests, and statistical recording and reporting are all statutory requirements of the TJTC legislation.

New York, like most States, has scarce resources to cover these costs. Without Federal funding to cover administrative costs, the burden on States would be harmful to the effectiveness of the administration of the program.

The targeted jobs tax credit program is a model of an initiative that has worked, and worked well, in this country. Everyone who participates in the program is a winner—from the economically disadvantaged workers to the employers who hire them, to the State and national taxpayers who see hundreds of thousands of men and women move on to the tax rolls.

I urge Congress to move swiftly to reinstate this invaluable program retroactively to July 1, 1992, and to make it accessible to those who just need someone to take a chance on them so that they can put an end to their own cycle of poverty and become productive members of society.

Thank you.

[The prepared statement and attachments follow:]



**STATEMENT OF THOMAS HINES**  
**New York State Department of Labor**

Congressman Rangel, Congressman Matsui, distinguished members of the Subcommittees on Select Revenue Measures and Human Resources, ladies and gentlemen, I am Thomas Hines, Executive Deputy Commissioner of Labor of the New York State Department of Labor. I welcome this opportunity to testify on the Targeted Jobs Tax Credit (TJTC) program on behalf of the State and citizens of New York.

I first want to thank you, especially, Congressman Rangel, for your constant espousal of the cause of the over 400,000 economically disadvantaged New York job seekers who have benefitted from the Targeted Jobs Tax Credit program since its inception in 1978. Your continued vigilance in this matter means that thousands more job seekers and employers will be brought together again in years to come when the Program is re-authorized.

Today, I would like to update you on how successful the program has been in New York State. My testimony will cover the following points:

- The need to make the Targeted Jobs Tax Credit program a permanent part of the nation's job creation and economic development strategy;
- The success of the program in New York State in encouraging employers to hire economically disadvantaged individuals and provide them with full-time employment;
- The budgetary cost savings associated with the shifting of individuals away from public assistance, home relief and other government funded subsidies to self-sustaining full-time employment;
- The direct economic benefit and stimulus effect throughout the national and state economies from the thousands of jobs associated with the Program;
- The need to restore program eligibility for 23-24 year old economically disadvantaged individuals, whose unemployment has reached 15 percent.
- The positive response of the business community to our direct mail application and monitoring process.

New York State continues to be one of the nation's leaders in employer use of TJTC. This program has been well-received in the business community and forms one of the foundations of the State's Business Incentive Tax Program. The benefits of TJTC are so evident in opening the door to jobs for the economically disadvantaged, hard-to-place employees, and those who are marginally impaired in seeking employment.

We have worked hard to make it easier for both employees and employers to take advantage of the program. Despite the June 30, 1992 expiration date for TJTC certifications, we issued over 18,000 tax credits during a year when many states were closing down their operations.

The New York State Labor Department provided eligibility determinations for over 39,000 people in FY 1992. As a result, employers obtained tax credits for 18,743 individuals.

We continue to pre-approve the eligible job seeker through our Community Service Centers and local offices. These applicants present their TJTC certification to potential employers who simply have to contact the State's central TJTC processing center on or before the applicant begins work to get their application approved.

Mail applications for tax credits have further broadened the use of the program by the employer community. Use of our mail-in application program and central staff processing system has resulted in an increase of over 25 percent in the number of

employer mail-in applications processed by the department in FY 1992 over the prior year.

We also are part of the marketing and promotional campaign to inform businesses not only of the TJTC program, but the full array of economic development incentives available to them. For these reasons, the State of New York urges favorable action by your Committee and the full Congress, to extend and make permanent this important employment program.

In New York State, we have seen countless examples of men and women who have overcome real or perceived barriers to employment and now have rewarding careers that allow them to provide for their families with dignity.

There is no doubt that TJTC has had a profound impact on the lives of thousand of individuals who went into the program with marginal skills and uncertain futures. But at the same time, TJTC has also benefitted hundreds of employers throughout New York, from national corporations such as Key Bank and the United Parcel Service to homegrown firms such as the Golub Corporation, a major supermarket chain in upstate New York and Stewarts Convenience Stores. By lowering the costs of just one factor of production -- labor -- TJTC has helped stimulate business development through the state. Businesses then use these savings to reinvest in their plant and equipment. As the business grows, so does the potential for new jobs and further economic growth.

Since its inception in 1978, the program has been universally praised by both employers and job seekers alike. TJTC is not a dumping ground for businesses to hire and then dispose of employees after their tax credits have expired. TJTC has shown itself to be the first step towards permanent employment for hundreds of thousands of economically disadvantaged men and women across the country.

The TJTC-subsidized job serves as a stepping stone from dependence to independence. Businesses know that by providing that first job, individuals who might otherwise remain in a government subsidized program are given a chance in a structured work setting. Budget savings result as persons belonging to targeted groups are placed in private sector jobs. Chart 1, provides a display of the eligibility criteria of those individuals eligible for TJTC.

During FY 1992, the TJTC program encouraged employers to hire approximately 24,000 economically disadvantaged and hard-to-place New Yorkers. As shown in Chart 1, approximately 30 percent are former public assistance recipients. Of the total, 6,952 New Yorkers who had been receiving Public Assistance; 3,769 were receiving Federal Aid to Dependent Children (ADC) benefits.

By transferring the source of these persons' income from government subsidies to private wage income, average annual savings of up to \$5,700 would be realized from the case closing, assuming a complete departure from the welfare roles.<sup>1</sup> Since the maximum tax credit for any individual hired is only \$2,400, and the average credit used by employers is only \$1,400 per employee, encouraging employers to take a chance on hiring public assistance recipients saved U.S. taxpayers up to \$26.8 million in social service spending last year. And these savings, unlike the one-time cost of the credit, continue.

In New York State, the savings are even greater since the costs of our Home Relief Program are fully borne by the State and its localities. We estimate that by placing people in TJTC jobs, the State and its localities were able to reduce Home Relief caseload and related medical insurance costs by \$9.3 million in FY 1992. The direct

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<sup>1</sup>. The average caseload in New York state consists of three persons. This analysis assumes a average caseload of two persons.

taxpayer savings generated by TJTC are shown in Chart 2.

In New York State, we like to think of TJTC and our other job stimulation tools as one of our most effective weapons in controlling social service expenditures. Similar budgetary savings occur each time we shift an individual away from a direct government subsidized program to private employment. Not only are we helping the individual achieve the dignity of a full-time job, but we are also making the best use of our scarce revenues.

We have been advised that many individuals with disabilities have become employed for the first time thanks to the entree provided by TJTC. Agencies specifically assisting this targeted population repeatedly point to the tangible financial benefits of TJTC in their meetings with prospective employers. TJTC benefits were instrumental in bringing roughly 1,800 physically challenged New Yorkers into the workplace.

Hiring ex-offenders has generated large savings. Because of a steady job provided by TJTC, they often can break the cycle of recidivism. It costs New Yorkers upwards of \$40,000 to keep a person in prison for a year. It costs the taxpayer only \$1,400 for an average TJTC credit. In FY 1992, 1,615 ex-offenders were placed in TJTC jobs. If TJTC helps keep just 10 percent of this population from returning to prison, the savings to the State's taxpayers would total \$6.5 million.

TJTC also benefits disadvantaged youth. The unemployment rate among the State's youth age 16 to 19 is a staggering 22 percent. They comprise 10 percent of the total unemployed population. Yet they only comprise 7 percent of the state's population. TJTC is one of the tools we have used, along with the Title II-B and State Summer Jobs monies to address the needs of our young. More importantly, TJTC places these young men and women in private sector jobs, thereby freeing up scarce public resources for other needy youth. We urge the committee to restore the eligibility for this group back through age 24. This would allow us to additionally serve up to 200,000 of our youth population.

The brave men and women who served in the armed forces in defense of our country also need our help. In FY 1992, we were able to place 443 disadvantaged Vietnam-era veterans in TJTC jobs. That is not enough. We must provide more for those who have served regardless of the enemy or the war. There are 1.7 million veterans in New York State. Approximately 10 percent of all people in New York State who are currently receiving unemployment insurance benefits are veterans. The proven track record of TJTC in helping bring employers and job seekers together would provide a powerful weapon in reducing unemployment among our veteran population. We fully support efforts to expand the program's eligibility to include all veterans.

We estimate that the total amount of the TJTC payroll for the more than 400,000 participating New Yorkers hired since 1978 is roughly \$3.5 billion. The cumulative multiplier effect from this economic stimulus could be as high as \$10 billion. This is not to say that this economic activity occurred only as a direct result of the TJTC program.

The important point is not whether the lowering of labor and production costs through the provision of TJTC has resulted in new economic and job development activity. That is a reasonable assumption, whether it can be scientifically proven or not. The most important point is that jobs were created and people with prior barriers to the job market are now contributing to society.

New York has been particularly hit hard by the prolonged national recession and economic downturn of the past four years. Our unemployment rate more than doubled from 1988 to 1991 and it currently remains above eight percent. The 1992 unemployment rate for minority youth was a staggering 38 percent. Even

experienced and white collar workers have become permanently displaced by the massive restructuring of the State's industrial and financial service sectors. As of November 1992, there were 200,289 employable public assistance and 182,466 home relief recipients in New York State. Overall there are an estimated 2.2 million New Yorkers who are in need of employment and training to help them overcome their barriers to full participation in the work force.

The current Job Training and Partnership Act, our JOBS program, and other state-funded programs can not reach all those in need. In recent years, uncertainty regarding the availability of federal funding, coupled with the scarcity of state and local resources, have forced us to provide our services to ever smaller groups. We are optimistic that under the new Administration this will change and the necessary resources will be forthcoming.

New York has led the nation in utilizing TJTC as a valuable job creation and economic development tool. Our commitment to TJTC will continue and you can be assured of our ongoing participation and support. However, we urgently need adequate funds to support the costs of administering the program. While some TJTC activities are an integral part of the Department's Job Service activities in our Community Service Centers and local offices, many are not. Also, much of the program is administered centrally in the Department. Applicant screening, eligibility determination, completion of TJTC forms, receiving and filing requests for certification and statistical recording and reporting are all statutory requirements placed on the states by the TJTC legislation. It is imperative that the reauthorization include an expanded appropriation of sufficient administrative funds for state operations.

The Targeted Jobs Tax Credit Program is a model of an initiative that worked, and worked well, in this country. Everyone who participates in this program is a winner -- from the economically disadvantaged workers, to the employers who hire them, to the state and national taxpayers who see hundreds of thousands of men and women move from the public assistance rolls to the tax rolls.

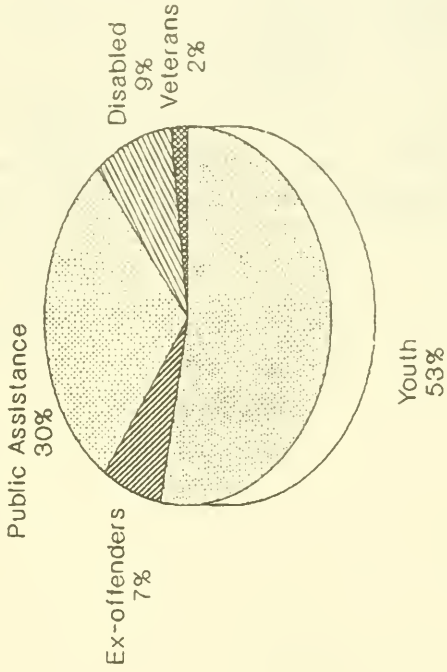
I urge the Congress to move swiftly to reinstate this invaluable program and make it accessible to all of the men and women who just need someone to take a chance on them so that they can end their own cycle of poverty and become productive members of society.

Thank you.



Chart 1

# TJTC Eligibility Characteristics for FY 1992



Source: New York State Department of Labor

Chart 2

Taxpayer Savings Generated by the TJTC Program in FY 1992

Government Payment	Case Savings <sup>1</sup>	Federal Savings	State/Local Savings
Welfare-Federal ADC	\$4,600	\$ 17.4 million	\$ 17.4 million
Welfare-State Home Relief	\$3,900	--	\$ 5.7 million
Medical Insurance-ADC	\$2,500	\$ 9.4 million	\$ 9.4 million
Medical Insurance-HR	\$2,500	--	\$ 3.6 million
Federal-SSI	\$3,500	\$ 1.0 million	--
Cost of TJTC Credit	\$1,400 <sup>2</sup>	\$ (27.8) million	--
Net Taxpayer Savings		\$ 18.1 million	\$ 45.3 million

1. Annual case savings reflect an average two person case and a 50 percent retention rate for employees.

2. Assumes an average TJTC tax credit is \$1,400 per employee.

Chart 3

Demographic Characteristics of TJTC Employees in FY 1992

	Characteristic	Employees	Percent of Total
Sex:	Male	11,545	46.1%
	Female	11,981	50.9%
Age	16-18	3,447	14.7%
	19-24	12,452	52.9%
	25-34	4,739	20.1%
	35 and over	2,888	12.3%
Race/Ethnicity	White not Hispanic	10,008	42.5%
	Black not Hispanic	7,495	31.9%
	Hispanic	4,438	18.9%
	American Indian	103	0.4%
	Asian/Pacific Islander	431	1.8%
	Other	1,051	4.5%

## Chart 4

Distribution of Wages to TJTC Employees in FY 1992

	Employees	Percent of Total
Under Federal Minimum <sup>1</sup>	294	1.2%
Federal Minimum	56	0.2%
\$4.26-\$4.99	14,449	61.4%
\$5.00-5.99	5,397	22.9%
\$6.00 and over	3,330	14.2%

<sup>1</sup>. Composed of persons earning tip income.



Chairman RANGEL [presiding]. Thank you, Mr. Hines.  
Mr. Burtless.

**STATEMENT OF GARY BURTLESS, PH.D., VISITING PROFESSOR OF PUBLIC AFFAIRS, UNIVERSITY OF MARYLAND, AND SENIOR FELLOW, ECONOMIC STUDIES PROGRAM, THE BROOKINGS INSTITUTION**

Mr. BURTLESS. Thank you. I am sorry I have to leave early today. My wage is paid by the taxpayers of Maryland and the tuition payers at the University of Maryland, and they expect me to stand in front of a class and teach this afternoon.

I would like to talk briefly about two different tax credits. The first is the earned income credit; the second is the targeted jobs tax credit. Both credits have a common goal. They aim to put money in the pockets of low-wage workers in this country. They just use a different method to achieve that goal.

The earned income credit tries to achieve it by reducing the tax burdens on low-income breadwinners or giving them refundable tax credits if they have earnings. The credit directly raises the net incomes of about 13 million breadwinners—and I am accepting the Green Book's estimate—and it may indirectly encourage some workers to raise their pretax earnings by inducing them to work more than they would work without the credit.

The targeted jobs tax credit takes a different approach to the problem. It offers potential employers tax credits if they put hard-to-employ workers on their payrolls. Because target group workers cost less money to hire, we expect employers to hire more of them, boosting the earnings of disadvantaged job seekers.

Now, you might say that the EITC is a bribe to workers to join the work force or earn more. The TJTC is a bribe to employers to give disadvantaged workers a chance and better job opportunities.

How do the two credits work? The surprise here is that even though we spend a lot more money on the earned income credit, I think we know a lot more about the effects of the targeted jobs tax credit. It has been the subject of a lot closer evaluation and scrutiny.

On balance, my judgment is that the earned income credit achieves its goal of raising the net incomes of low-income breadwinners. However, it probably reduces their gross or pretax earnings somewhat. I am merely saying what the GAO has already said, I think, and what some later witnesses will say, too.

The TJTC fails to raise either the aftertax or the pretax earnings of target group members. The credit fattens the bottom lines of participating companies without really changing the hiring decisions they make. Companies would have hired nearly all those target group workers even if the credit hadn't been available.

At the same time, we have good experimental evidence showing that nonparticipating companies actually discriminate against job applicants from the target groups once they learn that these job applicants are covered by the credit.

In other words, the credit probably harms the job prospects of more low-wage workers than it helps. So I think the credit should be scrapped or drastically modified.

Let me talk about these two credits one at a time. Many people think the EITC unambiguously encourages work because it raises the net incomes of workers, but leaves the incomes of nonworkers unchanged. Part of this is certainly true. I expect the credit does sometimes tip the balance in favor of work and against continued public dependency for some people. But for people who already work, the credit has a different kind of effect. It is a moderate work disincentive, as is explained in my testimony and explained by others.

There are more people in the income range where the credit hurts work incentives than there are in the income range where it helps work incentives. So I suspect the program probably reduces low-wage workers' pretax earnings, if only a bit.

So why do I strongly favor the program? Well, if you can find another program that succeeds in transferring \$10 to \$12 billion a year to low-income families while creating such small work disincentives, I think you should certainly consider it. But I don't see any program like that out there. The EITC is the best program we have that gives a hand to hard-to-employ workers without imposing a big penalty on their own efforts to help themselves. That is why I favor liberalizing the program further, although I would continue to restrict the credit to workers who are responsible for supporting children or elderly and disabled relatives.

On the TJTC, let me just say this: The program has survived since 1978, with a couple of lapses, without any very persuasive evidence that it actually helps the people it is supposed to help. The program reduces the tax liabilities of participating companies without really changing their hiring decisions. The extremely low takeup rates in the program invite great skepticism that the program is really working. A lot more workers in the target groups get jobs each year than are claimed for tax credits on employers' tax returns.

The most depressing evidence about the credit is summarized in my formal statement. Basically, the Government has conducted two experiments to see how the program's performance could be improved. What it found instead was how much the program was hurting workers' chances of finding jobs. The basic idea in the experiments was to get target group members to advertise their eligibility to prospective employers. One theory about why so few employers use the program is that they don't know which of their job applicants is eligible or which of their new job hires is eligible. If they knew, they would go out of their way to hire these target group members.

Well, the experiments showed that just the reverse is true. When employers were told which of their applicants were eligible for the credit, even though they were offered a \$4,500 bribe to hire these people in the form of tax credits, they were a lot less likely to offer jobs. Compared to a second group of identical workers who didn't advertise their eligibility for the credit, the group that advertised its eligibility landed a lot fewer jobs.

This isn't the finding of one experiment in one mildly deranged labor market. This is the finding of two different experiments conducted in three different labor markets.

Well, the state of affairs, in my opinion, is this: We have offered a credit for 15 years. Few employers use it. Few workers are hired under it. And we have very reliable evidence that the credit hurts the job opportunities of eligible people who advertise their eligibility to prospective employers.

A natural question occurs to me. Why do we still offer this credit or why do we want to reauthorize it? It costs real money, which could be better spent in programs that we're sure work, and it probably hurts the very people it is intended to help, or at least some of them. If we want to help low-income workers by giving subsidies to someone, the evidence suggests that we should give the money directly to low-wage workers themselves, not to their prospective employers.

Thank you.

[The prepared statement follows:]

EFFECTIVENESS OF THE EARNED INCOME AND  
TARGETED JOBS TAX CREDITS

Testimony for the  
Subcommittee on Human Resources and  
Subcommittee on Select Revenue Measures  
Committee on Ways and Means  
U.S. House of Representatives

March 30, 1993

by

Gary Burtless<sup>1</sup>

*Summary*

The Earned Income Tax Credit and the Targeted Jobs Tax Credit represent two related, though distinctive, approaches to helping low-wage workers. The Earned Income Tax Credit, or EITC, supplements the wage earnings of low-income breadwinners by providing them with refundable income tax credits. The Targeted Jobs Tax Credit (TJTC) encourages private employers to offer jobs to the hard-to-employ by providing companies time-limited, nonrefundable credits covering part of the wages paid to eligible workers. The EITC attempts to boost the earnings of low-wage workers by encouraging them to become employed or increase their work effort; the TJTC seeks to raise the earnings of disadvantaged workers by persuading private employers to hire more of them.

Neither approach to helping disadvantaged workers has aroused much political controversy. First enacted in 1975, the EITC has been liberalized several times since that year, in each case with little political opposition. Many people, including myself, favor further liberalization of the program. Nonetheless, it has been the subject of remarkably little scrutiny. The TJTC was first authorized in 1978 and, with modifications, has survived to the present day without any very persuasive evidence it actually succeeds in improving the job prospects of target-group members.

In my testimony I will assess the effectiveness of the two tax credits. Have they succeeded in raising the net incomes of disadvantaged workers? Have they raised the gross (or pretax) earnings of target-group workers?

My interpretation of the evidence is mixed. It seems likely that the EITC has raised disadvantaged breadwinners' net incomes -- that is, their wage earnings net of tax payments and tax credits. I think it unlikely, however, that the EITC raises the *pretax* earnings of workers who receive the credit. It almost certainly induces some nonworkers to join the labor force, and it encourages workers with earnings below about \$7,760 a year to raise the amount they work. On the other hand, it probably discourages extra work among an even larger number of breadwinners.

Workers who earn more than \$7,760 but less than \$12,200 a year receive no marginal incentive to work extra hours, but they do receive a higher net income than they would without the credit. This probably reduces the work effort and earnings of at least a few of these workers. Some breadwinners who earn between about \$12,200 and \$23,000 work a little less than they would in the absence of the EITC. Their net incomes are raised by the credit, and their marginal tax rates are raised by 13-14

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<sup>1</sup> Visiting Professor of Public Affairs, University of Maryland, and Senior Fellow, the Brookings Institution, Washington, D.C. The views expressed are solely my own and should not be ascribed to the University of Maryland or to the staff or trustees of the Brookings Institution.



percentage points as a result of the phase-out of the credit. Both these changes in a worker's tax status tend to discourage work on the margin. Even if the combined effect of the work disincentives is small for each person affected, many wage earners fall in the relevant income range. While the work reduction is probably small in the aggregate, it offsets to some extent the intended redistributive impact of the credit by lowering the pretax earnings of some breadwinners affected by the credit.

The most powerful argument in favor of the EITC is that it raises the net incomes of participating families without causing sizable reductions in their own self-support. *In comparison with other methods of reducing the tax burdens or raising the transfer benefits of the working poor, the EITC has a very small work disincentive effect.*

My interpretation of the evidence on the TJTC is much less favorable. The credit has never provided benefits to more than a small fraction of the population eligible for coverage under the program. Evaluations of the credit in the mid-1980s indicate that a high percentage of tax expenditures on TJTC goes to employers whose hiring behavior is unaffected by the credit. Other evidence is even more discouraging. Two government-funded experiments suggest that when employers learn that a worker is eligible for coverage under the TJTC they are less likely to hire the worker. On balance, the credit probably *harms* the employment opportunities of more workers than it helps. Our experience with this program provides no reliable evidence that it helps intended beneficiaries. The credit should be scrapped or fundamentally reformed.

#### *Earned Income Tax Credit*

The EITC was passed by Congress in 1975 mainly to offset social security taxes and to encourage job holding among poor breadwinners with children. Instead of shrinking as a recipient's earnings grow, the credit rises, at least up to a specified limit. At low earnings levels the credit increases by 18¢ or 19¢ for each extra dollar earned by the breadwinner. Parents who have no wages are ineligible to receive the credit, so the credit provides a modest incentive for unemployed parents to find work.

The maximum credit is now a little over \$1,500 a year for families containing two or more children. This credit level is achieved when annual earnings reach \$7,760. When a family's earnings rise above a moderate threshold (about \$12,200 in 1993), the credit is gradually phased out. It is eliminated altogether when a family's income exceeds about \$23,000 a year. Since its introduction in the mid-1970s, the program has enjoyed steady popularity in Congress. Liberalized in 1986 and 1990, the EITC now transfers about 40 percent as much money to low-income families as the AFDC program.<sup>2</sup> About 13 million families received a credit averaging \$680 in 1991. The value of the credit is projected to rise fairly steeply over the next couple of years, even if Congress does not liberalize the program in the current session.

The EITC is a form of income supplement known as an earnings subsidy. Many economists are more enthusiastic about an earnings subsidy than other types of government benefits because it encourages rather than discourages work among the eligible population.

The basic purpose of government transfers to the poor is to raise recipients' income and consumption. However, most transfers induce behavior on the part of recipients that offsets part of the intended redistributive effect of the transfer. In particular, most transfers, like public assistance and food stamps, discourage work among recipients. They raise recipients' nonwage incomes, thus diminishing the need for recipients to work. And they reduce recipients' net wages, thus lowering the reward from work. An earnings subsidy raises recipients' nonwage incomes, like other transfer

<sup>2</sup> In fiscal year 1991, the total amount of the EITC was estimated to be \$8.75 billion (1991 *Green Book*, p. 901) while public outlays on AFDC benefits amounted to \$20.7 billion.

benefits. But it raises rather than reduces the reward for work by increasing the recipient's net wage.

If the earnings subsidy is to be restricted to the low-income population, it must be limited in some way. Otherwise, highly paid workers would receive much larger subsidies than the poor. The EITC does not give any extra subsidy for working to breadwinners who earn more than \$7,760 a year. This implies that it provides an inducement to work extra hours only for those with very low levels of work effort. People whose wages are already above \$7,760 are made better off by the credit, but their reward for working longer hours is left unchanged. The credit provides no incentive for extra work on the margin, but by raising families' incomes by \$1,500 a year (the maximum credit) it reduces the necessity for family members to work as much when their earnings are between \$7,760 and \$12,200.

When breadwinners' earnings exceed \$12,200 a year, the EITC constitutes an unambiguous work disincentive, no different in effect than public assistance or food stamps. In this range, breadwinners' incomes are higher than they would be without the credit. Moreover, the phase-out of the credit raises the marginal tax rate on earnings by 13 or 14 percentage points, nearly doubling the federal income tax rate faced by most low-income families. Both the need for extra work and the reward for working have been reduced by the credit. Results from the Seattle-Denver Income Maintenance Experiment suggest that for breadwinners in this income range the EITC will reduce work effort by a small but noticeable amount.

It is hard to assess the overall impact of the EITC on work effort of the poor. I'm sure some potential breadwinners who would otherwise be unemployed are encouraged to take jobs as a result of the credit. Many if not most working-age people on public aid would prefer work and self-support to a life of dependency. By raising the net income a family can receive when the breadwinner goes to work, the EITC can tip the balance in favor of work and against continued public dependency. This effect of the credit is wholly positive.

But it is difficult to avoid the conclusion that this effect of the program is offset by the program's work disincentive effects, especially among families earning between \$12,200 and \$23,000 a year. There are probably many more breadwinners in the income range where work effort is discouraged than there are breadwinners earning less than \$7,760, who are encouraged to work harder or longer. Hence, the EITC probably reduces work effort in the aggregate, if only slightly.

Assuming that the EITC slightly reduces total earnings, how should this affect our view of the program? An earnings subsidy like the EITC improves the net incomes of poor breadwinners responsible for raising children. For some breadwinners, the income gain might be just large enough to keep them from applying for or remaining eligible for public assistance. It certainly improves the situations of low-income families who are not currently receiving welfare. And it makes work more attractive to some single mothers who do not work at all.

The major argument for this kind of earnings subsidy -- one that I find persuasive -- is that it raises the well-being of participating families without causing major reductions in low-income families' own self-support. Most taxpayers probably approve of the distributional consequences of the program because, unlike public assistance, it provides larger rewards to beneficiaries who do the most to support themselves. In comparison with alternative methods of transferring income to low- and moderate-income families, the EITC probably creates far smaller adverse incentives.

Congress and the Administration are still faced with painful trade-offs if they want to make the EITC more generous or improve work incentives in the program. If the earnings subsidy rate were raised for very low-income earners, the maximum credit amount would increase. While this is desirable from the point of view of making work

more attractive, it also raises the required phase-out tax rate for the credit, discouraging extra work among people whose incomes are in the phase-out range.

In order to keep the phase-out tax rate fairly low, the President and Congress might increase the income threshold where the credit is totally phased out, raising it from \$23,000 to, say, \$30,000 or \$35,000. While this strategy certainly decreases marginal tax rates in the phase-out range, it increases the proportion of workers who face marginal tax rates affected by phase-out of the EITC. Moreover, this design greatly boosts the cost of any liberalization because it extends EITC benefits to a larger share of the population. In the absence of very careful simulation analysis by the staff of the Joint Tax Committee or the CBO, it is hard to decide on the best liberalization strategy from the point of view of encouraging work among low- and moderate-wage workers.

If Congress liberalizes the EITC in the current session -- a policy that I favor -- I think the most prudent course would be to keep the phase-out tax rate as low as possible, even if this means that workers with moderately high incomes receive benefits under the program. It seems to me preferable to impose slightly higher marginal tax rates on a very broad population than to discourage work through sharply higher marginal taxes on a narrow group of moderate-income families.

### *Targeted Jobs Tax Credit*

The theory behind the TJTC program is simple. The federal government offers to reimburse employers for a fraction of the wages they pay to workers in selected target groups. The reimbursement is limited to a maximum amount and to a restricted period -- currently 40% of an eligible worker's first-year wages up to \$6,000. Because the hiring subsidy makes the net cost of employing target-group workers lower than it otherwise would be, companies are encouraged to increase their employment of subsidized workers. This may occur either because overall employment grows as a result of the reduced cost of labor or, more likely, because employers replace unsubsidized with subsidized workers on their payrolls.

The first tax subsidy of this type was the WIN (Work Incentive Program) tax credit, which was enacted in 1971. The credit provided tax benefits to employers hiring participants in the Aid to Families with Dependent Children WIN program. (The WIN credit was later superseded by the TJTC program.) The TJTC was established in 1978. The population covered by the credit has varied over time, but now includes members of nine hard-to-employ groups, including public assistance recipients, economically disadvantaged youngsters aged 18 to 22, and low-income participants in cooperative education programs. Economically disadvantaged youngsters holding summer jobs are also covered by the TJTC, though the maximum credit in this case is limited to \$1,200 instead of \$2,400.

Workers must be certified as eligible for the credit by a designated local agency before employers can claim the TJTC on their tax returns. In addition, workers must be employed for at least 90 days or perform at least 120 hours of paid work for employers to claim the credit. (The work thresholds are somewhat lower for youngsters holding summer jobs.)

Faith in the TJTC is rooted in the belief that employers must find the offer of subsidized workers irresistible. This faith is difficult to reconcile with the low take-up rates that have characterized the TJTC program since its inception. Only a very small percentage of potentially eligible workers finds employment that is actually subsidized under the TJTC.<sup>3</sup> In fact, most target-group workers who find employment typically

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<sup>3</sup> Fewer than a half million workers a year are certified as eligible for the TJTC. Yet the nine target groups covered by the credit include many more people who are seeking work or who actually find work during a typical year.

work for firms which do not know about or bother to claim the tax subsidy. If subsidized workers are irresistibly attractive, it is hard to explain the failure of so many employers to hire them or to obtain tax credits for eligible workers whom they do hire.

*Wisconsin TJTC experiment.* If aggregate statistics about participation in the TJTC are depressing, experimental estimates of the credit's effectiveness are alarming. Two experiments were independently conducted during the early 1980s to see how the design and administration of the TJTC could be improved. The first and smaller of the two was carried out in Eau Claire and Racine, Wisconsin, and evaluated by the Institute for Research on Poverty.<sup>4</sup> About 330 TJTC- and WIN-tax-credit-eligible job seekers were enrolled in the experiment. The sample was randomly divided into two groups. Members of the treatment group were informed that they were eligible for the tax credit and were encouraged to supply this information to prospective employers when applying for jobs. Members of the control group were not instructed about the tax credits or trained in how to use the credits in their job search.

Results of the Wisconsin experiment were surprising and disquieting. Members of the treatment group were only about half as likely to obtain jobs as members of the control group. That is, people using the tax credit to find a job were less likely to get hired than people who were not told they were eligible for the credit. Puzzled by this outcome, the experimenters asked members of the sample whether they had informed prospective employers of their eligibility for the TJTC. Only 6% of the people who told employers they were covered by the credit got jobs, while 22% of the people who didn't mention their eligibility found employment. The authors of the evaluation concluded that the act of telling employers about one's eligibility for the tax credit caused a sizable drop in a worker's chances of landing a job.

*Dayton wage voucher experiment.* This conclusion from the Wisconsin experiment was reinforced in a later experiment conducted for the U.S. Department of Labor in Dayton, Ohio.<sup>5</sup> The experiment was designed and conducted without any knowledge of the findings from the smaller experiment in Wisconsin. The design of the Dayton experiment was very simple. A job-search and job-training agency in Dayton was used to recruit job seekers who were eligible for the TJTC. Slightly more than 800 eligible job applicants were enrolled in the experiment and were then randomly assigned to three different groups.

The first group was informed of its eligibility for TJTC and given written material describing the tax advantages to employers if TJTC-eligible workers were hired. This group was strongly encouraged to advertise its eligibility for the tax credit and to give explanatory material about the program to prospective employers. In 1980-81, when the experiment was conducted, the TJTC was more generous than it is today. The credit reimbursed employers for 50% of first-year wages and 25% of second-year wages up to a maximum two-year credit of \$4,500. (The maximum credit today is just \$2,400.)

The second treatment group was offered a similar hiring subsidy. The subsidy was equal in value to the TJTC, but it did not work through the tax system. Employers hiring eligible workers from this group were sent direct *cash* subsidy payments instead of tax credits to encourage them to hire the target-group workers. It was thought that employers who earned no taxable profits or who feared entanglement with the tax system might find cash hiring subsidies more attractive than a tax credit. However, for firms with positive tax liabilities, the cash subsidy had the same value as the TJTC. People enrolled in this group were given job-search training and written material that

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<sup>4</sup> Stanley Masters *et al.*, "Jobs Tax Credits: The Report of the Wage Bill Subsidy Research Project, Phase II" (mimeo), Wisconsin Department of Health and Social Services and The Institute for Research on Poverty, University of Wisconsin, Madison, WI (January 1982).

<sup>5</sup> Gary Burtless, "Are Targeted Wage Subsidies Harmful? Evidence from a Wage Voucher Experiment," *Industrial and Labor Relations Review*, Vol. 39, no. 1 (1985).



was similar to that given to the TJTC group. They were also encouraged to mention their eligibility for special subsidies when contacting prospective employers.

The third group of people enrolled in the experiment was not told about its eligibility for TJTC and was not encouraged to use TJTC in its job finding. Few members of this group even knew they were eligible. In other respects, however, these people received the same training and job search help as members of the other two groups.

Results obtained in the Dayton experiment mirror those from the Wisconsin experiment. Job seekers from the two groups enrolled in the hiring subsidy plans were much less likely to find jobs than job seekers in the control group. A simple tabulation of the findings is presented below.

#### JOB FINDING RATES IN DAYTON HIRING SUBSIDY EXPERIMENT

Treatment group	Sample size	Number finding jobs	Percent finding jobs
TJTC vouchered group	247	32	13.0%
Cash subsidy group	299	38	12.7%
Control group	262	54	20.6%
<i>Total</i>	<i>808</i>	<i>124</i>	<i>15.3%</i>

Source: Burtless, "Are Targeted Wage Subsidies Harmful?" *Industrial and Labor Relations Review* (1985).

The two groups encouraged to advertise their eligibility for hiring subsidies achieved a significantly lower average placement rate than did the control group (only 12.8% found jobs versus 20.6% in the control group). This finding implies that when employers learned that job applicants were covered by a hiring subsidy they tended to discriminate against them in hiring. Some employers may have reasoned that if the job applicants were so disadvantaged that they required a wage subsidy to find work, they were poor prospects for hiring and training. Alternatively, employers might have inquired to find out why applicants were eligible for the subsidy and learned that the applicants were public assistance recipients or economically disadvantaged. The employers evidently used this information to eliminate some vouchered job applicants from their hiring pool.

Although the job-finding success of the vouchered job applicants was substantially below that of members of the control group, there is no evidence the groups obtained different kinds of jobs. The average hourly wage of new hires in the two vouchered groups was \$4.07; the average wage among Dayton controls was \$4.06. The vouchered workers simply got fewer jobs and jobs that were no better than those obtained by members of the control group.

*Other experimental evidence.* Evidence from recent unemployment insurance experiments also suggests that hiring subsidies to employers is an ineffective way to improve employment prospects of the jobless. One of the reemployment bonus experiments offered UI claimants small bonuses if they found new jobs within a specified period of filing an initial claim for benefits.<sup>6</sup> The bonus caused claimants to

<sup>6</sup> S.A. Woodbury and R.G. Spiegelman, "Bonuses to Workers and Employers to Reduce Unemployment: Randomized Trials in Illinois," *The American Economic Review*, Vol. 77, no. 4 (1987).

end their unemployment spells significantly earlier than claimants not offered reemployment bonuses. As a variant of this basic plan, experimenters tried a second reemployment bonus scheme. They offered employers a small bonus if they hired UI recipients early in recipients' unemployment spells. When the bonus was offered to employers rather than unemployed workers, it had far less effect on the speed with which UI claimants found jobs. This result suggests that a subsidy paid directly to a worker — rather than to a prospective employer — has a much greater impact on the worker's chances of employment.

*Conclusion.* I interpret the findings from the Wisconsin and Dayton experiments to show that the design of the TJTC is seriously flawed. Economically disadvantaged workers who are clearly identified to potential employers as disadvantaged have a smaller chance of being hired than workers who are equally disadvantaged but who do not identify themselves as members of the disadvantaged target group.

The amount of damage inflicted by identifying a worker as disadvantaged must be considerable. The same document that alerted employers to the disadvantaged circumstances of a job applicant also informed them that up to \$4,500 of the job applicant's wages would be reimbursed by the government. Although the subsidized workers were offered to employers at a steep discount, employers seemed to interpret the discount to mean that subsidized workers were "damaged goods."

In view of this evidence, it is hard to see how the TJTC can be achieving its main goal. The program hurts rather than helps many of the workers it is supposed to benefit. To be sure, some companies use the program and claim large tax credits on their returns. A few of these companies may actually hire more target-group members than they would hire without the credit. But most hiring that is subsidized by the tax credit would occur anyway. The credit reduces government revenue (and fattens the bottom line of participating companies) without affecting the employment or earnings of the great majority of target-group workers whose wages are subsidized. At the same time, the findings from Wisconsin and Dayton suggest that the credit actually *hurts* the employment prospects of a sizable number of target-group members who advertise their eligibility for the TJTC but who do not find jobs.

The government revenue currently used to finance the TJTC should be diverted to other programs with proven benefits for disadvantaged workers — job search assistance, job training for adults, and the EITC. If we wish to offer subsidies to encourage extra employment among the disadvantaged, the evidence suggests we should give the subsidies directly to disadvantaged workers rather than to employers.

Chairman RANGEL. Thank you.

Dr. Burtless, how did you reach your conclusions? Did the University of Maryland study these programs?

Mr. BURTLESS. I was a Government employee at one time. I worked in the U.S. Department of Labor in the Office of the Secretary, and there we were responsible for carrying out a study mandated by Congress to figure out whether the TJTC could be improved. And we set up an experiment in Dayton, Ohio.

Unbeknownst to us, the Institute for Research on Poverty and the State of Wisconsin had conducted a similar experiment in Wisconsin, and they derived exactly the same results.

Chairman RANGEL. So you have those studies to make available to the committee?

Mr. BURTLESS. Sure. Actually, I have the study right here in my briefcase. I happened to bring the study that I published.

Chairman RANGEL. Now, I don't know really beyond studies. Unfortunately, I have to live with the targeted groups in both of these cases, and so I don't know when you were working for the Department of Labor exactly how close you got to the problem. But take the earned income tax credit. You have no problem in trying to keep these people working and the Federal Government encouraging it in one way or the other to keep working, rather than to make welfare more attractive, right?

Mr. BURTLESS. Absolutely correct.

Chairman RANGEL. Now, what would you suggest to this panel that we do other than to give them a transfer payment in their checks to support their efforts in working? I know that you don't like the system, but what is it that you would suggest that we do instead of that?

Mr. BURTLESS. I like the earned income credit. I favor its liberalization.

Chairman RANGEL. You have no problem.

Mr. BURTLESS. Yes.

Chairman RANGEL. OK. Now, with the targeted jobs credit, I have seen—first of all, when you have high unemployment, especially with teenagers, you are able to hire extremely qualified people. I mean, you can get college kids to do a lot of things when they can't get jobs other places, and so these employers, to me, don't have to hire the type of people that they are hiring now. They can hire people that don't come into the job market with the impediments that are outlined in the targeted jobs credit. People just don't want old people, disabled people, convicts. These are not groups that employers reach out for. You agree with that, right, doctor?

Mr. BURTLESS. Right. I think that the problem is that in many cases a job applicant shows up and asks for a job, and the employer really doesn't know that this job applicant has any serious problem or comes from a seriously disadvantaged background. And when we tell the employer that this person is a public assistance recipient, this person comes from a very disadvantaged family, that kind of information can tip the balance in the employer's mind and make the employer think maybe I don't want to hire this person. His or her problems are too serious for me to overcome, and the tax credit isn't going to make a difference.

That is the only conclusion that we can derive from the experiments.

Chairman RANGEL. Now, what study was that? Because we find the opposite to be true. And I wish we didn't have to bribe these people to hire them, but unfortunately, human nature being what it is, you know, one man's bribe is another person's incentive. But we are paying for it one way or the other.

What would you suggest that we do with these hard-to-place people?

Mr. BURTLESS. I think if the employer already knows what the disadvantaging condition is that the——

Chairman RANGEL. You have to assume he knows.

Mr. BURTLESS. But it turns out that they don't always know. In the Wisconsin experiment, about twice as many people——

Chairman RANGEL. Doctor, doctor, we can't find out subjectively what the guy knows or doesn't know. I am just saying most people come in—they don't even come in if they have got a record because they know if the guy next to them doesn't have a record, they take the one without the record. You have to assume that when a guy lays out that he is not very likely to get employed by other people, you have to assume the employer is finding that out for the first time, the same way I would find out with anyone applying. And I am saying that once you make that assumption, just for my sake, that here is a guy that is very difficult for me to find a job for, unless I pay off, bribe, or give an incentive to the employer or somebody, do you have any way we can handle this better?

Mr. BURTLESS. Well, job search clubs have helped a lot of people——

Chairman RANGEL. Clubs?

Mr. BURTLESS [continuing]. From very different kinds of background. Pardon?

Chairman RANGEL. Job search clubs?

Mr. BURTLESS. Job search clubs, yes. This is a different way to organize the job search activities of people.

Chairman RANGEL. OK. You have done research on that, too?

Mr. BURTLESS. Oh, yes.

Chairman RANGEL. Well, that will be very helpful. You have them in inner cities that you know of, in Cincinnati, Dayton, and Cleveland? They have these clubs?

Mr. BURTLESS. Yes.

Chairman RANGEL. OK. Well, maybe we can do something nationally to get these clubs more active, because I have never heard of them, but I probably missed it.

Well, I know that you have to leave. Are there any questions that other members of the panel have? I think we can excuse Dr. Burtless because he has a time schedule problem.

Acting Chairman MATSUI. Thank you, Mr. Chairman.

Commissioner Hines, let me ask you a question.

Chairman RANGEL. Hold it. I am sorry. I just wanted to see whether anyone, regardless of order, wanted to question Dr. Burtless. He had indicated that he had to leave.

[No response.]



Chairman RANGEL. Thank you so much, doctor, and share with this committee any other additional materials you have, especially that job club. I like that.

Mr. BURTLESS. Thank you, and I am sorry to leave.

Chairman RANGEL. Right.

Acting Chairman MATSUI. Thank you.

Commissioner Hines, let me ask you a followup question. There are two components of the targeted job credit. One is the incentive for the employer to actually create a job or to hire somebody, and then the second would be to hire a particular kind of person in the work force who might not have received a job. Is that a fair assumption?

Mr. HINES. That is correct.

Acting Chairman MATSUI. Now, where will the emphasis be on this in terms of the targeted job credit? On the one hand, I would imagine that, you know, if an employer is about to hire somebody, they are going to hire that person, obviously the credit plays a role in that, but they are going to hire the person; but then the universe that they work from, I think that is a whole different matter, right? Does this give other people a greater opportunity that might not have an opportunity to find a job? Is that where the emphasis should be and is in terms of the purpose of this credit?

Mr. HINES. Yes. I think that hits the nail right on the head, and I think Chairman Rangel was correct in indicating that, particularly in times of economic distress such as this, there is a lot of competition out there. There is an excess supply of labor in the pool, and the issue that is stressed here is the opportunity for an individual who otherwise would most likely be passed over in the decisionmaking process to have an entree.

One of the differences between an earned income tax credit is you have to earn income, and we are talking about a number of individuals who, in many instances, are breaking into the work force for the first time or perhaps reentering it after a long absence and will be given an opportunity to actually earn a wage.

One of the issues that was just discussed I found kind of interesting. There are a number of enlightened major corporations that are very interested in the use of the targeted jobs tax credit program, and I recently took part in a job fair at the University of Delaware about 2 months ago that involved 40 national employers in the hospitality industry, hotel chains, and major restaurants. And one of the issues that I was asked to speak about, both to the students who were there—a lot of them were 2-year students—and to the employer representatives, was the issue of the targeted jobs tax credit program. And the corporate sponsors who had invited me were suggesting that these folks should become aware of the fact that this is an advantage that they have when they go to try to enter the job market for the first time, and that employers are, indeed, interested in their eligibility for this.

Acting Chairman MATSUI. Let me just ask you one other question. Mr. Burtless mentioned that, to some extent, the targeted job credit creates a stigma against the employee. I think that is what he said. I probably should have asked him to remain to get a clarification of that. But have you found that in your experience with the employers? In other words, if a person is eligible, if an em-

ployee is eligible to serve under the program, that all of a sudden it is much more difficult for that person?

I think that is what he was saying. I don't want to mischaracterize it, but I sense that there was a stigma attached to this position.

Mr. HINES. I am sure that there are some employers out there who discriminate, but our experience is contrary to that. As I mentioned, there are some national corporations that are well known, but in New York the vast majority of the users of the TJTC program happen to be small- to medium-sized employers.

I have a backlog right now of 50,000 letters of requests from employers, notwithstanding the fact that the program expired on July 1, who are very interested in participating in this program. And I have got tens of thousands of job seekers who are interested in participating in it. So I would suggest that the verification of the utility of this program is best measured by the degree of interest in it on both the employer and the job seeker side in New York.

Acting Chairman MATSUI. Thank you, Mr. Chairman.

Chairman RANGEL. Mr. Hancock.

Mr. HANCOCK. Mr. Hines, you said you had how many applications or how many requests from employers?

Mr. HINES. From employers, I have about a 50,000 backlog. We continue to accept the mail and box it, notwithstanding the fact that the program expired on July 1, although we didn't get official notice about the expiration of the program until some time late in October or early November. So we still get letters of request from employers, and we have a backlog in our offices right now of about 50,000. We get on average in New York State about 5,000 a month that come in of employers who are interested in participating in this program.

Mr. HANCOCK. What is your effective unemployment rate in New York right now?

Mr. HINES. It is about 8.1, 8.3 percent. We get new numbers that come out this Friday. I hope they improve.

Mr. HANCOCK. It would appear to me that if you get 50,000 job openings, more or less—I mean, employers are looking for these things—it looks to me like it would be a good idea to open the mail and get that out to your employment offices some way.

Mr. HINES. I am sorry. I didn't understand the question.

Mr. HANCOCK. Well, if I understood you right, you said you have approximately 50,000 letters from employers wanting to hire people under this targeted jobs program.

Mr. HINES. Right.

Mr. HANCOCK. And you have got an 8.1 percent unemployment rate.

Mr. HINES. Yes.

Mr. HANCOCK. And you said that you box those letters that you didn't have time to go through.

Mr. HINES. Well, it is not a matter of time. We have no authorization to continue this program right now, so what we do is we receive the material and we hope that we will be able to respond to them retroactively. But we can't process applications because we have no program. So rather than refuse those materials, we con-

tinue to gather them, and we hope that we will be able to go back in with sufficient administrative support and pull them all out and begin to process those requests.

Mr. HANCOCK. Could you give me a rough idea of what type of jobs these are, just kind of generally? Are they strictly entry-level jobs, minimum-wage jobs?

Mr. HINES. No. Actually, we did a little survey before we came down here so I would be prepared for a question like that, and we discovered that about 92 percent of our jobs are above the minimum wage. We only really have about 8 percent of our jobs under TJTC that are at or below the Federal minimum wage. When I say below, those are individuals who would be involved in a situation to be eligible for tips. But the vast majority of the jobs are above the Federal minimum wage. They range as high as \$6 an hour.

Mr. HANCOCK. Are these mostly service jobs, service-type jobs, or are there any jobs that are apprenticeship-type jobs that could lead to advancement?

Mr. HINES. Yes. We have applications in a variety of areas, the trades, services, manufacturing, construction, finance, transportation, and then we have a category of all others. So they are pretty much spread across the board.

Banking industries are very interested in using this. Hotel chains are very interested in using it, among the big corporations. And then, as I said before, the majority of the utilization, however, notwithstanding the visibility of an entity such as Key Bank or Marriott, the majority of the utilization in New York is with small-to medium-sized employers who would not be recognizable names. But they recognize this program, and in New York State, we have very aggressively marketed this program out to our employers, and our employers receive it very, very favorably. So there is a high degree of interest in the program, and I think the continued application, notwithstanding the demise of the program, is the best evidence of that.

Mr. HANCOCK. Your program works, I am assuming, the same way it does in other States, a 90-day training period, 90 days to 6 months. Do you have any idea of how much money the State is spending on this program? I am not talking about in the form of tax credits and what have you. I am talking about just the overhead and operation of the program.

Mr. HINES. At this point in time?

Mr. HANCOCK. Yes.

Mr. HINES. Well, we are not spending anything on it right now other than just receiving the mail and storing it because we have no program to administer at this point. So other than receiving the materials—

Mr. HANCOCK. But your job service organization, is that in New York?

Mr. HINES. Job service in New York, but we were advised by U.S. DOL when the program was dismantled that we were not authorized to expend Wagner-Peyser dollars to continue the administration of the program or, in fact, to recoup the expenses that had been incurred during the 4 months before we were officially put on notice the program had been taken down. So we can't utilize State



expenditures on this, and we have been precluded from using Wagner-Peyser resources.

Mr. HANCOCK. Thank you, Mr. Chairman.

Chairman RANGEL. Mr. Kopetski.

Mr. KOPETSKI. Thank you, Mr. Chairman.

Mr. Hines, as a followup on the TJTC, what are your thoughts in terms of adjusting the policy from the administration to target other people other than by age? For example, people who have exhausted their unemployment insurance benefits, including the extended benefits, and/or people who have been on public assistance, you know, 8 out of the last 12 quarters or something like that?

Mr. HINES. Well, I have to confess I am not that familiar with those aspects of what would be proposed. We would embrace any program that would encourage the ability for us to reemploy the work force at this point in time. I just am not that familiar.

I think one of the proposals is to develop some economic development zones, which we think, in fact, would overlap the existing development zones that are in New York. So we are not sure how much more impact it would have other than now the individuals would be eligible by virtue of geographic address.

So I don't know enough about it to respond. In general, I would just indicate that this program has been a very successful one for us in New York, and I am sure that there are other ways in which it can be applied to other individuals who could use it as an entree to the work force.

Mr. KOPETSKI. Generally, let me ask it a different way. In your experience in looking at unemployment figures and the demographics of that, is age the best way? Part of the problem with the credit is it costs money and we have a deficit and we are trying to deal with it as well, so we have to put some strictures on the credit.

Mr. HINES. Right.

Mr. KOPETSKI. The administration is suggesting to do it by age. Is this, in your estimation, the best way to approach it, through an age demographic, or is it a work history demographic or work experience demographic?

Mr. HINES. I guess I am not familiar with what kinds of restrictions they want to put on by age.

Mr. KOPETSKI. Well, it is eligibility, those from 16 to 20.

Mr. HINES. Right. Oh, I see. They want to expand it.

Mr. KOPETSKI. Right.

Mr. HINES. Yes.

Mr. KOPETSKI. Older people.

Mr. HINES. OK. Now I understand.

Mr. KOPETSKI. Seniors.

Mr. HINES. I would strongly support the expansion of that for several reasons, not the least of which is that we have discovered a very troublesome pattern in the employment history of our youth, which is not particular to New York, but it is a national trend also. That is, that the youth coming out of school, whether they drop out or they complete a high school program, do not attach themselves to the work force, quite frankly, until, on average, at about age 25 or 26. And so the expansion to age 24 I think is very important be-



cause it reflects the difficulty that young people are having finding jobs.

Another issue—and this is a thought I just formed while I was sitting waiting to come up here—I worked very closely with the Defense Department and the U.S. Department of Labor on the downsizing of the military establishment. The issue of the combination impact that expanding the definition of veteran to eliminate the reference to the Vietnam era and bumping the age group up to 24 would help us to capture and make available this type of an incentive for reemployment for the substantial numbers of people who are going to be reduced from the military.

But I think the first issue is the most important. There is a very troublesome lack of significant work history and a serious entree to the world of work that exists in this country for many of our youth. And I think that moving it up to 24 is very important.

Also, to be able to serve those individuals who have tried to avail themselves of some kind of an educational experience and are maybe entering the market for the first serious time after 3 or 4 years of attempting to get an education. I think that moving the age limit up to 24 would be very helpful to those folks also.

Mr. KOPETSKI. In your estimation, which is more important, to have the tax credit available for people 16 to 18 or 22 to 24?

Mr. HINES. I can't honestly say I have ever studied that. I mean, the substantial involvement we have now are the 16- to the 19-year-olds. I would rather not be confronted with a choice like that, to be honest with you. I think it is equally important to both categories, but I haven't done the empirical evidence to come back at you and say that, you know, it has to be for this group more than the other.

It would seem to me that kind of a prima facie case would be made for the younger group, but I would suggest to you that the reasons why we focused on the younger group in the past, all those reasons have now extended themselves much further into the 20s, as both a sociological impact of some changes in this country in the last 10 to 15 years and the simple fact of the economy that has been facing us in the last 3 to 4 years. Those two things colliding would suggest that the difficulties for the younger group have now marched themselves up halfway through the decade of the 20s.

Mr. KOPETSKI. Mr. Hines, that is very good testimony. I appreciate that. That has helped me a lot.

Mr. Wetzler, can I get your feelings on the EITC? And you made reference to college students, for example, people who are over 22, maybe in a graduate program or finishing their undergraduate or working on a Ph.D. who have some income and whether as policy they should be eligible for the EITC.

What are your feelings on that?

Mr. WETZLER. Well, I think you are going to have a pretty strict budget constraint when you mark up the tax bill later on this year. And my own personal opinion is, giving earned income credits to graduate students is not a high priority.

Mr. KOPETSKI. Because you do not think we should help them through their education in this manner or—

Mr. WETZLER. No, no. We should help them with their education. I think there are much needier people who will be bearing higher

burdens of energy cost. Keep in mind, we are talking about childless single persons and childless couples.

Mr. KOPETSKI. Right.

Mr. WETZLER. If I could suggest a value judgment, personally I think that people with children need the assistance more than the people without children, given the high cost of raising children these days.

Mr. KOPETSKI. OK, thank you.

Mr. WETZLER. Just to suggest a value judgment.

Mr. KOPETSKI. All right, thank you. Thank you, Mr. Chairman.

Chairman RANGEL. Thank you.

Mr. Hines, please share with me that information on the question Mr. Hancock asked about the minimum wage. I was pleasantly surprised to see that there were higher paying jobs. If you have the breakout, that would be very good for me.

Mr. HINES. Yes, sir.

Chairman RANGEL. Mr. Wetzler, you had indicated that the EITC was complicated. Have you heard any testimony that would have you believe that we are going to make it less complicated?

Mr. WETZLER. Well, I thought there were several good suggestions this morning. I think the administration's proposal, as outlined by Mr. Sessions this morning, would simplify the credit quite dramatically. I think the ideas presented by the GAO this morning, which would conform the treatment of dependency for purposes of the dependency exemption, the head-of-household rules, and the earned income credit. I do not see any good reason why they should be different, and if you could conform them, you would enable the IRS to compute the earned income credit for those people who file tax returns and do not claim it.

Under the administration's proposal, you are moving the earned income credit up to people well into the 20-plus thousand dollar range of income. There are going to be a lot of ordinary taxpayers who will now be eligible for earned income credits, and I think it would be very helpful to have a credit designed so that the IRS could compute the credit for people who failed to claim it as part of the routine computer processing of the tax returns each year.

That was the situation between 1978 and, I believe, 1990, and it was in 1990 that you complicated the credit to prevent that from being possible.

Chairman RANGEL. Well, thank you. And stick with us, because you not only bring a broad knowledge of what we are trying to do up here, but now running the New York State tax and finances you understand what other States and local governments are going through, so it brings a sense of reality to what we are doing on the Federal level. So stick with us beyond the hearing, because we do not look at you as a staffer, but we certainly appreciate the support that you have—

Mr. WETZLER. Well, it is a pleasure to be back. I notice you have made one improvement since I left. These water pictures are very nice. [Laughter.]

Chairman RANGEL. OK.

Mr. KOPETSKI. Mr. Chairman, could I just follow up on a question?

Chairman RANGEL. Sure.

Mr. KOPETSKI. An idea that you have presented. And that is on the simplification issue, Mr. Wetzler.

What happens—is there a way for the second year that a family is eligible for the credit to just have that as a presumption, that if you had it last year, that you are going to get it this year? I mean, does that simplify a whole bunch of paperwork for folks?

Mr. WETZLER. Well, it is a presumption, but the taxpayer still has to fill out his tax return, and he is either eligible or he is not when he fills it out. I mean, I think—

Mr. KOPETSKI. But in terms of, as Ms. Stathis testified about, people are not using it through the year. They are getting the lump sum. And so that if after 1 year you get it, then you are eligible just to walk in to your employer, check a box someplace or another, and then the employer adjusts the withholding accordingly.

Mr. WETZLER. Well, I think you need to make the information available to both the employers and the employees that they are eligible for these advance payments.

On the other hand, if people would prefer to get their credit in a lump sum, so they can use it to pay bills or whatever, you know, as far as I am concerned, there is nothing particularly wrong with that.

Mr. KOPETSKI. Right.

Mr. WETZLER. I do not think the distinction between the advance payments and the lump sum is crucial. I worked here when we drafted the advance payment rule. We had high hopes for it. It turns out that it is not so popular. If it were that popular, the employees and the employers would be more likely—would make greater use of it. So I—

Mr. KOPETSKI. In terms of the simplification issue, forget the payouts and that, just if there is this presumption that exists once you were eligible, so you do not have to repeat all of the forms again.

Mr. WETZLER. Well, the problem with the presumption is that if the employee has the earned income credit withheld or paid to him over the year, and then at the end of the year turns out not to be eligible, then that employee—because his income has gone up or because his dependency status has changed—that employee is in a pretty seriously difficult position when he files his tax return and has to repay those advance payments.

I mean, the taxpayers very much like to get refunds and very much dislike having to write checks.

Mr. KOPETSKI. OK.

Mr. WETZLER. And I think that is a well-established preference, and I think you are seeing that in the preference the eligible people are expressing for getting their earned income credit as a refund rather than through the advance payment mechanism, for which there were high hopes when it was originally enacted back, I believe, in, you know, 1978.

Chairman RANGEL. Ms. Stathis, on the question of the option as to whether or not the employee knows that they could get it up front, do you think that we could, by statute, require the employer to notify the employee that they have an option and how they can receive the EITC, or do you have another suggestion?



Ms. STATHIS. In fact, that was a recommendation that we made in our advance payment report, not that the Congress require it, but that IRS try to have employers do that.

In fact, employers are required to notify employees about the earned income tax credit itself. And the IRS has an arrangement with the employers that they can do that by printing a notice on the back of the W-2. But the notice did not say anything about the advance payment option. So our suggestion to them was at least have that notice mention the advance payment option. We surveyed a variety of potential recipients, and a variety of employers, both ones who were providing the advance payment option and ones who were not. About 60 percent of employers who were not providing it on an advance basis did not know about the option. They did not know it was available. And we had only 37 of the potential recipients out of 438 who had ever heard of it.

So there are just a lot of people that have no idea that it is available on an advance basis. So one of the things we said in the report is that really to give it a fair chance, to know whether it will work or not, we have to do a lot more outreach to make sure that people know about it.

Chairman RANGEL. Your testimony was invaluable, because I had suspected what you said was true, but I did not get that impression from IRS this morning. So I am glad that you were here.

This has been a real great panel, and I want to thank all of your for your contribution.

The next panel, just two are left on it now. That is Dr. Marvin Kusters, who is the director of economic policy studies for the American Enterprise Institute, and Robert Greenstein, the executive director of the Center on Budget and Policy Priorities.

Your testimony will, without objection, be entered in its entirety into the record. We are forced to apply the 5-minute rule because of the legislative agenda we have, but we want you to feel free to highlight your testimony, and we will start with Dr. Kusters.

Welcome to the committee.

**STATEMENT OF MARVIN H. KOSTERS, PH.D., DIRECTOR,  
ECONOMIC POLICY STUDIES, AMERICAN ENTERPRISE  
INSTITUTE**

Mr. KOSTERS. Thank you, Mr. Chairman.

I appreciate the opportunity to participate in these hearings, and I will limit my discussion to only the work incentive effects of the earned income tax credit.

Everyone is aware, I think, of the favorable work incentive effects of the EITC. It encourages work for people who are not working and it encourages the working poor with the lowest incomes to work more. At the same time, it helps to lift their aftertax income.

Families in the lowest income range get a positive work incentive in what I call the subsidy range; their work incentives are strengthened. They get an extra 20 cents almost for every additional dollar they earn under current law if they have two dependents and supplemental credits are ignored.

For families with incomes in the intermediate range, the tax effects on them are essentially neutral. The additional income that they keep after taxes is essentially exactly the same as the addi-



tional money they earn. So they do not have any additional work incentives from the EITC, but they do have additional income.

In the higher income range where the EITC is gradually phased out, in this phaseout range, there is a work disincentive effect. Work is discouraged. The size of the tax credit payment is reduced by about 14 cents for every additional dollar that workers end in that range.

This aspect of the earned income tax credit, where work and incentives are weakened, often gets less attention than the positive work incentives, although it was mentioned by some of the other witnesses this morning.

Now the reports that I saw before I prepared my testimony showed a slightly different structure from the Treasury proposal that was announced this morning, but the differences would not change the main points in my prepared statement. The main changes in the proposal are that the subsidy rate would be significantly increased at the lowest income levels; the maximum credit would be doubled; and the phaseout range would be extended to significantly higher incomes, to the \$28,000 level apparently.

One way to analyze the work incentive effects of the EITC is to compare the importance of the favorable and the unfavorable work incentives that EITC generates among the working poor. We can ask what effects we might expect for those families where work incentives are strengthened compared to the effects that we might expect for those families where work incentives are weakened.

I discuss these comparisons in more detail in my prepared statement, but I would like to summarize those results very briefly here and essentially compare the gains with the losses that should be expected from work incentives under the EITC. In my prepared statement, I make relevant comparisons for both current law for 1993 and for the new proposal, as it was described in various reports before the details announced today became available.

I make three kinds of comparisons, and I will indicate what those comparisons basically show to preview my results. Basically they show that among the working poor we lose more from reduced work incentives than we gain from families with improved work incentives. The losses outweigh the gains by a big margin, especially for the new proposal.

Now let me describe in detail what I am comparing. First of all, I consider only potentially eligible married couple families and I simply count numbers of families and workers in each income range. I find—and this is reported in my prepared statement—that losses outweigh the gains or the numbers experiencing work disincentives outweigh those whose work incentives are strengthened by a factor of 6-to-1 or so under current law and by much more under the new policy. Many more families are in the phaseout range than in the subsidy range.

The second comparison I make takes into account the fact that phaseout rates are smaller than subsidy rates. If you make the appropriate adjustment, it reduces somewhat the ratio of losses to gains.

The third comparison I make is to ask how output is affected, how is GDP affected, by the combination of reinforced work incentives for some, and disincentives for others. With that comparison

I find that there is a much larger loss in GDP than gain. That is, the losses in output outweigh the gains by a factor of some 10-to-1, as I estimate them, under the current proposal and by much, much more under the new proposal. So loss ratios of that magnitude lead me to question whether this is the kind of program that should be expanded.

In view of its mixed effects on work incentives, I believe that a major expansion of the EITC is ill-advised. In my prepared statement, I suggest some alternative ways to lift the aftertax incomes of low- and middle-income working poor families that would have less deleterious effects on their work incentives, and I note some aspects of the new proposal that I believe deserve support.

Thank you, Mr. Chairman.

[The prepared statement follows:]

Statement of Marvin H. Kusters  
 Director, Economic Policy Studies  
 American Enterprise Institute  
 before the  
 Subcommittee on Select Revenue Measures  
 and the Subcommittee on Human Resources,  
 Committee on Ways and Means  
 March 30, 1993

**The Earned Income Tax Credit: How Are the Working Poor Affected?**

Mr. Chairman and Members of the Committee: I am pleased to be invited to testify at this hearing. The subject announced for the hearing — "the extent to which our current tax laws provide work incentives for low-income families and help create alternatives to welfare" — is timely and important. The significant expansion of the Earned Income Tax Credit (EITC) in 1990 and the recently proposed further expansion heighten the importance of examining its impact on all families who are affected. Because the EITC influences work decisions in different ways for families with different levels of income and working status, its incentive effects are especially pertinent. I appreciate this opportunity to describe the various effects of the EITC on work incentives for the working poor.

**How the EITC Affects Work Incentives**

The EITC is a refundable tax credit available to people with earnings from work and with dependents. In my analysis of its effects, I focus on families with working adult members. I do not examine its implications for families without earnings, for whom the EITC encourages a transition to working status, and I do not take into account the effect of credit payments on incomes of working families, which produce incentives for less work among the working poor.

The EITC provides a subsidy to earned income at the lowest income levels, thereby strengthening work incentives in this subsidy range. At higher income levels, however, the EITC subsidy is phased out. In this phase-out range, where the credit is gradually withdrawn, the effect of the EITC on work incentives is to impose an implicit tax on each additional dollar of earned income. The implication for work incentives is that they are strengthened for low-income families in the subsidy range, but weakened for families with higher incomes in the phase-out range.

It may be useful to illustrate these characteristics of the EITC more specifically. Immediately before its expansion in 1990, the EITC provided a subsidy of 14 cents for each additional dollar of earnings of eligible families up to almost \$7,000 of annual income. The maximum EITC payment of about \$950 was available to families with earnings between about \$7,000 and \$11,000 per year. In this range, where the maximum credit was available and the amount was unchanged in response to earnings differences, work incentives were neither strengthened nor weakened. In the range where the credit was phased out — from about \$11,000 to \$20,000 annual income — for each additional dollar of earnings the credit was reduced by 10 cents. This is equivalent to imposing an additional tax at a 10% rate on earnings from work by families in this income range.

I chose the year 1990 deliberately to illustrate how the EITC works. After 1990 both the size of the credit and the subsidy and phaseout rates were increased sharply. The EITC was also further complicated by conditioning it on whether eligible families had one or two dependents, presence of children less than a year old, and eligibility for a health credit. After these changes in the EITC in 1990, it acquired several features traditionally more frequently associated with income transfer programs than with tax policy. By 1993, for example, almost 90 percent of EITC funds are expected to be accounted for by federal cash payments to eligible families instead of offsets to income taxes they would otherwise need to pay.

### Tax Policy and Income Transfer Rationales

From the time it was introduced in 1975 until 1990, the EITC subsidy rate for the lowest income eligible families was roughly equivalent to the total payroll tax rate under the Federal Insurance Contributions Act (FICA). It was broadly consistent with the idea that, up to a certain income level (almost \$7000 in 1990), working poor families with children should not be required to make any net contribution to federal tax revenues, including social security.

The EITC had certain attractive features as a mechanism to relieve workers with the lowest incomes from paying federal taxes. This result could be achieved through the EITC without reducing the comprehensiveness of coverage under FICA. Thus, workers would receive credit under OASDI for their contributions, and the trust accounts would be credited with these contributions. When the EITC is considered by itself, eligible families with the lowest incomes receive an earnings subsidy that strengthens work incentives. When the EITC is considered together with total FICA taxes, however, it is clear that tax incentive effects were roughly neutral in the subsidy range if the entitlement that is earned to benefits under the social security system is not taken into account.

In the EITC phase-out range, of course, the phase-out rate (10% in 1990) was equivalent to a 10 percent marginal tax rate on earned income, in addition to the total FICA rate (for the employee and employer taken together) of 15.3 percent. The weakening of work incentives for families with incomes in the phase-out range could be viewed as the price paid for relief from net federal tax payments for the lowest income families. To simplify the discussion that follows, I do not consider further the effects of the FICA payroll tax. It is important to note, however, that since 1990 cash payments to eligible families in the subsidy range have become significantly larger than the combined total FICA taxes paid by these workers and their employers.

In addition to increasing percentage rates, the expansion of the EITC in 1990 has introduced other complications of a kind that are customarily addressed by agencies administering income transfer programs. These agencies are probably in a better position to deal with questions involving needs and eligibility than the Internal Revenue Service. They are also better equipped to provide income transfer payments on an ongoing basis instead of as a lump-sum refund after the tax year is completed. In any event, many of the families in the EITC subsidy range are also participants in other programs, and the merit of having an additional agency, the IRS, administering welfare-type programs is far from obvious.

### Work Incentive Effects on Low-Income Families

Since families at different income levels experience very different work incentive effects under the EITC, it is important to consider how many families are affected and how they are affected. In particular, the number of workers and families in the subsidy range can be compared with those in the phase-out range to obtain a comprehensive view of the effects of work incentives generated by the EITC for eligible working families.

Data are readily available from Current Population Survey sources on work experience and income levels for married-couple families with children. Although the family units described in these Census data do not correspond precisely to definitions of taxpayer units, and there are also some differences in relevant income definitions, these Census data probably provide a fairly reliable indication of the relative numbers of workers and families who are affected in the income ranges that are relevant for the EITC. Data from this source are frequently used to analyze the impact of tax and income transfer policies on different parts of the distribution of income. Unfortunately, comparable data for working single-parent or female-headed families with children are not readily available to me.



The basic data I use to examine work incentive implications are shown in Table 1. It is immediately apparent in these data that the number of families and workers in each income range increases steadily with moves up the income scale from the lowest levels. To estimate the numbers of families and workers affected by the EITC, I have updated the income brackets to 1993 and interpolated between brackets to estimate how many are affected in the income range where earnings are subsidized, in the range where the maximum credit is available and effects on work incentives are neutral, and in the phase-out range where additional earnings are subject to an implicit tax as the credit is reduced.

Table 1  
Income and Work Experience in 1991:  
Married Couples with One or More Children  
(thousands)

	Total Married-Couple Families with workers	Workers in Family:			Total Workers in Married-Couple Families
		Husband Worked	Wife also Worked	Wife only Worked	
Total Families:	24,612	23,989	17,810	623	42,422
Income < \$5,000	245	223	83	22	328
\$5,000 < 10,000	523	453	167	70	690
10,000 < 15,000	1,063	966	436	97	1,499
15,000 < 20,000	1,397	1,345	757	52	2,154
20,000 < 25,000	1,603	1,549	986	54	2,588
25,000 < 30,000	1,925	1,865	1,366	60	3,291

Source: Money Income of Households, Families, and Persons in the United States: 1991, Current Population Reports, Consumer Income, Series P-60, No 180, Table 19, pp.77ff.

Estimates of the numbers of families and workers in each of the respective ranges are shown in Table 2. It is very clear from these estimates that the number who experience incentives that discourage work in the phase-out range of the EITC exceeds by a wide margin those who experience incentives that encourage work. Under current law, for example, the ratio of workers discouraged to those encouraged is on the order of 5 or 6 to 1. This imbalance is much more pronounced in my estimates for the new policy proposal, based on reports I have seen on how the proposal is structured. According to these estimates the ratio of workers discouraged to those encouraged would rise to something on the order of 15 or 19 to 1 if the proposed policy were applicable in 1993.

Table 2

**Estimated Numbers of Married-Couple Families and Workers Affected by Work Incentives  
under the EITC in 1993: Current Law and Policy Proposal**

Current Law		
	<u>Number of Families</u> (thousands)	<u>Number of Workers</u> (thousands)
Subsidy range (0 to \$7,760)	487	647
Neutral range (\$7,760-\$12,210)	602	823
Phase-out range (\$12,210-\$23,070)	2,698	4,104
Ratio of numbers in phase-out range compared with subsidy range	5.5 to 1	6.3 to 1
Policy Proposal		
	<u>Number of Families</u> (thousands)	<u>Number of Workers</u> (thousands)
Subsidy range (0-\$6,000)	313	418
Neutral range (\$6,000-\$12,560)	846	1,152
Phase-out range (\$12,560-\$30,000)	4,934	7,847
Ratio of numbers in phase-out range compared with subsidy range	15.8 to 1	18.8 to 1

These estimates suggest that attitudes toward the desirability of favorable work incentive effects for families with the lowest incomes among the working poor should be tempered by a recognition that many more families experience an implicit tax on additional earnings that tends to discourage work. These families are somewhat less poor, but many of them still have relatively low incomes — at least under current EITC income ranges. Under the new policy proposal, however, the income range for EITC eligibility would be much higher. Married-couple families with two children would apparently receive the maximum credit of \$2,400 at incomes up to about \$12,560. The proposed credit would not be completely phased out for such families until their income reached \$30,000, a level approximately equal to median household income in 1991 and more than 83 percent of median family income.

Up to this point I have considered only numbers of families and workers in different income ranges. The rate at which earnings are subsidized in the lowest income range and the rate at which the credit is reduced in the phase-out range are also important and need to be taken into account. Moreover, both under current law and the proposed policy, phase-out rates are significantly smaller than subsidy rates which attenuates the degree to which work is on balance discouraged when both ranges are considered.

Under current law the phase-out rate (with two dependents but excluding supplemental credits) is about 13.9 percent compared with a subsidy rate of 19.5 percent. Thus although many more workers are in the phase-out range than in the subsidy range, the higher subsidy rate can be expected to exert more pull than the phase-out rate for each worker affected. I recognize that there is a great deal of uncertainty about just how strongly work behavior is affected by tax incentives. However, if work responses to tax incentives are roughly similar in percentage terms throughout the income ranges of the EITC, the effects of incentives for families in the subsidy and phase-out ranges can be compared directly without information about the absolute size of work incentives.

To take into account phase-out rates that are smaller than subsidy rates, the relative number of workers and families in each range need to be adjusted to reflect the difference in rates. The difference between rates under current law (13.9 and 19.5 percent) is even larger under the new proposal, where the rates I use of 13.75 percent in the phase-out range and 40 percent in the subsidy range are based on reports describing the proposal. Adjustment of the ratios of numbers of families and workers affected reported in Table 2 to take into account these differences in rates leads to the following estimates:

**Comparisons of Estimated Relative Work Incentive Effects  
for Phase-out and Subsidy Ranges of the EITC**

<u>Ratio of losses to gains</u>	<u>Families</u>	<u>Workers</u>
Current Law	3.9	4.5
Policy Proposal	5.4	6.5

These estimates show that the larger relative numbers in EITC phase-out ranges are partly counter-balanced by lower phase-out rates. This is especially evident for the policy proposal, where the pronounced difference in rates brings the combined adverse work incentives down to nearly the same range as under current law.

Comparison of these various estimates illustrates two dilemmas inherent in the design of tax-based programs to provide income transfers to low-income families. The first is that the favorable work incentives produced by subsidizing earnings at low incomes are accompanied by unfavorable incentives in the higher income range where the subsidy is phased out. The second is that an effort to attenuate unfavorable work incentives in the phase-out range by reducing the phase-out rate relative to the subsidy rate inevitably involves extending the income range over which credits are phased out. Unfavorable work incentives for each worker are smaller as a result, but more workers and families are affected.

Another relevant difference between families in the subsidy and phase-out ranges of the EITC is that the higher earnings of those in the phase-out range in general reflect some combination of higher wages and a larger fraction of the year at work. Consequently, a given percentage work reduction in the phase-out range results in a loss in value of output (GDP) that is much larger than the increase in output that results from increased work in the subsidy range. It is accordingly illuminating to further adjust estimates of relative impact in phase-out and subsidy ranges to take earnings and output differences into account. To make sure that the adjustment for value of output differences is modest, and almost surely significantly understated, I use the top of the subsidy range and the midpoint of the phase-out range to make the relevant comparison of ratios that include relative numbers of families and workers, differences between subsidy and phase-out rates, and differences in average value of output produced in each range. The results are as follows:

**Comparisons of Estimated Relative Impact on Value of Output  
for Phase-out and Subsidy Ranges of the EITC**

<u>Ratio of losses to gains</u>	<u>Families</u>	<u>Workers</u>
Current Law	9.0	10.3
Policy Proposal	19.2	23.1

According to these estimates, some 9 or 10 times as much output is expected to be lost because of reduced work effort in the phase-out range as the output gained through increased work in the subsidy range. Under the new policy proposal the estimated output loss would apparently outweigh the gain by a multiple of about 20. The estimates I have presented could be improved in a number of ways. However, I do not think such improvement would change my general conclusion — incentives that have the effect of discouraging work and reducing output are large in relation to favorable work incentives under the EITC in its current form, and this imbalance would be exacerbated under its proposed expansion.

#### **Income Redistribution and Work Incentives**

What conclusions can appropriately be drawn on the basis of estimates like those presented above? The design of policies like an EITC should obviously not be guided exclusively by its impact on GDP, because distributional considerations are important. Neither should its impact on output be entirely disregarded, however. Similarly the effects of an EITC on total work effort is only one consideration, but its implications for work incentives should not be neglected either. It should also be recognized that the estimates I have presented include only married-couple families with children. Even though comparable data on single-parent families are not readily available, they may represent a larger share of EITC beneficiaries than members of married-couple families. Estimates I have seen suggest that the ratio of reductions in working hours and output for single-parent families compared with gains in the lowest part of the distribution are not as severe as for members of married-couple families. Nevertheless, estimates for single-parent families also indicate more of them with incomes in the phase-out range than in the subsidy range, and the same work incentive principles are applicable to single-parent families as to married-couple families.

As a practical matter, of course, it is necessary to recognize that virtually any income transfer program tends to weaken incentives for work and other behaviors that reduce dependency. The relevant question then is whether other policies to transfer additional income to the poor are available that would lead to a more favorable balance of work incentives than an expansive EITC. I believe it is possible to develop more promising policy combinations. The key to developing such policies, in my view, is to consider the combined effects of programs, to examine the cumulative effects of such policies on marginal incentives to work, and to keep unfavorable work incentives as small as is feasible for attaining any particular distributional outcome. The combination of implicit and explicit tax rates generated by programs that affect families presumably influence work incentives at the margin, and examining such incentives only on a program-by-program basis can be quite misleading.

The relationship between tax rates in the personal income tax schedule and the EITC illustrates the importance of taking into account the effects on work incentives at the margin of the combination of policies that affect families. A variety of specific circumstances of particular families influence their eligibility for the EITC and the income level at which they must begin paying individual income taxes. Apparently, however, under the new proposals many eligible families in the EITC phase-out range would also have income subject to taxation at a 15 percent rate. Families in these circumstances would be receiving a credit that partially offsets, and in some instances more than offsets, their positive income tax liability. These families,



nevertheless, face a tax rate on each additional dollar they earn of almost 29 percent. That is, the marginal rate for them is a combination of the explicit rate of 15 percent and the implicit rate of 13.75 percent as their credit under the EITC is withdrawn. By restructuring tax policy it would be possible to almost cut in half the total rate at which their additional earned income is taxed at the margin. This could be accomplished by simply increasing the standard deduction or personal exemption levels enough to raise after-tax income for taxpayers in the phase-out range of the proposed EITC. This would, of course, mean moving the EITC phase-out range down toward lower incomes.

Most families eligible for the EITC with incomes in the subsidy range are already eligible for or receive income support under one or more means-tested programs. For many of them, the tax credit for which they are eligible under the EITC, in combination with their earned income, is too small by itself to provide adequate income, and the timing of the credit they receive depends on the uncertain and variable timing of their work, with many receiving a lump-sum adjustment after the close of the tax year. I believe that the balance should be shifted back toward relying more heavily on administration through income transfer programs in which these families are already beneficiaries in order to relieve the burden of adverse work incentive effects under a large and costly EITC program.

Placing more reliance on means-tested income transfer programs for the lowest income families and raising the after-tax income of families with taxable income by reducing their tax liabilities directly instead of by offsetting such tax liabilities through the EITC focuses attention on families with incomes between these ranges. In my view the question of how much income support they should be provided and how such support should be conditioned on other potential sources of support should be confronted directly. Although administrative procedures should be designed to encourage self-sufficiency, unfavorable work incentives in simple economic terms are essentially unavoidable for some range of incomes no matter what formulas are considered for phasing out an EITC, food stamps, rent subsidies, or other income-conditioned transfers in any combination. This is the basic reason why I favor keeping EITC rates low and limiting eligibility to the lower part of the income distribution to keep the number of families who experience unfavorable work incentives under this and other programs relatively small.

### Concluding Comments

I believe an EITC can play a useful part as an element of tax policy. I do not believe, however, that a bigger and more expansive EITC is necessarily always better. In my view, an EITC with rates and income ranges roughly in line with those that prevailed in 1990 and earlier is preferable to an EITC with the dimensions of current law. The further expansion that has been proposed would be another major step toward too much reliance on the EITC to redistribute income under the guise of improving incentives to work, even though the available evidence strongly suggests that work in families with low and moderate incomes taken together would be discouraged and output reduced.

Although I believe expansion of rates and income ranges for those currently eligible for the EITC is ill-advised, some aspects of the new policy proposal deserve support. First, elimination of supplemental credits under current law is desirable, both because this would eliminate the additional increment to implicit tax rates they entail and because this would help to simplify administration in a program that has become excessively complicated for families who might not otherwise find it necessary to engage the services of an income tax consultant. Second, I favor extension of eligibility for the EITC — at modest rates and only for a limited range in the lowest part of the income distribution — to young workers without dependents. The main reason I favor this expansion of eligibility is that I think it is appropriate to shift the balance toward policies that make young people eligible for at least partial participation in a program that provides relief from federal taxes at very low income levels before they fulfill qualifications on which participation is now contingent — responsibility for supporting dependents with too little income to provide for them adequately.

Chairman RANGEL. Thank you, Dr. Kusters.  
Mr. Greenstein.

**STATEMENT OF ROBERT GREENSTEIN, EXECUTIVE  
DIRECTOR, CENTER ON BUDGET AND POLICY PRIORITIES**

Mr. GREENSTEIN. Thank you, Mr. Chairman.

I am going to focus on the earned income credit, an issue which I think takes on particular importance given the trend going back to the 1970s of an erosion of wages, especially for low-skilled jobs.

Last year, a census study found that the proportion of full-time, year-round workers paid wages too low to lift a family of four to the poverty line has grown by half just since 1979. By 1990, nearly one out of every five full-time, year-round workers was paid a wage too low to lift a family of four to the poverty line.

This erosion in wages has been accompanied by an increase in poverty rates for working families. At the end of the 1970s, fewer than 8 percent of families with children in which the family head works lived below the poverty line. By 1991, 11.2 percent did.

Primarily developments in the private economy contributed to these erosions in wages, but some public sector policies contributed as well. For example, in the 1970s, the minimum wage lifted a family of three to the poverty line if a worker worked full time. Today, if you work full-time year round at the minimum wage, you will be \$2,700 below the poverty line for a family of three.

Similarly, we have, to a significant degree, eliminated AFDC benefits for the working poor. The table in the Green Book shows that 20 years ago, a mother with two children, who worked and earned wages equal to three-quarters of the poverty line, qualified for AFDC in 49 States. Today she is eligible for AFDC in only five States. And even after we add in the earned income credit and food stamps, it turns out that that mother, working and earning three-quarters of the poverty line, today has \$3,000 less in disposable income than she did 20 years ago.

This increase in the ranks of the working poor poses various problems. If full-time work fails to bring a worker and his family or her family out of poverty, the value and the importance of work can be diminished, and other ways of obtaining resources ranging from public assistance to minor hustling may grow more attractive.

Similarly, the inability of work to lift many families out of poverty increases child poverty, and we now have a child poverty rate in this country that is double the rate in Canada, four times the average in Western Europe.

This brings us to the administration proposals unveiled this morning. Those proposals appear to succeed in meeting the President's stated goal that a family of four with a full-time worker should be brought to the poverty line. Achieving such a goal is of historic importance, and achieving that goal, it would seem to me, ought to be something that is not a partisan, a liberal or a conservative, Republican or a Democratic issue. I remember that 4 or 5 years ago a Heritage Foundation publication called for a sufficient increase in the earned income credit so that a full-time working family of four would not be poor.

As you may know, such a step would also be crucial to making welfare reform more effective. The principal examinations of wel-

fare-to-work programs find that even successful welfare employment programs do relatively little to reduce poverty or raise family income, because families typically lose nearly as much in welfare and other benefits as they gain in earnings from a low-wage job. These evaluations have often noted that policy changes in other areas like the earned income credit are needed if work is to raise family income and enable welfare recipients to escape poverty by working.

I would also like to comment briefly on the administration's proposal to establish a new small EIC for childless workers with incomes below \$9,000. The credit would equal 7.65 percent of their first \$4,000 in earnings. I believe such a proposal would represent wise policy. In seeking to encourage work, the last thing we should be doing is taxing the working poor deeper into poverty, and that principle should apply to those without children, as well as those with children.

Currently the earned income credit provides working parents with an offset to the regressive payroll taxes they pay if they are poor, but poor workers without children qualify for no such offset because they are not eligible for the earned income credit, and their payroll taxes do push them deeper into poverty. Moreover, for families with children, they do not begin owing income tax until their income exceeds the poverty line. But for single filers, they begin owing income tax when their earnings are \$1,000 below the poverty line.

The administration's EIC proposal would address both of these problems, offsetting the payroll tax for very poor workers and raising the point at which they begin owing income tax so it reaches the poverty line.

I would also just note briefly that one of the previous witnesses, Mr. Wetzler, talked about the concern that those with Social Security income and students would be beneficiaries. As I read the administration's proposal, however, it is limited to those with earnings. It is limited to those 22 and over and not claimed as dependents by other households. So it seems to me that very few Social Security recipients and not that many students would qualify. If you are concerned about graduate students, you could always exclude them.

He noted that families with children need more. I would agree. But the administration's proposal provides an average benefit of only \$100 to \$200 for the workers without children.

Finally, the last thing I would note is that when we talk about the work incentive questions, I think we need to distinguish those people for whom the EIC has a positive work incentive effect, those working little or not at all who we want to get into the labor force, and those in the upper range for the EIC for whom the EIC may encourage somewhat less work. Those in the upper range are primarily two-parent families with children, and the effect here is often one of encouraging the second earner in the family to work a little less and spend a little more time with her children.

I do not think we should equate those two effects. What we really want to do is to encourage people not working at all to get into the labor force. The administration's proposal would do this much more strongly than the current earned income credit by both greatly in-

creasing the credit and greatly widening the difference between the positive credit in the low end of the range and the phaseout rate in the upper end of the range.

This is the last point I will make. Under current law when fully phased in, you have a 23 to 25 percent positive credit for those with low earnings, and it phases out at 16 to 18 percent in the upper part of the range. The phasein and phaseout percentages thus are fairly close to one another.

But under the new proposal, the administration's proposal, the positive credit rate is 34 to 40 percent. A 40 percent wage subsidy for families with two or more children can be a very powerful work incentive. At the same time, the phaseout range of the credit for those in its upper range would be about the same as current law and would be less than half the positive credit rate at the bottom.

In short, I think the administration's proposal is quite well designed and should increase the work incentives in the earned income credit while substantially reducing poverty and rewarding work among those not working or working little, if at all.

Thank you.

[The prepared statement follows:]



**STATEMENT OF ROBERT GREENSTEIN**  
**Center on Budget and Policy Priorities**

I appreciate the invitation to testify here today. I am Robert Greenstein, executive director of the Center on Budget and Policy Priorities.

The Center is a non-profit organization that conducts research and analysis on public policies affecting low- and moderate-income families. Over the past 10 years, we have worked extensively on issues related to the earned income credit and have published numerous reports and analyses on the EITC.

The Center also coordinates a national EITC outreach effort that involves more than 6,000 national, state, and local organizations and agencies and provides information to working families on the EITC and the requirements for filing for it. We work closely on this endeavor, now in its fifth year, with the Internal Revenue Service, governors, mayors, the United Way and other charitable and religious organizations, state human services agencies, and local service providers, businesses, labor unions, and community-based organization and advocacy groups.

My testimony here today concentrates on the EITC. It begins with a review of conditions facing the working poor, followed by a discussion of recent improvements in the EITC and the need for further reforms. The testimony then discusses the Clinton Administration's EITC proposals as well as other EITC improvements that warrant consideration.

**Background: Increases in the Ranks of the Working Poor**

Wages in the United States have been eroding since the 1970s and have declined most sharply for low-skilled jobs. A Census Bureau study issued last May found that the proportion of full-time, year-round workers paid wages too low to lift a family of four to the poverty line has grown *by half* since 1979. In 1979, slightly under 12 percent of full-time workers were paid wages this low. In 1990, some 18 percent of full-time workers — nearly one in five — were paid this little.

The downward trend in wages has coincided with increases in poverty rates among working families. In 1979, the peak year of the economic recovery of the 1970s, some 7.7 percent of families with children in which the family head works lived below the poverty level. In 1989, the peak recovery year of the 1980s, some 9.8 percent of such families were poor. By 1991, the poverty rate among these families rose further to 11.2 percent, meaning that one of every nine such families was poor. The poverty rate among families with children in which the family head works thus was nearly 50 percent higher in 1991 than in 1979.

These trends contrast sharply with the experience of the 1960s and 1970s. During the 1960s, the percentage of workers who were poor fell considerably. In the 1970s, the percentage declined further, although at a slower pace.

These statistics may seem of limited relevance to those who assume that most of the poor do not work. In fact, about 60 percent of all poor families — and nearly two-thirds of all poor families with children — include a worker. In 1991, some 15 million people lived in families with children that contained a worker. A majority of these families contained members employed for eight or more months of full-time work during the year. Some 5.5 million people lived in working poor families with children that contained a member employed full-time year-round.

Earnings data tell a similar story; they show that earnings are a very significant source of income for poor families. In 1991, earnings accounted for 60 percent of the money income of poor two-parent families and 38 percent of the money income of poor female-headed families. Among poor individuals under age 65 who live alone, earnings constituted 52 percent of income.

The working poor are a group that defies stereotypes. A solid majority of the working poor are non-Hispanic whites. Most are between the ages of 25 and 64. The

working poor are especially prominent in rural areas, where they make up a larger proportion of the population than in urban areas. Some 60 percent of the working poor have completed high school. Among the working poor who are employed full-time year-round, a majority are men, while women make up the majority of the part-time working poor.

The downward trend in wages — and in the incomes of these working poor families — is due predominantly to developments in the private economy, including international competitive pressures. In some areas, however, government policy appears to have played a role. The minimum wage has eroded substantially in recent years. During the 1960s and 1970s, full-time, year-round work at the minimum wage usually lifted a family of the three above the poverty line. In 1993, full-time minimum wage earnings fall \$2,700 — or 23 percent — below the estimated three-person poverty line. The minimum wage is currently 22 percent below its average level during the 1970s, after adjusting for inflation.

Sharp reductions in AFDC benefits for working poor families also have had an effect. In nearly all states, AFDC benefit levels and income eligibility limits have eroded substantially over the past two decades. In addition, changes in AFDC enacted in the early 1980s eliminated eligibility for many working poor families.

A table in the *Green Book* published by this Committee tells an interesting story. It shows that in 1972, a mother with two children who worked and earned wages equal to 75 percent of the poverty line qualified for some AFDC assistance in 49 states. In 1980, such a mother was eligible for AFDC in 42 states. But in 1991, a mother earning wages equaling 75 percent of the poverty line, about what full-time minimum wage work now pays, qualified for AFDC in just five states.

It is true, of course, that the Earned Income Tax Credit was expanded significantly during these years. Nevertheless, many working poor families who used to qualify for AFDC lost more in AFDC benefits than they gained in EITC payments. When wages, AFDC, food stamp, and EITC benefits are added together — and federal income and payroll taxes are subtracted out — a mother with two children who works and earns wages equal to 75 percent of the poverty line had \$3,000 less in disposable income in the average state in 1991 than she would have had in 1972. Even if the EITC increases enacted in 1990 had been fully effective in 1991, this mother still would have had \$2,500 less in disposable income than in 1972.<sup>1</sup>

### **The Increase in Poverty Among Working Households is a Problem**

This increase in the ranks of the working poor poses a significant problem. It causes more poverty among children, a particular concern in light of a new study suggesting that child poverty may adversely affect child intellectual development. In addition, if full-time work fails to bring a worker and his or her family out of poverty, the value and importance of work may be diminished — and other ways of obtaining resources, ranging from public assistance to minor hustling, may grow more attractive. In short, rather than diminish the importance of work that pays low wages, our society needs to promote work, stress its value, and show that those who "play by the rules" and work hard will have at least a minimally adequate standard of living.

These problems are underscored by the large gap in child poverty between the United States and our principal western European competitors. A study conducted by a distinguished institutional research team has found that the child poverty rate in the United States is about double the rate in Canada and four times the average in

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<sup>1</sup> Much of the preceding section is based on a forthcoming Center report.

Western Europe. This should cause particular concern, especially since those who are children today will constitute the workforce of tomorrow.

The findings of this study are relevant for another reason, as well. When the study's researchers attempted to discern the reasons for the much higher poverty rates in the United States, they found that differences in work effort, race, and family structure played only a small role. Work effort among those who were poor before receipt of government benefits was similar here to the average in Western Europe. Racial factors also did not explain these differences; poverty rates were significantly higher just for non-Hispanic whites in the United States than for the entire populations of Canada and the western European countries. Nor did differences in family structure explain more than a modest share of the large differences in poverty rates.

The researchers did, however, find one factor that accounted for most of the difference in poverty rates. They discovered that the single most important factor explaining the higher U. S. poverty rates was much weaker government benefit and tax credit policies here. The poverty rate *before* taxes and government benefits was about the same in the United States as the Western European average. But the poverty rate *after* taxes and benefits was far greater here. Government income support policies lift a much larger proportion of families out of poverty in Western Europe and Canada than in the United States.

These findings present us with a critical challenge. We need to develop policies that avoid the pitfalls of the current welfare system and that lift families out of poverty while promoting rather than undercutting basic values of work and personal responsibility.

### **The Earned Income Credit**

The earned income tax credit is one such policy and is very different from traditional welfare programs. In welfare, families without earnings receive the largest benefits because they have the lowest incomes. Under the EITC, those without earnings receive no benefits. Similarly, in welfare, benefits decline as earnings rise, which can discourage work. Under the EITC, benefits *increase* as earnings rise for families that earn small or modest amounts, thereby encouraging work. In addition, in welfare, the eligibility rules are considerably more restrictive for two-parent families than for single-parent families. In the EITC, no such differential treatment exists. For such reasons, the EITC is widely considered pro-work and pro-family and has strong support across the political system, despite the absence of any lobby or association of EITC beneficiaries or tax preparers working on its behalf.

Major progress has been made in recent years in improving the EITC, in no small part due to the work of the Ways and Means Committee. EITC benefits have been made significantly larger. Also, a differential in benefit levels has been established between families with one child and families with two or more children. This is a crucial step. Family expenses, the poverty line, and welfare benefits all rise with family size. But wages do not. As a result, as the number of children in a low-wage working family grows, the family is more likely to slip below the poverty line (or to fall further below the poverty line). In addition, work becomes less competitive with public assistance as family size grows. A family size adjustment in the EITC can help to address these problems.

Another major EITC improvement was the overhaul and removal in 1990 of a series of exceedingly complex, highly technical EITC rules that few families could comprehend and the IRS could not enforce and that consequently led to considerable error. A diligent joint effort in 1990 by staff of this Committee, the Senate Finance Committee, the IRS, and the Treasury Department resolved this problem and cleaned

up and greatly simplified the rules for qualifying for the EITC. In addition, the IRS introduced a Schedule EIC, which families now must complete and attach to their tax return to receive the credit. Prior to the introduction of Schedule EIC in 1991, some of the computations and data needed to determine EITC eligibility were found only in taxpayer worksheets never sent to the IRS. Now that information appears on Schedule EIC; this provides the IRS much more of the information needed to determine EITC eligibility than it secured in the past. As a result of these steps, as well as other measures the IRS has taken, program integrity has been greatly enhanced.

#### Some Problems Still Remain

Some major problems remain, however. Further EITC reforms are needed. The key problems include:

- EITC benefits still are much too low to lift full-time working families to the poverty line. A family of four with full-time minimum wage earnings will be \$5,100 below the poverty line in 1993 when its wages and EITC benefits are counted and its payroll taxes are subtracted. Even if the family receives food stamp benefits and these benefits are counted as income, the family remains \$2,000 below the poverty line.
- Two EITC supplemental credits that were written into the tax code in 1990 have created major new complexities and added potential for error and abuse; they serve little purpose. I am referring to the EITC health insurance credit and EITC young child supplement. The health insurance credit was the subject of a hearing just last month by the Oversight Subcommittee of this Committee. A Subcommittee investigation found evidence of abuse by insurance agents and companies. The Ways and Means Committee and the full House have twice voted to repeal these two supplemental credits and plow the savings back into enlargement of the basic EITC. That would be a wise course of action.
- The "advance payment" mechanism under which eligible families can receive EITC benefits throughout the year in their paychecks does not function effectively. Few EITC families receive their benefits in this manner.
- While EITC participation has risen in recent years, some eligible families still do not receive the credit. The IRS has substantially enhanced its outreach and public information efforts on the EITC and is to be commended for this work. But some further steps can be taken.
- One of the initial purposes of the EITC was to offset the regressive burden of the payroll tax on low-income working families with children. But for very poor workers without children, there is no offset to the payroll tax.

#### The Clinton Administration EITC Proposals

In his State of the Union address on February 17, President Clinton made an important announcement. He declared his strong support for the goal that full-time working families with children should not be poor and emphasized the critical role of the EITC in meeting this goal. He stated:

"The new direction I propose will make this solemn, simple commitment: by expanding the refundable earned income tax credit, we will make history; we will reward the work of millions of working poor



Americans by realizing the principle that if you work 40 hours a week and you've got a child in the house, you will no longer be in poverty."

The Administration's budget document, *A Vision of Change for America*, provides some additional information, noting that the Administration's EITC proposal "will assure that a family of four will not be forced to live in poverty, if one of the parent works full-time at a minimum wage job." This implies that the EITC benefit increment for families with two or more children will be substantially enlarged.

While the details of the Administration's final EITC proposal are not yet available (I hope they are released at this hearing), these statements provide some strong clues of what the proposal will look like. It apparently will involve a sufficient increase in the EITC to bring families of four with a full-time minimum wage worker to the poverty line, if the family has a child. That would be an outstanding achievement. I commend the Administration for it.

Bringing families of four with a full-time worker to the poverty line should encourage work and underscore its value even when the work pays a low wage. Such a step would be crucial to making welfare reform more effective. As the Manpower Demonstration Research Corporation, the organization that has evaluated numerous welfare-to-work programs, has reported, even successful welfare employment programs do relatively little to reduce poverty or raise family income because families typically lose nearly as much in welfare and other benefits as they gain in earnings from a low-wage job. MDRC has indicated that policy changes in other areas such as the EITC are needed if work is to raise family income and enable welfare recipients to escape poverty by working.

An EITC expansion of this nature would also have a significant effect in reducing poverty, especially among children. CBO data tabulations published in the *Green Book* show that when the EITC expansions enacted in 1990 are phased in fully, they will lift one million children out of poverty. The new EITC expansions proposed by the Clinton Administration are likely to lift many more children from the ranks of the poor.

Two other features included in the Administration's original EITC design that was subsequently pulled back and modified — and that I hope remain in the final Administration proposal — also warrant discussion. The original plan would have repealed the EITC health insurance credit and the EITC young child supplement and used the funds to help finance the expansion in basic EITC benefits. Such an approach would represent sound policy. Since this Committee has already approved such an approach twice in the past, I will not discuss it at further length here.

In addition, the original Administration plan would have established a new, small EITC for childless workers with income below \$9,000. That credit would have equaled 7.65 percent of their first \$4,000 in earnings.

The establishment of such a credit would represent wise policy. In seeking to encourage work, the last thing we should be doing is taxing the working poor deeper into poverty. This applies to poor workers without children as well as those with children in the home.

Currently, the EITC provides low-income working parents with an offset to the regressive payroll taxes they pay. Poor workers without children qualify for no such offset, however, because they are ineligible for the EITC; payroll taxes do push them deeper into poverty. Moreover, single tax filers start to owe federal income tax on their earnings when those earnings are more than \$1,000 below the poverty line. An EITC proposal such as that in the Administration's original plan would address both

of these problems, offsetting the payroll tax and raising the point at which income taxes begin being owed so that this point is about at the poverty line.

Such a proposal would also have another beneficial effect. It would shield these very poor workers from having their poverty deepened by the proposed energy tax.

Of course, the proposal to extend the EITC to workers without children should not be confused with the proposal to expand the EITC for families that do have children. Under the original Administration proposal, the new EITC for workers without children was very small, providing a maximum benefit of \$306 and an average benefit of between \$100 and \$200 — a small fraction of the EITC benefits for families with children. The proposal for childless workers was best understood as a proposal to shield very poor workers without children from taxation, rather than as a proposal to raise their living standards or lift them out of poverty, as would be done for families with children.

#### **Additional EITC Reforms Could be Considered**

Based on what I know to date about the Administration's EITC proposal, I would urge favorable consideration of it. I hope to be able to comment further on the proposal at the hearing if additional details about it become available during the hearing.

In addition to the various changes in EITC benefit rules and eligibility criteria that the Administration is proposing, several other modest EITC reforms could also be considered. These reforms are designed to make progress on two other fronts — increasing the proportion of eligible families that receive the credit and improving the functioning of the EITC advance payment mechanism so that more families receive their EITC benefits in their regular paychecks.

Regarding steps that could be taken to increase receipt of the EITC by eligible households, I would suggest three modest steps. Two of these three steps would require legislation. The three recommendations, which grow out of the Center's EITC public information efforts, are as follows:

- Under current law, employers are required to provide an IRS-designed notice about the EITC to workers whose wages were so low that they had no income tax withheld from their paychecks during the year. The notice is distributed around the time that W-2 forms are distributed. This requirement was enacted in 1986 at a time when all that an eligible family had to do to obtain the EIC was to file a tax return. The provision targeted workers who had no income tax withheld because they are less likely than other EIC-eligible families to file a tax return.

Since the time when the current notification provision was enacted, however, the requirement to file Schedule EIC has been added. We suggest the notification requirement be broadened so that the notice is provided to all workers with gross wages below the EITC income limits. We also recommend that IRS modify the wording of the notice to explain the need to file Schedule EIC as well as the requirement to file a tax return.

- Our second suggestion would resolve a technical problem in legislation passed last summer and would better enable states to inform unemployed workers about the EIC. Early last year, several states concluded that the most effective way to get information about the EITC to workers who received some unemployment insurance benefits during

the year was to include an EIC notice with the 1099-G forms that are sent each January. (The 1099-G form shows the total amount of unemployment benefits an individual received in the previous year.) But under the law as it stood in early 1992, a state that included non-germane information in an unemployment insurance-related mailing was required to reimburse the Labor Department for half the mailing cost, even if the added information did not raise the cost of postage.

A modification to this rule — permitting states to send EIC information at no charge with 1099-G forms so long as it did not raise the cost of postage — was included in unemployment legislation enacted last July. But, as it turned out, some states send their 1099-G forms in so called "self-mailers" and cannot enclose additional paper with such mailings. For these states, the next most efficient way to tell unemployed workers about the EIC is to include an EIC notice with a monthly unemployment check. Unfortunately, the legislation enacted in July did not apply to the mailing of unemployment checks; it only covered 1099-G mailings. This occurred because the problem with 1099-G self-mailers was not understood at the time. Therefore, we suggest that the legislation be modified to allow states to send EIC information with any unemployment insurance-related mailing, including monthly unemployment checks, so long as it does not raise the cost of postage.

- A third suggestion could be implemented administratively. IRS could consider establishing a toll-free hotline to help callers locate their nearest VITA site. (VITA sites are established by IRS and staffed by trained volunteers who offer free tax assistance to low-income filers.) This hotline would be separate from the regular IRS hotline. Currently, taxpayers who want to find the location of their nearest VITA site must call the IRS' basic toll-free assistance number, which is often clogged with callers seeking other tax information. Operators at the VITA hotline would not have to be tax experts; they would need only to explain what VITA does and to provide the address and phone number of a VITA site in the caller's area. Moreover, the VITA hotline could be relatively inexpensive since it would only need to operate three months a year, the months that VITA sites are open.

### **Advance Payments**

One of the most significant areas where improvement is needed is in the "advance payment" system, under which eligible workers can receive their EITC benefits in their regular paychecks. Fewer than one percent of EITC families now receive their EITC benefits in this manner.

Several options might be explored. First, as the GAO has recommended, the IRS could send information about the advance payment option, along with a copy of the W-5 form (the form that employees submit to employers to receive advance payments), to all filers receiving EITC refund checks. That one step could substantially increase knowledge about the EITC advance payment option and should lead to some increased use of it.

Second, the rules governing the amount of a family's EITC benefit available through the advance payment mechanism could be changed. Some families may be reluctant to use the advance payment option because they wish to receive a refund at the end of the year. Moreover, if a family receives advance payments but turns out ultimately to be eligible for a smaller EITC benefit because of a year-end bonus, a spouse finding a job, or some other reason, the family can owe a significant amount

back at the end of the year. That, too, can discourage use of the advance payment system, while also creating difficulties for the IRS.

As a result, we suggest that consideration be given to setting the advance payment amount at some percentage of the full EITC benefit for which a worker would appear to qualify. The advance payment level could be set at somewhere between 50 percent and 75 percent of the annual EITC benefit for which a worker would qualify. That would enable workers still to receive refunds at the end of the year and would significantly lessen the chances that they would owe money back at year-end. In conjunction with such an approach, we would suggest that there be separate parts of the advance payment table, with different advance payment benefit amounts, depending on whether the worker had one child or two or more children.

Finally, we would suggest that work be undertaken to ascertain if, over the longer term, there are ways to deliver advance payments benefits that do not require the involvement of employers. Some employers are reluctant to provide this service. Some employees are apparently reluctant to ask their employer to perform it. As earnings data become increasingly automated, perhaps some mechanism can be found for the government to make EITC payments to eligible families at regular intervals. This matter deserves study.

#### **A Final Note: Modification of Assets Rules**

I would like to raise one final point. With EIC benefits rising, assets rules for AFDC and food stamps need some modification. At present, EITC benefits are excluded from being counted as assets in these programs only in the month the benefits are received and the following month. As EITC benefits grow, this will increasingly become a problem. Some families will face the choice of spending part of their EITC payment very rapidly or losing benefits such as food stamps (and in some cases, AFDC and Medicaid).

There are several possible ways to address this problem. For example, under rules governing the SSI program, a beneficiary who meets the SSI asset test and then receives an SSI retroactive lump-sum payment (covering the months his or her application was being processed) is not disqualified if the lump-sum payment would bring his or her assets above the assets limit. Instead, the assets limit for such a beneficiary is suspended for six months. One possibility would be to use this approach for EITC payments received by families already enrolled in the food stamp and AFDC programs. The assets limits for these families could be suspended for six months. A provision of this nature could be used in combination with a provision such as that included in H.R. 11 last year which allowed AFDC families to accumulate assets in excess of the program's regular assets limit if the additional assets were set aside for a designated and approved purpose, such as self-employment, education, homeownership, or moving to a new home.

That concludes my testimony. I appreciate the opportunity to testify here today.



Chairman RANGEL. Thank you, Mr. Greenstein. We also thank you for your support and the work you have given to the administration to reach this point, the work that you have done over the years without a receptive administration, and the fact that we can still count on you to affect the proposals in front of us.

Before I ask the members if they want to inquire, let us do some housekeeping.

Those bells that you have just heard mean that we are going to have to go to the floor, and we are going to have a series of votes, a series of 5-minute votes. It is going to take at least 40 minutes.

When this panel is released, we will not be coming back here until 1:45. So for the second and third panels—for the last and next to last panels rather, we are sorry for the inconvenience, but it is the business of the floor that forces us to do this. So when we come back, we will start with the last and the next to the last panels.

Mr. Matsui.

Acting Chairman MATSUI. Thank you, Mr. Chairman.

I will be very brief, because I know we have a few minutes, and I do not think we want to keep this panel.

I would like to just ask you, Bob, a question. Maybe you can put it in writing if you feel that you need more time with it, but has the outreach program on the EITC been effective and sufficient?

I just found out that this document that we were shown by the IRS folks is just really a very new effort on their part, and so it probably has not even been tested yet.

Could you give me some ideas on that? And then maybe what we can do about it and maybe, again, you may have to—

Mr. GREENSTEIN. As you know, our center has been coordinating an outreach effort on the earned income credit for 5 years. In the last several years, the IRS has become increasingly active. They have put a lot of effort into it. They have had those materials out for a couple of years, and we have been pleased with their response.

I do think, however, that more can be done, and in my written testimony, I have several specific ideas—some are administrative; some are legislative—for additional steps that could be taken in the outreach area. We also have more detail than the testimony contains on those particular proposals, and I will be happy to provide that.

Chairman RANGEL. Mr. Hancock.

Mr. HANCOCK. Thank you, Mr. Chairman.

Just a real quick question to Dr. Kusters. Do you agree with Mr. Greenstein that it is mostly two-parent families in the phaseout range and single parents in the incentive range of the earned income tax credit; do you agree with that?

Mr. KOSTERS. Congressman Hancock. I present in my prepared statement data on married-couple families with children. There are substantial numbers of wives working throughout the income range, with larger proportions at work as you move up the income scale. I do not have data readily available to me on single-parent families. So I do not know exactly how single-parent families would compare.

I think, though, that there is a question as to why it is much more valuable for second members of a two-parent family to stay

at home with children in an income range between \$10,000 and \$20,000 than it is at a lower income range. I think caring for children is valuable in any case, but I think that it is most appropriate to let parents decide on that kind of question.

But we should try to avoid facing them with the kind of tax rate that the people in the upper part of the phaseout range would face, which is the 15 percent bracket in the regular personal income tax, and about 20 percent more in addition under the new earned income tax credit proposal for a total of about 35 percent.

Mr. HANCOCK. In your statement—and I have not read it in detail—but you were talking about from zero to \$8,000, and then someplace in there, that individual or that family loses Medicaid and other benefits. They are phased out as earnings increase. Around \$8,000; at \$8,001 say, you lose \$3,000 to \$4,000 worth of medical benefits on a family of four. Am I correct on that?

Anyway, you have got to go a long ways to make that up real quickly between that \$8,000 and \$13,000 brackets, and that would work out that way, would it not?

Mr. KOSTERS. Well, I do not discuss this in any detail in my prepared statement. However, it certainly is the case that in addition to whatever effective tax rate incentives are present in a combination of the regular personal income tax and the earned income credit, we also need to take into account the incentive effects of withdrawal of many of the other programs, from Medicaid to food stamps to other programs. The combination of those phasing out can create very serious work disincentives. The highest marginal effective tax rates in the whole income distribution are probably applicable to people who are poor or near poor.

Mr. HANCOCK. Thank you.

Chairman RANGEL. Thank you. I thank the panel, and I will look forward to continue working with you. The committee stands in recess until 1:50.

[Recess.]

Chairman RANGEL. These hearings will resume, and the next panel will be Stephen Holt, Congress for a Working America; Charles Sullivan, director of the Citizens United for Rehabilitation of Errants; Robert Brabham, psychologist, South Carolina; from the Children's Rights Council and Vermonters for Stronger Families, Laurie Casey, policy analyst.

I apologize for the delay. We are ready to go back to business. Your statements, without objection, will be entered into the record. And we will start with Stephen Holt.

**STATEMENT OF STEPHEN D. HOLT, ACTING DIRECTOR,  
CONGRESS FOR A WORKING AMERICA, INC., MILWAUKEE, WIS.**

Mr. HOLT. Thank you, Mr. Chairman.

I want to highlight a few points from my written testimony, focusing my remarks on advance payment of the earned income credit.

As you heard again this morning, very few eligible workers take advantage of the advance payment option of the EIC, and I want you to know that this is not simply due to a lack of awareness of the credit and of that option. That many employers and employees

do not know about advance payment is certainly important, but it does not explain the problem.

In Milwaukee, since 1989, we have promoted the advance payment option aggressively as part of our earned income credit outreach, and we have found employers to be generally supportive and cooperative. We have even had employers who have taken strong initiative in identifying potentially eligible employees, explaining to them the advance payment option, explaining to them how they can go about getting it, and even in these cases most workers decline to participate.

Why? Because the advance payment system, as it is currently configured, is basically flawed. Unless we can make improvements in advance payment, we are never going to really achieve the anti-poverty, prowork aims that we have for the earned income credit.

The most basic problem is one problem that is usually not directly apparent to recipients of the earned income credit, but it is something that is of indirect and still very real concern to them. It is the fact that the way in which we calculate advance payment is inherently flawed, because it is different from the way that we calculate the earned income credit. And for the worker considering advance payment, this is usually manifested in the fear that they express to us: "I am going to owe money back at the end of the year."

This problem cannot be solved very easily either. Currently an employer has no way of knowing what someone's earnings for the entire year are going to be at the time they make an advance. They do not know what a person's earnings from another job might be, even if that job has been a past job, and certainly it is much worse if it is a job that they are holding at the same time. They do not know what other earnings might be coming from a spouse.

All of those will significantly affect what someone should get in terms of earned income credit. However, the employer will not be able to include any of that in calculating what the person gets in terms of their advance.

We have got to have better information available to employers or to some other entity about an individual's or a couple's earnings in order to make an accurate earnings supplement, and that is going to require far-reaching and long-term reforms. Congress for a Working America, working with business leaders, government leaders, and recipients in the community, has come up with some ideas on how to approach those reforms. Obviously we do not have time to go into any detail about those now. What I want to emphasize is the necessity of addressing this inherent underlying problem in the advance payment system.

At the same time, we can make some quick and relatively easy reforms that will dramatically increase the attractiveness of this participation option for eligible families.

Most important is something we call the 50 percent option. Today, a worker looking at whether he or she wants to take advance payment has only two options: zero percent—in other words, not taking anything in advance—or 100 percent.

Given the real concerns that people have about owing money back at the end of the year and the even more often expressed desire—that we also heard echoed this morning—of wanting to get

money back at the end of the year in some kind of a refund, most workers choose the zero percent option. They choose not to receive anything in advance. And I do not think that is the policy result that you on this committee want to see, because that deemphasizes the earnings supplement aspect of the earned income credit. It turns it more into a benefit program where you get a check once a year, and that is really not the kind of prowork incentive that I think you want to focus on.

With the 50 percent option, it will lessen people's concerns about getting too much money, and it will also give them a chance to get a tax refund at the end of the year. Then we can look at other improvements in increasing awareness.

One idea we have had is to combine the W-4 and W-5 forms into a single tax-planning document, so that as you look at how many withholdings you want, you would also look at that time about whether you are eligible for and whether you would like to receive advance payment.

And we also think that the IRS nationally should follow the lead of our Milwaukee District of the IRS—and also some of the suggestions of the GAO—and more aggressively and creatively promote the advance payment option.

Thank you.

[The prepared statement and attachments follow:]





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Testimony of  
**STEPHEN D. HOLT**  
 Acting Director

to the  
**SUBCOMMITTEE ON SELECT REVENUE MEASURES**  
 and the  
**SUBCOMMITTEE ON HUMAN RESOURCES**  
**COMMITTEE ON WAYS AND MEANS**  
**U.S. HOUSE OF REPRESENTATIVES**  
 March 30, 1993

Thank you, Chairman Rangel and Chairman Matsui and other Subcommittee members, for the opportunity to appear before you today. On behalf of Congress For a Working America, Inc. (CFWA), I appreciate being able to speak on the subject of how our current tax laws provide work incentives for low-income families and help create alternatives to welfare. My remarks will focus on the Earned Income Credit (EIC). Specifically, I want to highlight:

- 1) CFWA's experience promoting the EIC in Milwaukee;
- 2) suggested enhancements of the EIC; and
- 3) most importantly, needed improvements in the Advance Payment option.

#### CONGRESS FOR A WORKING AMERICA

CFWA is a Milwaukee-based non-profit organization that works to ensure that everyone has the opportunity to work at a decent, productive job. CFWA actively promotes the EIC as a way to help increase the decency of low-wage jobs. In tandem with a higher minimum wage, the EIC can fulfill the community's obligation to ensure that those who work are not poor.

#### THE MILWAUKEE EIC CAMPAIGN

CFWA coordinates the Milwaukee EIC Campaign. The Campaign is a joint effort with the Greater Milwaukee Committee (a private-sector civic group of business, labor, and educational leaders) and the City of Milwaukee, in close cooperation with the Milwaukee District of the Internal Revenue Service. Begun in 1989 at the initiative of Milwaukee Mayor John Norquist, the Campaign works to improve use of the federal and Wisconsin Earned Income Credits by Milwaukee-area low-wage working families.

The Milwaukee EIC Campaign is a broad-based effort designed to reach eligible working parents through direct marketing, community institutions, and employers. The Campaign uses television and radio public service announcements, ads on Milwaukee County buses, bulletin board flyers, and mailings to targeted groups. CFWA manages joint promotional programs with employers, child care providers, unions, schools, and community organizations.

The Milwaukee EIC Campaign is part of an informal national network of local outreach efforts coordinated by the Center on Budget and Policy Priorities here in Washington. The Center distributes high-quality promotional materials, assists in local campaign design, and serves as a clearinghouse for ideas. With the leadership of the Center on Budget and Policy Priorities, awareness of the EIC has increased dramatically among low-wage working families across the country.

ENHANCING THE EIC

We applaud President Clinton's announced intention to expand the EIC so that workers in the United States will not be poor. Although we do not yet know the details of the President's proposals, we support the broad outlines that have been publicized. I urge you to support the President's plan for EIC expansion and simplification as it moves through the Congress.

Our experience indicates that you should advance the following changes in the federal EIC to increase the work incentives for low-income families and promote economic self-sufficiency.

**REPEAL THE YOUNG CHILD AND HEALTH INSURANCE SUPPLEMENTAL CREDITS.** Neither of these supplemental credits provides sufficient funds to achieve its stated purpose. There is also not clear consensus about the policy goals underlying these credits.

Moreover, the existence of these supplemental credits has unreasonably complicated the process of filing for the basic EIC. One of the chief merits of the EIC has been its administrative simplicity. The calculations eligible families must now use constitute an unnecessary barrier to participation. The Milwaukee EIC Campaign has had to devote considerable effort in the last two years to recruiting volunteers who can help families calculate their credits and file accurate returns. There is no justification for continuing this complexity.

**ELIMINATE SCHEDULE EIC.** The IRS developed Schedule EIC in response to the changes Congress enacted in the EIC in 1990, principally the young child and health insurance supplemental credits. Once these credits are repealed, Congress should ask the IRS to eliminate the separate EIC form.

In our view, the only residual purpose of Schedule EIC after repeal of the supplemental credits would be reporting of information about non-dependent qualifying children. The IRS should allow families to list these children in the dependents section of Form 1040 or 1040A and to check a box indicating that they are being listed for purposes of the EIC only.

Eliminating Schedule EIC would greatly simplify the process for obtaining EIC benefits, encouraging more families to take advantage of the credits they have earned.

**INCREASE THE BASIC EIC.** The EIC should ensure that those who work are not poor. Specifically, the EIC should make up the difference between full-time, year-round earnings at the minimum wage and above-poverty income. This requires a significant increase in the credit percentages for families with two or more children.

**CREATE A HIGHER CREDIT RATE FOR FAMILIES WITH THREE OR MORE CHILDREN.** The principle of bridging the gap between earnings and poverty requires attention to the added living expenses of larger families. Wisconsin recognizes this in its unique state EIC. Wisconsin's credit, calculated as a variable percentage of the federal EIC, gives families with three or more children a benefit three times that of families with two children and fifteen times that of one-child households. The federal government should follow Wisconsin's lead and create a new credit rate for larger families.

**LENGTHEN THE PHASE-OUT OF THE EIC, EXPANDING ELIGIBILITY TO FAMILIES WITH HIGHER LEVELS OF INCOME.** In any benefit program targeted at families with low incomes, an inherent complication is the disincentive created by the phase-out of benefits. As the federal government's principal tool of providing work incentives, the EIC should not be phased out so quickly that families receive

little return from working more hours or at higher wages. Phasing out the credit at an annual income of \$28,000 to \$30,000 would significantly reduce the high marginal effective tax rates that will otherwise result from credit expansion.

A lengthened phase-out would have the added benefit of making additional families beneficiaries. This is important for two reasons. First, most families with annual incomes between \$23,000 and \$30,000 are struggling economically. They work hard but find it increasingly difficult to support themselves. Second, these families are a powerful constituency of support for the EIC and its underlying principles; extending benefits to them strengthens the program.

#### THE ADVANCE PAYMENT OPTION - PROBLEMS

We can be most helpful to your subcommittees and other policy makers with respect to improvements in the Advance Payment option of the EIC.

Through the Milwaukee EIC Campaign, CFWA is the national leader in promoting Advance Payment. We conduct year-round outreach aimed at increasing participation in this woefully underutilized program. This experience makes us acutely aware of the shortcomings of Advance Payment and knowledgeable about how it can be improved.

About a year ago, CFWA convened a work group representing large and small employers, government, and EIC recipients. This work group evaluated the Advance Payment program, identified key problems, and made suggestions for both immediate and long-range changes. A list of the members of the work group appears at the end of my remarks as Appendix A. My statement today reflects the conclusions of this group.

The Advance Payment option enables eligible families to receive their EIC benefits from their employers throughout the year. Workers initiate Advance Payment by filing IRS Form W-5 with their employers. In 1993, an employee can receive as much as \$120 in additional disposable income each month. However, the best estimate available is that fewer than 1 in 200 EIC recipients choose the Advance Payment option.

We have identified three principal reasons for low participation in Advance Payment: 1) lack of awareness among eligible families and employers; 2) an inflexible payment structure; and 3) an inaccurate method of calculating benefits.

LACK OF AWARENESS -- Even those who currently receive the EIC are unaware of the Advance Payment option. Almost all publicity for the EIC focuses on receiving benefits at year-end through the tax return. Many groups involved in EIC outreach have been reluctant to promote Advance Payment because of problems inherent in the current system.

Many employers are also not aware of Advance Payment. The IRS has made little effort to inform employees about it. Employers who do know about Advance Payment are often confused about their responsibilities and liabilities. A key problem appears to be lack of clarity in the instructions provided in Circular E, the Employer's Tax Guide.

I want to note that, contrary to what many believe, employers are generally receptive and willing to fulfill their Advance Payment obligations. Some Milwaukee businesses are in fact aggressive promoters of this benefit to their workforce. Unfortunately, because of the other problems with Advance Payment, several have found little receptivity among their employees.

INFLEXIBLE PAYMENT STRUCTURE -- The most commonly cited reason for not taking advantage of Advance Payment is a desire to receive a large tax refund. The only choice currently available to EIC recipients is all-or-nothing: 100% Advance Payment, or 100% at year-end. Coloring this choice is the possibility of receiving too much in advance and incurring a repayment obligation. It is not unreasonable for most families to pick the large refund, even though many desperately need additional cash throughout the year.

INACCURATE BENEFIT CALCULATION -- The data upon which Advance Payment is calculated -- current period earnings of one wage-earner from one employer -- are in many cases an inaccurate predictor of the total annual EIC for which a household will be entitled.

Inaccurate computation places low-wage families at risk of being overpaid and owing money back to the IRS at year-end. Uncertainty about potential overpayment discourages use of the advance payment option (either at the taxpayer's own initiative or at the urging of tax preparers, case workers, etc.).

Three situations put workers at particular risk: income variability, multiple employers, and couples in which both work. An outline of these problems, together with specific examples, appears as Appendix B at the end of these remarks.

#### THE ADVANCE PAYMENT OPTION - SOLUTIONS

CREATE A NEW 50% ADVANCE PAYMENT OPTION. Participants should be able to choose either the full Advance Payment or one-half of that amount. This election can be included on Form W-5. A new column in the Advance Payment tables in Circular E would indicate the 50% amount to be advanced with each paycheck.

This change would dramatically increase use of Advance Payment. Families would be able to have additional money each month for everyday living expenses and still receive a year-end tax refund. Other taxpayers have flexibility in savings through withholding; EIC recipients should have greater choice, too.

This change also provides a cushion against overpayment risks. Even without other changes in Advance Payment calculation, more families could receive benefits throughout the year without fear of owing money back to the IRS at the end of the year.

COMBINE FORMS W-4 AND W-5. Workers use Form W-4 to set the number of withholding allowances. It is intended to be a basic tax planning tool. The decision to receive Advance Payment should be part of this planning.

More importantly, a combined form would greatly increase awareness of the Advance Payment option. It would ensure that Advance Payment information is presented to all new employees and to continuing employees who have had a change in family circumstances.

The new combined W-4/W-5 should include greatly expanded instructions. These should include easily understood examples of how Advance Payment works, cautionary notes regarding persons for whom the current benefit calculation system does not work, and attractive graphics consistent with general market EIC promotion.

MAKE THE FULL BASIC CREDIT AVAILABLE THROUGH ADVANCE PAYMENT. At present, only the basic credit amount for families with one child is available through Advance Payment. Given the small differential between this amount and the higher credit for families with two or more children, this does not present a problem.



However, if the EIC is expanded as it should be for larger families, these families will miss out on much of the benefit unless there is a change in Advance Payment.

This change could be achieved through Form W-5 (or the new combined form) by adding a line for number of qualifying children. This would follow the approach used now for setting withholding allowances. There would also need to be revisions in the Advance Payment tables provided to employers in Circular E.

**REQUIRE GREATER PROMOTION OF ADVANCE PAYMENT BY THE IRS.** Improvements could include sending Advance Payment information to all persons who filed for the EIC in the prior year (perhaps with refund checks), redesigning Form W-2 or creating a new notice to fulfill the current statutory notice requirement for employees who do not have income tax withheld, and revisions in Circular E (examples of how to advance the credit, greater detail on the process of financing advances through federal tax deposits, and clearer statements of employer responsibilities and liabilities).

**EXAMINE LONG-TERM IMPROVEMENTS IN ADVANCE PAYMENT.** The worst problems with the current Advance Payment approach -- those involving benefit calculation errors -- are not remediable without much more far-reaching changes. Employers do not have access to the wage information they need in order to make accurate calculations. Perhaps the wage reporting system should change to take greater advantage of electronic data transfer and storage technology. Perhaps employers should play a reduced role, with disbursement and even benefit calculation handled by a service bureau, the IRS, or the Social Security Administration. Perhaps electronic fund transfers to eligible families should become the primary means of payment.

Achieving the objectives of the EIC, and the work incentive objectives you are considering here today, will require an improved Advance Payment system that delivers funds into families' pockets throughout the year. We must ultimately make significant changes in our approach to Advance Payment. This requires intensive study as well as the input of a wide range of individuals and groups. Congress should undertake a thorough examination of these issues. You should also ask the Clinton Administration to recognize the importance and urgency of this problem by instituting its own review of potential improvements.

To conclude, I want to reaffirm the value of the EIC as an anti-poverty tool that encourages work and provides a real alternative to other options such as welfare. Proposed expansions of the EIC will help ensure that work does pay for all Americans. But truly realizing the promise of the EIC will require attention to the current Advance Payment option. Families must have a reasonable opportunity to receive their earnings supplements throughout the year. I urge you to adopt the recommendations I have outlined today.

Thank you again for this opportunity to share CFWA's experiences and ideas.

## APPENDIX A

MILWAUKEE  
EARNED INCOME CREDIT ADVANCE PAYMENT  
WORKING GROUP

Mr. David Riemer City of Milwaukee	Ms. Margaret Rasmussen Harley-Davidson, Inc.
Ms. Eve Galanter Office of Senator Herb Kohl	Mr. Lonnie Radcliffe Independence Bank of Chicago
Mr. Robert Milbourne Mr. Tim Rider Greater Milwaukee Committee	Mr. C. Everett Wallace Wallace Enterprises International (Chicago)
Mr. J. Lanier Little Ms. Anna Beshensky Mr. Jeffrey Johnson Norwest Bank Wisconsin	Mr. John Ader Milwaukee District Director, Internal Revenue Service
Mr. Doug Johnson Mr. Mike Johnson Bank One Milwaukee	Ms. Margaret Derus Wisconsin Department of Revenue
Mr. Dan Willett Milwaukee EIC Campaign Coordinator, 1990	Ms. Sara Ackley Arthur Andersen & Co.
Ms. Gail King C. Ross Home Health Care	Mr. Jere McGaffey Foley & Lardner

\* \* \* \* \*

## APPENDIX B

BENEFIT CALCULATION PROBLEMS

Income Variability -- The most obvious problem with the current computation method involves fluctuations in an employee's earnings over the course of the year. Because the credit earned is constant at annual incomes of \$7,750 to \$12,200 and then phases out at higher incomes, earnings in different pay periods may vary the amount advanced. Yet these variations, because they do not relate directly to cumulative or expected annual earnings, may have no relationship with the actual EIC due at year-end.

In many cases, fluctuating income will not cause any hardship. For instance, a minimum-wage worker whose hours vary between full-time and part-time will receive advances approximating the correct EIC benefit.

Problems arise when income increases during the year. These higher earnings will progressively reduce the EIC due. Although the amount advanced will also decrease, prior large advances may create a repayment liability.

The situation is seen most clearly in an extreme example. Suppose a person works full-time for the first six months of the year for \$6.00 an hour. Having filed a Form W-5 on January 1, she will receive about \$104 a month in Advance Payment. On July 1, she takes a new position paying \$16.00 an hour. Her Advance Payment will stop, because she is now earning at a rate higher than the annual EIC income ceiling. An ugly surprise awaits this worker at year-end:

Annual earnings:	\$22,880
Advance Payment received:	\$698
Actual EIC benefit for year (one child):	\$23
REPAYMENT LIABILITY TO IRS:	\$675

Although this individual is no longer low-income, the repayment will likely be a significant hardship. The inaccurate Advance Payment calculation operates as a penalty for success. The risk that unforeseen future events may transform the Advance Payment from a benefit to a burden makes many workers reluctant to take advantage of it.

Multiple Employers -- A greater problem involves individuals who work more than one job concurrently. It arises not from multiple advance payments, but from receiving a single advance based on understated earnings: the employer making advance payments cannot include any other wages in the Advance Payment calculation.

For a person earning less than \$7,750 in her primary job, understated earnings could result in underpayment. However, for most persons, it will cause overpayment. This is due to the phase-out structure of the credit, which reduces the EIC benefit when earnings rise above \$12,200.

The following examples are instructive. In each case, the employee files Form W-5 for Job 1. Each is a single-parent family with one child. Each assumes constant earnings year-round; fluctuations could introduce additional benefit calculation errors:

EXAMPLE #1: Job 1 is full-time at minimum wage (\$4.25 an hour). Job 2 is half-time at minimum wage.

Total earnings:	\$13,260
Advance Payment received:	\$1,427
Actual EIC benefit for year:	\$1,294
REPAYMENT LIABILITY TO IRS:	\$134

EXAMPLE #2: Job 1 is full-time at \$7.00 an hour. Job 2 is half-time at minimum wage.

Total earnings:	\$18,980
Advance Payment received:	\$1,121
Actual EIC benefit for year:	\$538
REPAYMENT LIABILITY TO IRS:	\$583

EXAMPLE #3: Job 1 is three-quarters time at \$8.00 an hour. Job 2 is half-time at \$8.00 an hour.

Total earnings:	\$20,800
Advance Payment received:	\$1,396
Actual EIC benefit for year:	\$298
REPAYMENT LIABILITY TO IRS:	\$1,098

In each of these cases, the employee would have been in compliance with the instructions for Form W-5. She would have no indication of the overpayment problem until she filed her tax return.

Married, Both Working -- By following current Advance Payment guidelines, households with married parents who are each working can easily receive overpayment of EIC benefits and bear a substantial repayment obligation at year-end.

As with a person working multiple jobs, the problem arises from the phase-out structure of the credit. Household earnings above \$12,200 reduce the EIC benefit. Even though the combined income of working spouses will often push household earnings above this level, the Advance Payment calculation base (earnings of the recipient spouse only) cannot account for it.

The special table used when both spouses file a W-5 mitigates the problem, because it starts phasing out the Advance Payment at a lower earnings level. But it assumes that each spouse is receiving the same wages. When there is a significant differential, the special table fails to provide an accurate advance.

The most egregious problem is treating a two-earner household with one W-5 filer as if it is a single-earner household. By generating a full advance based on the filer's income only, this approach will usually result in overpayment. It is possible for a family to receive the maximum Advance Payment when they actually qualify for only a small benefit.

The following examples illustrate the problem (in each case, the family has one qualifying child):

**EXAMPLE #1:** Parent 1 working full-time at minimum wage (\$4.25 an hour), and Parent 2 working half-time at minimum wage. Annual earnings: \$13,260. Actual EIC due (basic credit): \$1,294.

If both file a W-5, they will be due \$236 at year-end.  
 If only Parent 1 files a W-5, they will owe back \$134.  
 If only Parent 2 files a W-5, they will be due \$476.

**EXAMPLE #2:** Parent 1 working full-time at \$6.00 an hour, and Parent #2 working half-time at minimum wage. Annual earnings: \$16,900. Actual EIC due: \$813.

If both file a W-5, they will be due \$107.  
 If only Parent 1 files a W-5, they will owe back \$583.  
 If only Parent 2 files a W-5, they will owe back \$5.

**EXAMPLE #3:** Parent 1 working full-time at \$6.00 an hour, and Parent 2 working full-time at minimum wage. Annual earnings: \$21,320. Actual EIC due: \$229.

If both file a W-5, they will owe back \$122.  
 If only Parent 1 files a W-5, they will owe back \$1,167.  
 If only Parent 2 files a W-5, they will owe back \$1,198.

**EXAMPLE #4:** Parent 1 working full-time at \$8.00 an hour, and Parent 2 working half-time at \$4.75 an hour. Annual earnings: \$21,580. Actual EIC due: \$195.

If both file a W-5, they will owe back \$511.  
 If only Parent 1 files a W-5, they will owe back \$652.  
 If only Parent 2 files a W-5, they will owe back \$719.

Each of these cases assumes year-round, constant earnings. Again, variable earnings can exacerbate the problem by introducing additional benefit calculation errors.



Chairman RANGEL. Thank you, Mr. Holt.  
Mr. Sullivan.

**STATEMENT OF CHARLES SULLIVAN, EXECUTIVE DIRECTOR,  
CITIZENS UNITED FOR REHABILITATION OF ERRANTS (CURE)**

Mr. SULLIVAN. Yes, Mr. Chairman, thank you. You have my statement, and I will just make, if I could, a couple of points.

First of all, the TJTC is more crucial now for ex-prisoners than ever before, because in the last 12 years, starting back with the Son of Sam incident where I think this very committee removed Veteran's benefits and Social Security benefits from prisoners, there is really less money today in rehabilitation, and also there are less rehabilitative programs and release programs for ex-prisoners.

So it is very, very crucial that the targeted jobs tax credit maintain its existence.

However, it has been my experience—and I do not have any research on this, but just 20 years of experience in prison work—that really there needs to be a substantial increase in outreach. And where there is outreach, the credit has been very successful with ex-prisoners.

A good example is the Texas Employment Commission, which now even has videos that they give to prisoners at each one of the units about how to use fully the targeted jobs tax credit. I think that in the renewing of the credit that we must mandate that there has got to be outreach, and also this outreach should include those who are certifying the credit.

I know employers who have prisoners on work release, and they cannot receive certification for the targeted jobs tax credit. There has been a technical determination by the Department of Labor that work releases do qualify for the credit. And yet, I know personally employers that cannot receive certification.

Let me say, too, with outreach, it would cost less than \$15, I think, to write a letter to every Governor in the country and say this committee suggests that every prisoner that leaves prison has within their hands information on the credit. To me, it seems like States now are finding out ways to plug into Federal moneys and they would jump at this opportunity.

But the problem is that corrections is very busy; we have given corrections a lot of headaches, and so this is just one more headache, but unless you prioritize it, you are going to find probably only 10 percent of the prisoners that actually are released from prison probably know about the credit.

We have a homeless shelter that is downstairs where our office is. I went down and asked them last week if they had ever heard of the credit, and they have been doing this work for 10 or 12 years, and they said they had never heard of it. And they receive prisoners daily. They had never even heard of it.

So there has got to be a substantial increase in outreach. And I do not think necessarily it has to be on television. It has to go to the very spot where they are released. That is where, when a person is leaving, in Spanish as well as in English, we have got to explain it fully to them, and when I say fully, I mean the details of it. Although I think it certainly is very, very important for those

who do receive the information, we could increase, I would think, tenfold the use of the credit by ex-prisoners.

And let me just say with the EITC that it is something that is almost in the thinking stage—but I do not see why we could not begin to look at prisoners who work in prison being eligible for the credit when they are released. The problem, even with the targeted jobs tax credit, is, when a person is released from prison, they need money in their hands not tomorrow, but today when they are released. And there really is not anything. As you well know, they are very, very poor release programs where they are given a few dollars, maybe the clothes on their back, et cetera. But if they are working in prison, why can they not qualify for the credit?

And then when they are released, they could use that money. I realize it is in an area that I really do not know that much about, but I do not know why they could not receive the EITC if they are working for the State. I think the States would support this, because they are realizing that unless we begin to give money to people at the gate they are going to be returning. We are looking at a 70-percent return rate, as you well know, and a lot of returns are because they do not have any money when they are released.

It takes 5 days to be processed for food stamps in this city. And talking to people in this homeless shelter, what people do, they go around and they eat at the various homeless shelters until they get the food stamps. And that is all the money they have.

So it seems like if we could begin to at least do some thinking on using the EITC for prisoners who are working—they may not be being paid very much, but they are working and working to benefit the State, that they could qualify as well for the EITC.

Thank you, Mr. Chairman.

[The prepared statement follows:]



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## CITIZENS UNITED FOR REHABILITATION OF ERRANTS

"A National Effort to Reduce Crime Through Criminal Justice Reform"

TIMOTHY AND STATEMENT OF CHARLES SULLIVAN, EXECUTIVE  
DIRECTOR OF CITIZENS UNITED FOR REHABILITATION OF ERRANTS  
(CURE), A NATIONAL PRISON REFORM ORGANIZATION

The targeted jobs tax credit is an excellent program for those being released from prison, but there must be a substantial increase in outreach to this population.

In fact, TJTC can be the only "plank" available to keep ex-convicts "afloat". It could be the one hope in a correctional policy that has become a formula for increasing failure and recidivism. With rare exceptions, states today are providing fewer rehabilitative programs, and prisoners have less money "to make it" when discharged.

The major reason for this neglect of rehabilitation is that there has been a staggering increase in incarceration and prison construction. Funds once used for correctional education and job training are now being used for brick and mortar. Many classrooms in prison are now being utilized to house inmates.

This is also the reason why release programs are "drying up". Politics has played a role too in reducing "help" for the prisoner and ex-prisoner. Pre-release furloughs to allow a prisoner to find employment have drastically been curtailed since the 1988 presidential race.

Democrats, too, have been involved in this prisoner bashing. President Jimmy Carter and a Democratic Congress cut out social security and veteran benefits for the incarcerated in the same year, by the way, that amnesty was given to those who went to Canada.

Recently, Congress passed an amendment to a crime bill that federal benefits could be taken away from those convicted of drug crimes. Last year, Congress limited Pell Grant eligibility for prisoners. Although the House voted nine to one to eliminate all grants to prisoners, Sen. Claiborne Pell was able to save most of the program.

Finally, prisoners have less money at the gate because there has emerged, in the last few years, what I call the "felon tax". Prisoners now pay a fine in New York for violating a rule while 20% is taken by the Iowa prisons for "processing" money that is placed in the inmate's account.

Families of prisoners are not immune and hundreds of millions of dollars were made by states last year from commissions on inmate collect calls. Fines, restitution, court costs, charges for parole supervision (as ironically parole and parole services are disappearing)--the prisoner is tempted to steal to pay his or her bills! If TJTC was refundable, it would probably be taken away from the ex-prisoner through these so-called "felon taxes".

Thus, renewal of the TJTC is more crucial now than ever before. And, since half of these prisoners are under 25, there must be restoration of eligibility of the 23-24 year old economically disadvantaged youth.

But, please along with renewing TJTC and restoring 23-24 year olds mandate that the U.S. Department of Labor begin a very aggressive and continuous educational campaign in both english and spanish to make ex-prisoners aware of how to fully use the credit. I would not be surprised if, in the past, only 10% of the eligible ex-prisoners knew about TJTC.

Also, this outreach should include those certifying TJTC. For example, the Labor Department has determined that prisoners on work release can receive TJTC. And yet, I know employers with work releasees who cannot receive the TJTC.

In conclusion, you may ask why should we spend so much money on these "no-good" prisoners? All the other categories of the TJTC are persons who did not violate the law.

My answer is that although ex-prisoners are, by far, the most difficult to employ category in the TJTC, the potential savings in dollars and human suffering (especially in regard to future victims) dwarf, by far, any other category.

And seriously more than facetiously, if we really want to punish these prisoners, let's make them taxpayers!

Chairman RANGEL. Thank you, Mr. Sullivan.  
Mr. Brabham.

**STATEMENT OF ROBERT E. BRABHAM, PH.D., PSYCHOLOGIST,  
CHAPIN, S.C.**

Mr. BRABHAM. Thank you, Mr. Chairman.

My perspective and point of view is a little bit different than some of the comments you have heard today. I am a rehabilitation counselor, and I have supervised hundreds of rehab counselors, and have been the head of the National Rehab Association with thousands of rehab counselors. And so my point and perspective is a little bit different.

I am saying to you unequivocally, targeted jobs tax credits represent the single best tool we have to open the door for employers to consider people with disabilities. So no matter what else goes on in our conversation today, please understand that this is terribly important to those of use who pound the pavement and knock on doors trying to get jobs for people with disabilities. It is a tremendous resource for us.

With your permission, sir, I will not bother to read what you have got in writing. But I want to comment on a couple of things that you have heard here today.

One of the previous witnesses told you that studies indicate that TJTC does not make a difference. That just flies in the face of evidence; it flies in the face of my experience and that of my colleagues. This credit, as you said, is an incentive to one and a bribe to another. Well, this incentive means an awful lot.

In the latest GAO study—we are going to have people come and quote you some studies—the latest GAO study suggested that indeed employers have changed their hiring practices as a result of these incentives being there. So I would urge you to consider that in weighing this other study.

I would also remind you, that study was back in the 1980s—the data was collected in 1981, 1984, and 1985. The provisions were either about to expire, or they had expired, and they might be made retroactive. I would suggest to you very respectfully, it is very difficult for those of us trying to get jobs and to sell a program, particularly to small employers—8, 10, 20 employees; it is very, very difficult, then, to say: Well, it expires, and it might expire, and it may or may not include 23- and 24-year-olds.

I would suggest to you that the single best thing you could do for us who are trying to use this particularly for people with disabilities is to go on and make this thing permanent, tell us what it is going to be, so we can tell employers what it is going to be, particularly small businesses who just do not keep up with all the fine points of Government regulations.

So in spite of what you heard this morning, that has not been my experience, and I am talking about from thousands of rehabilitation counselors, who have placed literally tens of thousands, hundreds of thousands, of persons with disabilities. TJTC means an awful lot to us.

Secondly, you heard this morning, “well, it does not really affect the bottom line for people with disabilities; you are giving the



money to the employers, and it did not help the individual." That is simply not true.

The best way to get another job is because you have already had one. And so we have evidence—and again, go back to the GAO studies, and those are not exactly “wusses” when it comes to taking a look at programs—at their suggestion that indeed people who have had jobs have used those; they have been promoted; there are just thousands of examples of people who have, in fact, been promoted in the same jobs and have gone on to others.

The evidence you heard this morning simply does not seem to be consistent with what my experience has suggested.

I would also applaud you for considering 23- and 24-year-olds. That is going to be very important. People with disabilities, in particular, have not had the summer jobs, the weekend jobs, the jobs after school, and they simply have not had that maturation of work by the age of 20 or 21. So 23 or 24 would mean a lot to us in trying to place people with disabilities.

I would also add one other little quick rebuttal to some comments that you heard this morning, saying that employers have not changed, we also have over 1,000 employers that have written to this administration saying that, indeed, they are ready to support targeted jobs tax credits. And so you have got more evidence to the contrary than I think maybe you heard this morning.

I would also suggest to you that the vast majority of people with disabilities are still unemployed, and the other comment was, they are going to be hired anyway.

The fact remains, Mr. Chairman—Mr. Chairmen, that we have 66 percent unemployment amongst people with disabilities. And for someone to come to this committee and say, well, they were going to be hired anyway, I do not understand how anyone could look at the evidence and come to you and say something like that. Two-thirds of Americans with disabilities do not have a job. And so to say they were going to be hired simply is not true, and I rest my case.

I would also suggest to you that making it retroactive is important, because as you heard from New York, your colleagues there are continuing to file those applications in the hope that you are going to do that. It really is important, because the stopping and starting and going back and forth was simply not in our best interests.

I would also urge you to consider somehow in the economics of TJTC to consider the fact that if we do not, in fact, put people back to work, we are going to pay anyway. It is like that old oil filter commercial some years ago: You can pay me now, or you can pay me later.

Now we are paying an estimated \$200 billion a year to keep Americans with disabilities unemployed. And so I think it makes an awful lot more sense to do tax credits and make taxpayers out of tax recipients.

TJTC is very important to those of us in the rehabilitation community, and we appreciate very much your having included such individuals.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF ROBERT BRABHAM  
Chapin, South Carolina

Mr. Chairman:

On behalf of the rehabilitation-provider community serving persons with a wide range of physical and mental disabilities, it is my pleasure to appear before you today. I am Dr. Robert E. Brabham, former Director of the National Association of Rehabilitation Facilities. I am now in private practice.

In the years since the TJTC began, literally thousands of Americans with a wide variety of physical and mental disabilities have become employed as a direct result of TJTC. Evidence suggests that approximately 10% of the persons serviced under TJTC programs are persons with disabilities.

Before working with Rehabilitations Associations, I was the Assistant Commissioner for Client Services of a large State Vocational Rehabilitation Agency. I know first-hand from more than a decade of service in that capacity that TJTC works. Rehabilitation professionals need all the tools and incentives possible to help open the doors of economic opportunity for people with disabilities. TJTC opened "real doors in real places" of employment. These are not "pretend" jobs, but are viable and valuable positions to a variety of businesses and industries.

It has been the experience of rehabilitation service providers in America that employers have found TJTC to be one of the most logical and bureaucratically simple programs of government. It is also an extremely cost-effective program. We should also realize that the minimal cost of TJTC is only the tip of an iceberg. Continuation of the disability-related cycle of unemployment in America is of staggering economic and human costs.

Let me remind you that the plight of Americans with disabilities is of enormous proportion. A recent Harris Poll revealed that 66% of Americans of working age with a disability were unemployed. I quickly add that these individuals wanted to work, but have not yet overcome the barriers to employment.

TJTC often provides the "extra incentive" for employers to give people with disabilities a chance to earn their way in the job market. Unfortunately, the 1988 change in age eligibility of TJTC, which dropped 23 and 24 year-olds has also had a negative impact, particularly for people with disabilities. It is tragically ironic that it is 23 and 24 year-old persons who are struggling most to establish their independence and become heads of their own households. People with disabilities have often been delayed in entering the job market because of time lost while in hospitals, during rehabilitation programs and in their continued pursuit of academic training. They, especially, need the availability of these extra couple of years. We urge you to correct this matter in the extension of TJTC.

In my own experience with TJTC, reinforced by the experience of colleagues throughout the Rehabilitation community, TJTC has an enormous transferability of benefits for many instances in which the entry-level position made possible because of the incentives of TJTC became the starting position for later career advancements. Particularly in the case of people with disabilities they need only the extra assistance to get a start in employment. As dedicated, qualified workers they can prove themselves if they can but be given the chance to do so. TJTC provides that chance, and the job often provides the means to future advancement into more demanding and responsible positions. TJTC opens doors; hard work opens career advancements. Both are happening because of your support for TJTC.

The cost-effectiveness of TJTC has been widely heralded. The long-term cost benefits will be even greater as the transferability of skill in use I mentioned earlier continues, and as the benefits of employment contracted with the continuing cost of maintaining disabled American's chronic unemployment are fully realized. Unemployment is very expensive for America. Add the lost taxes the costs of disability-related benefits and we quickly come to one conclusion: American cannot afford to continue her current high rate of unemployment among people with disabilities.

We want to close on a positive note. By the very fact that you are holding these public hearings you have demonstrated your willingness to review the facts and the figures related to TJTC. We are confident that your objective evaluations, by any measure you use, will lead to the inevitable conclusion that TJTC helps Americans, especially those with disabilities, enter the job market. Extension of the Targeted Job Tax Credit is not an expense, it is an investment in the future of Americans who wish to fully take part in the promise of the "good life," a life that can include employment for thousands of people because the doors of opportunity are opened to them.

Thank you.

Chairman RANGEL. Thank you Dr. Brabham.  
Ms. Casey.

**STATEMENT OF LAURIE A. CASEY, POLICY ANALYST,  
CHILDREN'S RIGHTS COUNCIL, AND VERMONTERS FOR  
STRONGER FAMILIES, MORIAH CENTER, N.Y.**

Ms. CASEY. Hi. I am going to change the topic a little bit and head toward our kids.

I am here today on behalf of the children of divorced, separated, and never married parents. I am the policy analyst for the Children's Rights Council, a national 8-year-old child-advocacy group whom Grandparents United for Children's Rights and Mothers Without Custody are affiliated. The Children's Rights Council has also chapters in 23 States.

I also represent Vermonters for Stronger Families, fighting for the better interests of our children.

I am a custodial and noncustodial parent. I bring to this hearing insights from a divorced parent receiving public assistance to a remarried working mom supporting her own son and assisting her husband's efforts to adequately support his estranged daughter.

Because of child support enforcement programs, noncustodial parents can account for \$45 billion of financial support on behalf of their children. But to date, we have no records showing the actual cost of these children to their custodial parents. We must accept responsibility of our children—both parents. In this country, that does not happen. And the Federal and State Governments play a major role in this conspiracy against our children.

The incentives to collect and welfare reimbursement programs are the Federal Government's way of selling our AFDC recipient children to the States. The guarantees of direct revenue to the State's budget is more than any State can pass up, especially in these economic times.

In 1991, approximately \$2 billion was collected in child support on behalf of a welfare recipient child, yet only \$318 million actually were received by the children. The remaining \$1.7 billion was retained by State and Federal agencies in the name of welfare reimbursement and incentives to collect.

Since 1986, over \$9.7 billion has been collected on behalf of AFDC recipient children, yet only \$1.7 billion has actually reached them.

If the Government genuinely wishes to decrease the number of welfare recipients and families in poverty, then they must abide by a strict code of ethics. It must allow the child support it receives on behalf of these welfare recipient children to directly benefit the child and not a State's budget quota.

President Clinton recently remarked during a news conference regarding vaccines and pharmaceutical company profits that these "companies should not be making profits off our children." Yet the Federal Government has created its own profit center, the Office of Child Support.

In 1991, \$290 million was passed along to States as their incentives to collect, their commissions for doing a good job, for helping out children. But what good have these governments done? Our children are still in poverty, and the \$290 million of incentives to



collect was a direct allocation from the child support received on behalf of a welfare recipient child.

So, before we lay blame with a noncustodial parent, let us look at the system. Since 1987, OCS has collected in excess of \$350 million of child support via the employment intercept program. In 1991, more than \$140 million was collected in this manner. This represents an increase of 300 percent over the 1987 figure. At the same time, some 8 million cases of child support enforcement were being processed on behalf of welfare recipient children.

These numbers represent the realities of our economy, and with major companies continuing to downsize, these numbers of unemployed and underemployed and publicly dependent families can only expect to increase.

With that in mind, let us turn to the issues of tax relief. Noncustodial parents have in excess of \$45 billion in support, yet have not been recognized as major financial contributors to their children's financial well-being. As the financial responsibilities continue to increase for the noncustodial parents, we have to begin to be willing to equalize the entitlements associated with parenting.

Noncustodial parents do not only pay child support. They also provide for medical insurance, uninsured medical expenses, and child care costs. All of these are in addition to child support. They all qualify for tax relief, but currently only to a custodial parent.

The message is simple. When discussing financial issues, the noncustodial parent is accountable. When discussing entitlement, the custodial parent benefits.

We changed our Tax Code because both separated parents were taking tax dependency exemptions. So to lessen this misuse, we simply decided to presume that the custodial parent was providing the majority of the care.

Well, because of the child support system, the noncustodial parent can document \$45 billion in support. What have the custodial parents offered to document that they have contributed substantially to the financial support of their child, thus entitling them to the entire dependency exemption?

If we continue to argue that the noncustodial parent must assume the financial responsibility of the separated family, then it would be ludicrous not to acknowledge the entitlements that are due as the result of the noncustodial parent taking an active role in this duty.

It is a very simple matter. Change the language in the Tax Codes. Allow the noncustodial parent an avenue of judicial review. By excluding words such as "assumed" and "presumed," the decision of dependency exemptions can be decided by a court of law.

IRS could require documentation from child support collection offices to document child support paid, and court determinations could be required to be attached to income tax filings. The IRS could implement a shared-dependency exemption so both supporting parents would equally and equitably share in the tax relief.

Whatever the procedure, the IRS must accept the fact that a custodial parent, a noncustodial parent, and a child are a family. The IRS tax exemptions must be revised to include the right of both parents to share exemptions.



In summary, we need to acknowledge and require the accountability of the financial responsibilities of both parents. Federal and State policies can no longer require welfare recipient children to become financially responsible for the financial inadequacies of their custodial parent.

Welfare systems must be required to report AFDC expenditures by individuals. State and Federal agencies can no longer accept child support payments in excess of that child's actual cost in the name of welfare reimbursement.

Implementation of a shared-child exemption program would be beneficial to the children. By increasing cash receipts and extending the rights and privileges of tax exemptions and credits to paying noncustodial parents, OCS and the IRS would allow a balance to our current support collection system, while actually increasing benefits to our children.

In conclusion, child support collection and enforcement is a system that has been devised to combat a terminal social disease that Government calls poverty. But children in poverty are not the disease. Children are merely the vehicles in this sordid battle of bureaucracy and budget deficits. Our children have become tokens, profitable assets to the States' welfare systems.

If we allow this trend to continue, we can condemn no one but ourselves. We must continue to ask: Who is caring for our children? [The prepared statement follows:]

Prepared Statement of Laurie A. Casey, Policy Analyst Children's Rights  
 Council and Vermonters for Stronger Families  
 Before the Subcommittee on Select Revenue Measures and  
 the Subcommittee on Human Resources  
 Committee on Ways and Means, U.S. House of Representatives  
 March 30, 1993

## I. Introduction

I am a custodial and non-custodial parent. I bring to this hearing insights from a divorced parent receiving public assistance to a remarried career woman who now provides for her own son and assists her husband's efforts to adequately support his estranged daughter.

The Welfare Department and the Office of Child Support transformed my four year old son into a vehicle used in a battle of bureaucracy and budget deficits. It stripped me of my parental responsibilities. Instead, it turned to my ex-husband for the financial support of the family for which I, too, should have contributed. In fact, it asked nothing of me.

The "Incentives to Collect" and "Welfare Reimbursement" programs continue to transform our AFDC children into profitable assets of the states. Yet, the State and Federal Governments continue to blame the non-custodial parents for the our poverty stricken children. When in reality, the culprit is the system itself.

Example, from 1986 to 1991 some \$9.7 billion dollars have been collected on behalf of welfare recipient children. Only \$1.6 billion was received in the household where the child actually resided.

In 1991 approximately \$2 billion dollars were collected with only \$318 million or 19% actually finding it's way to the children. The remaining \$1.7 billion dollars is the price tag placed on our children by these federal programs. (49% went to the states and 32% was sent to Washington, all in the name of "Welfare Reimbursements" and "Incentives to Collect").

If the government genuinely wishes to decrease the number of welfare recipients and families in poverty, then it must enforce equitable standards on to itself by allowing payments received on behalf of welfare recipient children to directly benefit the child and not a state's budget quota. There must exist tax credits to low income families. And when applying these credits the IRS must recognize that a custodial parent, a non-custodial parent, and a child are a family. The IRS tax exemption must be revised to include the right of both parents to SHARE a dependency (child) exemption, to SHARE childcare and medical deductions, and to SHARE in the Earned Income Tax Credit program.

## II. Abilities and Limitations

Since 1987 state OCS offices have collected in excess of \$350 million dollars of child support via the unemployment intercept program. In 1991 more than \$140 million dollars of child support were received by OCS offices in this manner. This represented an increase over 1990's unemployment intercept by 80% and a 300% increase over 1987's collection figures. At the same time there were some 8 million cases being processed by the Office of Child Support on behalf of welfare recipient children.

These numbers represent the abilities and limitations of our unemployed and under-unemployed custodial and non-custodial parents. Between 1970 and 1991, total annual AFDC benefits have increased nearly five-fold from \$4.1 billion to \$20.3 billion dollars.

With major companies continuing to downsize the numbers of unemployed and publicly dependent parents can only be expected to rise.

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1  
 OCSE, Sixteenth Annual Report to Congress, yet unpublished Draft Version Dated Dec.28,1992 pg 46

2  
 OSCE, Sixteenth Annual Report Congress, yet unpublished, Draft Version Dated Dec.28, 1992 Table 34 less Table 36 to determine AFDC cases, Table 18 for Unemployment Intercept

3  
 1992 Green Book pg 653

Currently, 4 in 21 of our children under the age of 18 live in poverty. But, they do not live alone. They live with a custodial parent or reside with both parents. Poverty does distinguish between divorced parents or in-tact families. Poverty is a result of our economy and the fiscal mismanagement of our society.

If we are to eradicate this problem, then first there must exist useful and meaningful employment. If we want our citizens to work, then we first must have the jobs to offer them.

### III. Responsibility

Who must accept the financial responsibility of a child? Both parents of course. Yet, when a child is separated from one parent, the government designates the non-custodial parent accountable.

If it is our goal to free parents and children from poverty, it is necessary to require the custodial parent to bear an equal financial responsibility. It is, then, also necessary to require accountability of the custodial parent's management of child support funds.

Because of the Child Support Enforcement Program, non-custodial parents can easily account for over \$45 billion dollars in financial support to their children. But, to date, we have no records showing the actual direct costs of these children to their custodial parents.

The Federal Government plays a major role in this conspiracy against our children. It allows state welfare agencies to "retain" child support collections as "reimbursements" or "incentives to collect". This money is allocated directly from the child support payments received by OCS from non-custodial parents who pay on behalf of their welfare recipient children.

In 1991 the Federal Government paid in excess of \$290 million dollars to the states for "Incentives to Collect" otherwise known as "commissions on cash receipts." This money surely could have benefited the children if it had only reached them.

Title 33 ss4106 (f) states: "When an assignment is in effect, the state shall be guided by the best interests of the child." Yet, the Federal Government continues to sell the Child Support Enforcement Program to taxpayers and states via our welfare recipient children. Because of these children in need and the non-custodial parents' desire to meet their financial obligations, the states in this country are reaping the profits while our children are imprisoned below poverty level. Our representatives can no longer require a minor welfare recipient child to become financially responsible for the financial inadequacies of the custodial parent. Welfare systems must be required to report AFDC benefit costs by individual and "reimburse" themselves accordingly.

In 1991 the average monthly child support paid for an AFDC child was \$219 dollars although the total grant for the household was \$388 dollars. Policies must allow the custodial parents to recognize and accept their own financial responsibilities to the state welfare agencies and stop the practice of retaining child support payments to reimburse the states in excess of the direct costs of the child.

To achieve our goal, to provide for our children, we must face reality. It is not our mission to provide revenues to a welfare system FIRST and better our children SECOND.

### IV. Sharing Tax Exemptions and Credits

With child support collections on the rise, Congress must recognize that non-custodial parents are major financial contributors to their children's financial needs. This recognition must take the form of tax exemptions and credits that are currently available to custodial parents and in-tact families.

We have created a system, the Office of Child Support, which enforces the financial responsibilities of non-custodial parents, yet, we have failed to balance this with the rights and privileges afforded to others.

Each states' Office of Child Support should be required to issue at year-end a form equivalent to a "1099" to the custodial and non-custodial parents which would report the annual amount of child support owed, the current year's receipts, and any arrears by current year and prior years totals. It would include the allowable percentage of a dependency exemption to each parent as calculated and reported to the IRS.

In the calculation a distinction would be made between AFDC and Non-AFDC cases. If the child were an AFDC recipient the non-custodial parent would be entitled to a prorated dependency exemption based on his/her portion of contribution to that child's support relative to the direct costs of that child by public assistant programs or state guidelines whichever is lower.

**Example 1, AFDC Recipient:** A child's direct cost for the current year totals \$1764 dollars as reported by the Welfare Department, the non-custodial parent's contribution totals \$3630 and are current for the year, the custodial parent has no earned income, the state child support guidelines set support at \$4442, the calculation would then become \$3630 (the support paid) divided by \$1764 (the actual direct costs) the results: 206% We would then divide the amount paid (\$3630) by the state's guideline amount (\$4442), the result: 82%. A comparison would then be made of the two percentages, the smaller of the two would be the amount of the prorated exemption allowance to the non-custodial parent.

In the event that a child was an AFDC recipient, but the custodial parent had earned income, the same calculation would apply, except the custodial parent would be entitled to 18% of the dependency exemption, thus equitably sharing the total value of the exemption between the two parents.

**Example 2, Non-AFDC Recipient:** The basis for this calculation would be the total support for the child as defined by the state's Office of Child Support, \$4442 (from ex.1) The custodial parents portion of support is \$1826 and the non-custodial parents support due and paid is \$2616. So, the custodial parents percentage would be \$1816 (total support due and assumed used to directly benefit the child) divided by the support amount set by the state \$4442, resulting in a 41% share of the child exemption, the non-custodial parent then would be entitled to a 59% share of the dependency exemption (amt paid \$2616 divided by \$4442).

These percentages of shared dependency exemptions would also be applicable in determining the amount of Earned Income Tax Credit, childcare deductions and medical deductions that each parent could receive, if they qualify.

The IRS has to recognize when both parents provide for their child, then both parents are entitled to applicable tax credits in an equitable manner.

Once our Tax Codes' language sights non-custodial parents as eligible for tax credits and exemptions relative to parenting, we have balanced the some of the rights and privileges of custodial and non-custodial parents.

\$45 billion dollars has been paid by non-custodial parents, yet many of them are not entitled to tax relief under our current laws. As we continually look to the non-custodial parent to bear increasing financial responsibility we must recognize the imbalance in our current policies.

This policy would accomplish several goals: 1) it would increase the number of "current" child support cases vs "arrears" because the account would have to be "current" in order to qualify, 2) it would increase the number of cases handled by OCS, since OCS would be the issuing agency of the "1099's", 3) non-custodial parents and custodial parents would be more willing to accept their "fair share" of the financial responsibilities to their child, 4) financial data of both parents would be more readily available and 5) the Office of Child Support would be more widely viewed as actually benefiting the child.

#### V. Summary

We need to acknowledge and require the accountability of the financial responsibilities of both parents. Federal and State policies can no longer require AFDC minor children to become financially responsible for the financial inadequacies of the custodial parent.

Welfare systems must be required to report AFDC expenditures by individual. State and Federal Agencies can no longer accept child support payments in excess of the child's actual costs in the name of "welfare reimbursements."

State's not using the "income shares" model would be required to calculate support amounts to custodial and non-custodial parents. These amounts would constitute total support for the child.



AFDC custodial parents want to be responsible for their children. But, because of current policies they are trapped in a system that ignores their individual abilities and usefulness.

We must redirect the "incentives to collect" receipts to create a trust fund that would directly benefit the children.

State Governments should realize they should not have to be "bought" in order to provide for their citizens.

Implementation of a "shared child exemption" program would be beneficial both to the state and the children. By increasing cash receipts and extending the rights and privileges of tax exemptions and credit to paying non-custodial parents, state OCS offices and the IRS would allow a balance to our current support collection system while actually increasing the benefits to our children.

And finally, it is not to the detriment of our budget to forego our "profits" in the name of "child betterment", because our true profits lie within the child.

#### VI. Recommended Actions

1) Enforce compliance of Title 33 ss4106(f), which requires: "when an assignment is in effect, the state shall be guided by the BEST INTEREST OF THE CHILD" This can be assured by:

- a. Accountability of the Custodial Parents' distributions of support payments received
- b. Creation of TRUST FUNDS/EDUCATION FUNDS for future use by the child
- c. No longer allowing OVERPAYMENTS for "WELFARE REIMBURSEMENT"
- d. Recognize the direct relationship between access to one's child and support payments by the obligor.
- e. Recognize that the Federal Government cannot continue to "sell" our children to the states via "Incentives to Collect" and "Welfare Reimbursement" and stay in compliance with their own issued mandate.

2. Recognize the need, when developing laws and modifying existing laws to ensure EQUAL protection under such laws. Presently, laws are designed and interpreted unjustly resulting in a non-custodial parent being viewed as a CRIMINAL before a CRIME has been committed.

3. Redefined tax codes. Allow child support guideline payments to regulate IRS standards regarding dependency tests, EITC credits, medical and childcare deductions. Implement a "shared exemption" program which would balance the current support collection vs tax credit system.

And finally,

4. Questions that only ask for superficial band-aids such as how to increase child support orders, will not create stability for our children. Money alone is not the answer to our children's plight. The real questions to be asking our those concerning how to ensure our children the emotional and financial support of two parents.

#### VII. Conclusion

Child support collection and enforcement is a system that has been devised to combat a terminal social disease that government has labeled, "poverty". But, children in poverty are not the disease. Children are merely the vehicles in this sordid battle of bureaucracy and budget deficits. At the hands of their own Federal Government our children have become tokens, profitable assets, to a State's Welfare System.

If we allow this trend to continue, WE can condemn no one, but OURSELVES.

We must continue to fight, we must continue to ask:

"WHO IS CARING FOR OUR CHILDREN?"

Chairman RANGEL. Ms. Casey, if we were to do what you are suggesting, would that not encourage parents to stay away from the home? In other words, one of the things that we hope the incentive would do is to keep the parents and the children together. And I think you are encouraging or at least supporting the noncustodial parent; is that correct?

Ms. CASEY. I am not supporting either parent. I am supporting what is right for our children. I do not think we can bribe a female and a male to stay together over a tax exemption. I think——

Chairman RANGEL. Well, I think bribery——

Ms. CASEY. I think what I am trying to say——

Chairman RANGEL. We are trying to make—you know, finances sometimes break up a lot of marriages because they just cannot afford to be together, and if we can help them to take them out of poverty——

Ms. CASEY. We have children whose fathers are paying, and the children are still in poverty. We have men that are earning \$40,000 a year who are paying \$5,000 a year in child support, and their child still is in poverty because of the guidelines, because of the ability of States to keep this money in the name of welfare reimbursement.

What we have done is, we have made——

Chairman RANGEL. Is that not a different issue than the one before this committee, though?

Ms. CASEY. Excuse me?

Chairman RANGEL. Is that not a different issue than the one in front of this committee? What would you have us to do to be of assistance to the parent that is outside of the home where the child is located? What would you have us to do?

Ms. CASEY. I would have you recognize that there are responsibilities of both parents. There are emotional and financial responsibilities of the custodial parent as well as the noncustodial parent.

Chairman RANGEL. And share the tax credit with the parent that is outside?

Ms. CASEY. Yes. I am not asking that we strip away from the custodial parent the tax advantages of having a child in the household. What I am saying is, we need to recognize the responsibility that the noncustodial parent has accepted financially in supporting that child. I am simply asking that they be recognized in regards to tax issues.

Chairman RANGEL. OK. Now assuming that I agree with you and we do recognize them, what would you have us to do? They are recognized now; that is not an issue. What would you have us to do?

Ms. CASEY. There are several different ways that this can be accomplished. All of the information is available. You need Social Security numbers; you need the amounts of child support that is being paid; you need to have wages of the individual parents. All this data is now in a data base called the Office of Child Support Enforcement.

One option is to have the Office of Child Support in each State issue a statement equivalent to a 1099 that would stipulate what that State agency has calculated the share of each parent's right to the exemption to be.

In our particular case, we pay child support to the State of Vermont. They use an income shares model. We pay 85 percent of my stepchild's support. Thus, in this theoretical world, on this 1099 that the OCS office would send to us at yearend, it would state that we would be entitled to an 85 percent credit of the total dependency exemption.

Chairman RANGEL. OK. Well, we certainly want to do all we can to encourage parents who are outside the household to fulfill their responsibilities, and if we can do anything on a tax-writing committee to make it worth their while, we will want to do that.

Ms. CASEY. Well, thank you very much.

Chairman RANGEL. Mr. Brabham, I hope—is that correct, Brabham?

Mr. BRABHAM. Brabham, yes, sir.

Chairman RANGEL. There is nothing that you heard today that allows any of these committee members to believe that the targeted jobs tax credit is not working?

Mr. BRABHAM. No, sir.

Chairman RANGEL. Your testimony—I mean, they may not have been excited about the program as you, or it may not, for their particular constituents, have been as successful as it had been, and most of the people that will find negative things about it were not even involved in the programs, really, you know, and quite frankly even if you did hire somebody first and then found out that you were eligible, it seems like you would be more likely to retain that person than to fire them, if you were going to lose something as a result of it.

Mr. BRABHAM. The notion that somehow or another these credits would be a stigma make no sense at all, and particularly for a person with a disability, it is a little hard to pretend you are not, and a successful interview and a personnel director somewhere, they are going to be very quick to realize you did not have the educational background, you did not have the work experience, you do have a disability—that might be the stigma, but not the tax credit. That made no sense.

Chairman RANGEL. The stigma is when you do not get it. When you get it, it is a privilege. And as a veteran, I never thought I was being stigmatized. It was something where someone was saying: You are entitled.

Mr. BRABHAM. The person who said that has not been doing job placement. I have.

Chairman RANGEL. Well, you are doing a good job, too.

Mr. Sullivan, the way you were talking about earned income tax credit for prisoners and looking for employment and having them with something to leave with and not having them on welfare and all of these things, it shatters the myth that I have had that most people leaving jail were really unemployable misfits and that needed a lot of training before they could really go to work. And the way you talked about it is that they are working for the State; they are doing one heck of a job as it is and that we should give them an opportunity to continue to work.

Mr. SULLIVAN. Yes, Mr. Chairman. In fact, I think that my experience has been in Texas, and Texas is also like the Federal system. You are required to work in the system. And so we do have

prisoners working every day, 8 hours a day, in most prisons. It is just that they are not getting paid—Texas does not pay any wages at all. And, of course, they are paid—I call them slave-like wages in most places.

Chairman RANGEL. Well, do me a favor. I am very concerned about these people in jail. They are really eating up a large part of local and State and Federal budgets. I mean, it is really getting very expensive to take care of these people in jail. And unlike Texas, in New York, all they do is watch TV and pump iron, and they go in not too bright, and they come out dumber than they went in. And if you wanted to help them, it is very, very difficult to help a lot of those people that are being discharged, especially the younger ones that have gone in.

Now earlier I had said—and I am going to try to perfect this concept—I do not know whether you have been following the Haitian situation, but you have had the worst bums in the world in the Haitian Army. They did not get paid; they lived just by how much they stole, how much they have guns. I mean, they are the worst element.

But because Haiti is so poor, as we move forward to rebuild Haiti, they do not have the jails to lock them up. And then really they have taken a position, they are Haitians, and they should assist in rebuilding Haiti. So therefore they are starting educational and work programs for these bums, which just makes a heck of a lot of sense.

Mr. SULLIVAN. Right.

Chairman RANGEL. And the idea is that once you treat them with a little respect, who knows? They may start to respect themselves and start to make a real contribution as Haitians to the society.

I see no reason in the world for nonviolent crimes that have been committed, especially by young people, why we cannot really take that same concept, take the rascals out of prison, put them to work.

Mr. SULLIVAN. Right.

Chairman RANGEL. If they don't know, to teach them. During World War II, I remember, you had an option. If you wanted to go defend the country, they would give you some training, and if you did not do the training, you went back to the can.

Maybe when you meet with your associations on a national level, you might get information for me. We will start—well, you are from Texas, and Texas is a little different from most States, but you would know the national associations that you work with professionally to find out just how many people are eligible, how many people could be employable if they were trained.

Mr. SULLIVAN. Sure.

Chairman RANGEL. And it would seem to me that I would be able to find some way, whether we used the Tax Code or whether we used some deficit reduction, to try to clean out the jails, put people to work, and just keep those people there that are a threat to society locked up.

And I could tell in the way you gave your testimony—I have never seen anybody that felt so strongly about it, that you are prepared to give them earned income tax credits—it seemed like for



a lot of people, it might be better to stay in jail and work than to get outside and face unemployment.

But if your commitment is as deep as I think it is, then maybe you and I can share from your experience to see that I am not going against a brick wall here and see whether we can do some things to put those rascals to work. OK?

Mr. SULLIVAN. Thank you, Mr. Chairman.

Chairman RANGEL. I look forward to working with you.

Mr. Matsui.

Acting Chairman MATSUI. Thank you, Mr. Chairman.

I am going to be very brief. I would just like to make an observation and then maybe make a comment.

I notice that, Ms. Casey, the group that you represent is the Children's Rights Council, and I cannot think of a stronger misnomer than that. And I do not have any problems with what you are doing. I think, you know, everybody is entitled to a lobbyist; everybody is entitled to assert their cause.

But to suggest that a proposal like yours or a series of proposals like yours—and I have heard from the President, I think, last week when he testified before our subcommittee—it is really an effort to create a lot of confusion in terms of the whole child support issue. And, you know, to suggest that this is for children's rights is just absolutely ridiculous.

I have to say that there are certain obligations that a parent who bears a child, whether it is custodial or noncustodial, owes to society and to that child: medical care, making sure that the payments, the child support payments, are timely and are sufficient and are on time, and making sure that they give that child love.

And what I find is that to some extent your group is out there talking about the problems that the father and the mother have, and that is the reason why payments are not being made in many cases. I mean, it is just absolutely incredible.

And, you know, we will work with you, but I have to tell you, just as I mentioned last week, in terms of this whole child support issue, I am coming down hard. In any welfare reform package, we are going to have a very, very strong child support enforcement proposal.

And as I said, you know, in the early 1980s, we were talking about the welfare queen as the custodial mother, thinking that she lives in this great palace, right, someplace in Southeast Washington—well, we are going to be talking about the welfare king in the 1990s, because there are about 12 or 13 or 14 billion dollars' worth of moneys that the governments—State, local and Federal Government—are paying on behalf of the parent who has the capability, but is not making the payment to that child, because they are having problems, because they have another family or for whatever reason.

And that is just going to stop. I mean, we are going to make an issue—we are going to make an issue out of that noncustodial father who does not make that support payment. And I do not care what anyone says, that parent should be held responsible. If they bear a child, they owe an obligation to that child.

Ms. CASEY. May I respond?

Acting Chairman MATSUI. Please respond.

Ms. CASEY. Thank you.

I am here on behalf of noncustodial parents who pay their child support. I quoted you numbers from the Office of Child Support Enforcement's 16th Annual Report, totaling \$45 billion in child support collected. Those people are not deadbeats; those people are meeting their obligations; those people are not running and hiding under a rug. Those people support their children.

Those people, sir, also pay child support that their children never see. They never see that money, sir, because the Federal Government—

Acting Chairman MATSUI. And let me say this, too—

Ms. CASEY [continuing]. And the State governments are consuming that money in the name of "welfare reimbursement" and "incentives to collect."

I am sorry, sir. I am very adamant on this point.

Acting Chairman MATSUI. I understand that.

Ms. CASEY. We are taking money from welfare recipient children's fathers who are paying—

Acting Chairman MATSUI. Let me just tell you another thing, too.

Ms. CASEY [continuing]. Their support, and we are handing it back into the welfare system, and we are not helping those children. Those children are being maintained below poverty levels, even though those parents are paying their support.

Acting Chairman MATSUI. Well, then, what we will do is, we will increase those support payments, so it is—

Ms. CASEY. Well, sir, that will not help.

Acting Chairman MATSUI. I can just almost guarantee you that if you look at any child support order in America, except for maybe a Donald Trump or somebody who is very wealthy, the amount of payments made by the noncustodial father to the mother is not sufficient even to pay a fourth of that child's livelihood. We know that; you know that; and everyone else knows that, too.

And so even to suggest that the personal exemption should be divided up is ridiculous. You know that, and we all know that. So maybe we are going to have to increase the amount of the payments. Maybe that is what we should be talking about instead of this little thing that you are talking about.

Ms. CASEY. May I respond to that?

Acting Chairman MATSUI. Yes.

Ms. CASEY. Thank you.

We have 8 million cases of welfare recipient custodial parents. Where is their responsibility?

You cannot tell me that those 8 million custodial parents are incapable of working. We have custodial parents who refuse to work. We have custodial parents who are being protected by this system called the Office of Child Support. We protect them because we can rely on the noncustodial parent to supply this financial support.

You can threaten us with increasing child support amounts. Continue to increase them. We will continue to pay. For those parents who see this responsibility to their children, they will continue to pay to support their children and to stay out of jail.

But we will also continue to fight, to try to get that money to our children. My stepdaughter does not get her money. She does not get the livelihood of that child support collection. And it has noth-

ing to do with the amount that we pay. It has to do with the laws and the mandates that the Federal Government has applied to the States. That is what it has to do with, sir.

And while you increase the child support amounts, you should also look at those laws. And you should also read title 33, subsection 4106(f), which states: "When the Office of Child Support has an enforcement in effect, they shall be guided by the best interest of the child."

When the welfare and the Office of Child Support in each State maintains those children below poverty level, when their noncustodial parents are paying \$400 to \$500 a month in child support, then neither the State nor the Federal Government is adhering to that Federal mandate.

Thank you very much.

Chairman RANGEL. Ms. Casey, do you resent when the custodial parent is on welfare, and the parent outside the home makes a contribution to the child, that the State takes that money in part payment of the welfare payment that the taxpayers are giving to—

Ms. CASEY. Yes, sir, I do. I do because that child support is collected on the basis of the "best interest of the child." I see that money—

Chairman RANGEL. I just want to get your thinking.

Ms. CASEY. Yes. May I—

Chairman RANGEL. Listen.

Ms. CASEY. OK, I am sorry.

Chairman RANGEL. I just want to make certain I understand what you are saying.

Do you believe that the fact that the parent outside of the home contributed to that person being on welfare, that that person would not have been on the public dole if that other person who left would have been in the house?

I mean, I see that you are personally involved. You keep talking about a stepchild. But the way I look at is that, if the husband, just for the hypothetical, did not for good reasons or whatever reasons leave his wife, she would not have been on welfare in the first place.

Ms. CASEY. Sir, in most cases, I believe the national average is, approximately 87 percent of all divorces and separations are initiated by the female. Men are not deserting their families. Men do not abandon their children. Men are being forced out of their homes.

Chairman RANGEL. Well, again, I am asking—

Ms. CASEY. I would just like to stipulate the point that I am trying to make is: currently in the system, we have fathers who are paying, and we need to recognize that we have fathers that are paying. And we have to ask why they are paying. Is it simply because of a punitive risk that they may be taking if they do not pay, or could it be they really care about their children?

Chairman RANGEL. I am just saying that as the average taxpayer, if somebody is on welfare and one of the parents is sending in checks, I would want to see the taxpayer's money reimbursed. I mean—

Ms. CASEY. I would want to see the taxpayers' money reimbursed to the extent of the direct cost of the child. But we have cases, sir,



where the States, when they do not have a paternity case established, when they do not know who the father is, the amount that goes on the books as an account receivable in the name of child support is the total household welfare grant.

That is unacceptable to me, because now we are saying that the child is responsible for that custodial parent's inadequacies. That custodial parent has a responsibility to themselves. Any money that is collected on behalf of a welfare recipient child in excess of the welfare amount directly related to that child should be entrusted for that child's later use. It should not be consumed by a State and Federal welfare system.

Chairman RANGEL. And how about for the housekeeping for the mother, I mean, the fact that she is taking care of this guy's kid?

Ms. CASEY. Sir, that is not going to housekeeping funds. Those are going to reduce a deficit that is not going to be reduced. The money is simply put back into the system. It is going to subsidize the support.

When we retain the funds from a welfare recipient child support check, we pass along \$50. Let us use a hypothetical number of \$400. We have a household that is receiving \$500 in welfare benefits. There is a \$400 child support check. Of that, \$50 goes into the household. The remaining \$350 is retained by the State and Federal Government.

That money is then reintroduced into the system. It is introduced into the system as support for the Office of Child Support program. That is wrong, sir. That money was meant to take that child out of poverty. That is not taking the child out of poverty.

Chairman RANGEL. How many people are in your organization; do you know?

Ms. CASEY. No, sir, I do not know.

Chairman RANGEL. Is it a Vermont organization? Is it Vermont?

Ms. CASEY. In Vermont?

Chairman RANGEL. Or is it national?

Ms. CASEY. No, it is simply a Vermont, New England—Vermont, New York organization, sir.

Chairman RANGEL. Are there people from New York?

Ms. CASEY. Excuse me?

Chairman RANGEL. Do you have a branch in New York?

Ms. CASEY. I am the branch in New York. I am affiliated also with Parents Without Parents in New York. I travel to Vermont on a daily basis for work, and that is where the organization is based.

Chairman RANGEL. And you have a national office as well?

Ms. CASEY. Vermonters for Stronger Families is limited to the Vermont area, sir. The Children's Rights Council is national with 1,500 members and 13,000 affiliates.

Chairman RANGEL. And you are a New Yorker?

Ms. CASEY. I am a New Yorker, sir, upstate New York. I live right next to Lake Champlain.

Chairman RANGEL. Well, we will teach them. If there is another way to do it, we will think of a way to do it. And you bring an exciting, different view to this committee.

Thank you.

Ms. CASEY. Thank you very much.



Chairman RANGEL. Let me thank this panel. I will be working with you, Mr. Sullivan and Mr. Brabham. It makes us feel good to see that a lot of people who would never really get a good chance in life, that we are doing something to help this out, and I want to thank you, too, Mr. Holt.

Mr. HOLT. Thank you.

Chairman RANGEL. OK. Our last panel—and we apologize for the delay in time, but we had no way of knowing our legislative calendar—from the military, retired, Sgt. Maj. Michael Ouellette from the Military Coalition, he is the cochair; Nancy Kennedy, the chief of staff of the United Way of America; Roger Glunt, president of Glunt Building Co., representing the National Association of Home Builders; and Crystal Harrison, production line employee with Hewlett-Packard from Spokane, representing the section 127 Coalition.

By unanimous consent, the testimony of all of the witnesses here will be entered into the record, and you should feel free to highlight that testimony.

And Sergeant Major Ouellette, who is coming to the table now, if you are prepared to start off, we will listen to you, Sergeant Major.

**STATEMENT OF SGT. MAJ. MICHAEL F. OUELLETTE, U.S. ARMY (RETIRED), COCHAIRMAN, THE MILITARY COALITION; AND DEPUTY DIRECTOR OF LEGISLATIVE AFFAIRS, NON COMMISSIONED OFFICERS ASSOCIATION; AND ALSO ON BEHALF OF MS. SYDNEY TALLEY HICKEY, NATIONAL MILITARY FAMILY ASSOCIATION**

Sergeant Major OUELLETTE. Thank you, Mr. Chairman.

Mr. Chairman, on behalf of Ms. Sidney Tally Hickey, the associate director of government relations for the National Military Family Association, and the Non Commissioned Officers Association, I wish to thank you for the opportunity to present testimony this afternoon.

Incidentally, the statement submitted has received the endorsement of The Military Coalition, comprised of 24 military organizations with a 3.5 million member representation base of which I am privileged to currently serve as the cochair.

Mr. Chairman, in the interest of time, I will be very brief, in that this morning Representative Slattery came before you and discussed his introduction of H.R. 479. The Military Coalition, simply in the interest of time this afternoon, strongly endorses that legislation and the possibility that these subcommittees would consider expanding EITC eligibility to those qualified and eligible service members serving overseas.

Mr. Chairman, that concludes my remarks. Thank you very much.

[The prepared statement and attachment follow:]

**STATEMENT OF SGT. MAJ. MICHAEL F. OUELLETTE**  
**USA, Retired**  
**Deputy Director of Legislative Affairs**  
**Non Commissioned Officers Association**

Mr. Chairman. I am Retired Army Sergeant Major Michael F. Ouellette, Deputy Director of Legislative Affairs for the Non Commissioned Officers Association of the United States of America (NCOA) and Co-Chairman of The Military Coalition. The Association is a congressionally-chartered organization with a membership in excess of 160,000 noncommissioned and petty officers serving in every component of the five (5) Armed Forces of the United State; active, national guard, reserve, and retired; and veterans. The testimony presented today was prepared by NCOA and The National Military Family Association (NMFA) on behalf of The Military Coalition. The National Military Family Association (NMFA) is a volunteer, non profit organization composed of members from the seven uniformed services, active duty, retired, and reserve, and their family members and survivors. NMFA's sole focus is the military family and its goals are to influence the development and implementation of policies which will improve the lives of those families. NCOA and NMFA appreciate this opportunity to express their views. The Military Coalition represents 24 military associations with approximately 3.5 million members. A list of member organizations is attached.

### BACKGROUND

In 1975 the Earned Income Tax Credit (EIC) was enacted to provide relief from the Social Security payroll tax for employed low income tax-payers with children. For seventeen years, young military families serving overseas by order of the U.S. Government have been prohibited from benefiting from this tax relief, simply because of location. These young families, who qualify in every other way for the EIC reside overseas with more senior service families whose income is sufficient to incur a U.S. tax liability. No tax relief is accorded eligible military families stationed overseas. NCOA, NMFA and other military associations have pursued a correction to this inequity since enactment of the original Earned Income Credit in 1975. Both NCOA and NMFA strongly supported legislation introduced by Representative Jim Slattery (D-KS 2nd District) in the 101st and 102nd Congress that would have extended the EIC to military families overseas. We were grateful when the provision was included in the House version of the Omnibus Reconciliation Act of 1990 and extremely disappointed when it did not survive in conference. NCOA and NMFA come before you again to support legislation introduced by Representative Slattery, H.R. 479, which extends EIC to all eligible military families.

### DISCUSSION

Although The Military Coalition fully supports the Administration's proposal to raise the income limit for EIC eligibility, such action must also include the eligibility extension for the EIC to eligible military servicemembers stationed in overseas areas with their families. Current law discriminates against the young, married, military servicemember in the low income bracket. If he or she resides with his or her family stateside, or the family remains stateside while the member is deployed overseas, he or she may be entitled to EIC. If, however, the servicemember is assigned overseas and the family resides with him or in a foreign country, there is no entitlement in law. NCOA and NMFA point out that this law is patently unfair and should be amended.

### IMPACT OF INELIGIBILITY

What does the loss of EIC mean in real terms to the individual family? A young man entered the Army in September 1990 and was sent to Basic Training at Fort Jackson, South Carolina. At the end of that training he married and was sent to Infantry training at Fort Benning, Georgia. While in Georgia his wife had a baby. Since their baby was born in August of 1991, this Army E-1 was eligible for \$1,003 in Earned Income Credit for the taxable year of 1991. The soldier next received orders to the 3rd Infantry Division in Germany. He, his wife and their child transferred on their orders to the new duty station. It is 1993, and the young Army Private, now an E-2, is anxious to file his income tax form,

eagerly looking forward to the \$735 he is entitled to in earned income credit. His permanent change of station to Germany has typically produced costs substantially above his reimbursement from the Army. Because the family is on foreign soil, it is almost impossible for his wife to find employment and add to the family income. Imagine his surprise and lack of enthusiasm when he discovers that because he is overseas, he no longer qualifies for this credit.

Translated into monthly income, his EIC for 1992 is worth \$61.25 per month. That amount would purchase approximately 12 quarts of milk, 30 jars of baby food, 5 lbs. of ground meat, 6lbs. of chicken, 3 lbs. of frozen flounder, 10 lbs. of potatoes, 20 cans of vegetables, 5 lbs. of flour, 2 lbs. of carrots, 3 lbs. of apples, 5 lbs. of bananas, 64 ounces of orange juice and 3 loaves of bread. Whether it is the young Airman assigned to the 5th Air Force in Japan, the Marine Lance Corporal in Okinawa, the young Seaman Apprentice assigned to the USS Belknap, in Gaeta, Italy, or the Army Private in Germany, the dollars lost equal a degradation in their quality of life.

Additionally, overseas tours of duty are often costly for military families due to decreased opportunities for spousal employment, the status of the dollar relative to foreign currency, and the difficulty and expense of locating housing off-base. For these young families, overseas tours can be financially devastating. Every penny that they spend must be carefully prioritized. Denying them the EIC simply because they are serving their country at an overseas post is not only an inequity, it is punitive.

### ADDITIONAL CONCERNS

NCOA and NMFA have not stood alone in their efforts to rectify this inequity in law. The Departments of Treasury and Defense have endorsed our recommendation; however, resolution proposals offered have included a requirement to find offsetting revenue before the law could be amended. NCOA has pursued the amendment of EIC at various times since 1976. Satisfying the offsetting fund requirement has been the ultimate "roadblock" and has become even more unlikely in recent years because of stringent budget restraints. Now when the state of the economy is promoting tax reform legislation that would increase the EIC level, NCOA and NMFA emphatically endorse any measure that would improve the financial well-being of our young servicemembers who would be eligible for EIC relief. The inequity in law must be resolved prior to increasing EIC levels.

These distinguished subcommittees must clearly understand that The Military Coalition position in the EIC issue goes beyond the equity shortfalls of the law.

- o Taxpaying servicemembers, eligible for EIC, who are assigned overseas and whose family subsequently joins the servicemember late during the tax year, lose their entitlement to EIC. This occurs even if one of the aforementioned acts is accomplished on the last day of the tax year.
- o Loss of EIC entitlement is unfair, simply because servicemembers are ordered overseas during a taxable year and want to take advantage of an accompanied overseas tour with their families.
- o Advanced overpayment of EIC caused by unclear calculation formulas.
- o Improved reporting of non-taxable earned income by military finance centers would improve EIC qualification by eligible military personnel.
- o The complicated EIC filing claim form discourages eligible servicemembers from obtaining needed benefits.

The Military Coalition fully supports the administration's proposal to raise the income

limit for eligibility for EIC. Many more enlisted families will be eligible for the credit under this proposal. Retaining the health care credit will also encourage lower income families to join the Active Duty Dependents Dental Plan which has a monthly premium of \$19.30. However, increasing the number of military families eligible for EIC without simultaneously extending eligibility to those stationed overseas will make an already inequitable situation that much worse. The need for EIC expansion becomes even more important now that the overseas area troop strength is being reduced. This reduction will obviously force overseas base closure action, realignment and relocation of remaining forces in some cases. Subsequently this will result in the further loss of second income job opportunities for the working spouses. Such actions increase a need for EIC relief for those qualifying military families who continue to serve overseas.

### RECOMMENDATION

The Military Coalition urges you to reverse the seventeen year old discriminatory policy of not allowing otherwise eligible military families stationed overseas to qualify for EIC by favorably considering the provisions of H.R. 479, a bill that most adequately addresses both association's objection to the inequity in law as it applies to EIC eligibility and urges its inclusion in any tax legislation that Committee deems appropriate.

Thank you.



## THE MILITARY COALITION

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Chairman RANGEL. We had a member testify this morning, Mr. Slattery.

Sergeant Major OUELLETTE. That is right, sir.

Chairman RANGEL. And we all supported that effort, too.

Sergeant Major OUELLETTE. Very good. Thank you very much, Mr. Chairman.

Chairman RANGEL. Nancy Kennedy from the United Way of America.

**STATEMENT OF NANCY MOHR KENNEDY, CHIEF OF STAFF,  
UNITED WAY OF AMERICA**

Ms. KENNEDY. Thank you, Mr. Chairman. It is good to see you.

Chairman RANGEL. It is good to see you again.

Ms. KENNEDY. I come before you today on behalf of United Way of America, which is the service organization for hundreds of local United Ways across the United States, who work with over 40,000 local agencies in service to people in need.

I was asked to come today just to endorse the earned income tax credit and to convey to you the fact that we feel that it is a very important component, that we think it is a very important way to bring people off of dependency to self-sufficiency.

On the matter of the schedule, the EIC schedule, we have for the past 3 years been involved in a campaign, a public information campaign, with all those agencies across the country, and someone has calculated that we have gotten word to at least about 3 million families. Whether or not they signed up because of that, I do not know. But we are, in conjunction with the Internal Revenue Service and other agencies, trying to get the word out.

I think one thing that you might look at is the fact that if someone files a standard short form or does not file, then they do not benefit.

Thank you. That is all.

[The prepared statement follows:]

## Testimony of

NANCY MOHR KENNEDY  
CHIEF OF STAFF  
UNITED WAY OF AMERICA

hearing on  
Selected Aspects of Welfare Reform

before  
The Subcommittee on Select Revenue Measures  
and  
The Subcommittee on Human Resources  
Committee on Ways and Means  
U.S. House of Representatives

The Honorable Charles B. Rangel, Chairman  
The Honorable Robert T. Matsui, Acting Chairman

Tuesday, March 30, 1993

Chairman Rangel, Chairman Matsui, and Members of the Subcommittees on Select Revenues Measures and Human Resources, my name is Nancy Mohr Kennedy. I am Chief of Staff of United Way of America (UWA).

Thank you for the opportunity to appear here today in support of the Earned Income Tax Credit (EITC) as a means to provide work incentives for low-income families and help create alternatives to welfare.

United Way of America, along with local United Ways located across the country, support efforts to reform the nation's welfare system. Our shared goal is to create a compassionate, rational system to assist individuals and families in their quest for self-sufficiency.

Recently, United Way of America's Public Policy Committee met and reaffirmed it's commitment to work toward overcoming welfare dependency, as well as removing barriers to independence and self-sufficiency. Toward that end, our testimony focuses on the importance of the Earned Income Tax Credit in achieving those goals.

The EITC is a refundable tax credit from the IRS to working families earning less than \$22,370 with at least one child living with them, and is a worthwhile tax credit that helps strengthen and stabilize the American family by helping put food on the table and pay the bills. It is an important economic development effort because most benefits are spent locally, infusing over \$11 billion into state and local economies. The money is spent to pay bills, purchase food, and cover other family necessities.

Originally enacted in 1975, the Earned Income Tax Credit was greatly expanded in 1990 by President Bush and the Congress to reward and encourage work and also to help offset the growing burden that payroll taxes place on low-income working families. Almost 14 million families now qualify for the credit, which provides \$10.7 billion annually in benefits to low-income working families.

The EITC provides a dollar-for-dollar reduction in the taxes an eligible family owes to the Federal Government. Unlike most tax credits, the EITC is refundable. If the amount of the credit exceeds the taxpayer's tax liability, the balance is payable to the taxpayer. Therefore, families with very low incomes and who may not owe any taxes can receive at least a partial credit.

Additionally, under an advance payment system, eligible taxpayers may elect to receive the benefit of the credit in their periodic paychecks, rather than waiting to claim a refund on their return filed by April 15 of the following year.

As a result of changes in the law in 1991, those taxpayers who receive public assistance can still receive the credit without risk of losing those benefits as long as they have "earnings." Unlike welfare which often has the perverse effect of penalizing work, the EITC provides additional dollars to a low-income working family.

Currently, the basic credit is 18.5 percent of earned income for families with one child and 19.5 percent for those with two or more children. In 1994, because the basic credit is indexed for inflation, that amount is scheduled to rise to 23 percent and 25 percent, respectively. The Omnibus Budget Reconciliation Act of 1990 established two small supplemental credits: one for children 1-year-old and younger, and one for health-care costs.

Last year United Ways and State Organizations played a key role in helping three million additional low-income families receive the Earned Income Tax Credit, which is often referred to as the "working family's rebate."

For the past several years, United Way of America has worked with the Center on Budget and Policy Priorities and over 40,000 locally funded agencies to coordinate a national EITC campaign to alert eligible low-income working families to the credit and to explain how to receive it.

This year, alerting low-income families to the EITC is more important than ever because:

- Millions of working parents lost their jobs in 1992. As a result, many workers earned far less in 1992, than they previously did in their working lives. Consequently, many newly eligible workers may not know about the EITC.
- Eligible families must file a tax return (not the 1040 EZ -- also known as the short form), and they must also file a form called "*Schedule EIC*." Last year IRS had a flexible policy toward families that filed a tax return but did not attach the "*Schedule EIC*". If they appeared to be eligible from the face of the return they were awarded the credit.

This year IRS has rescinded this policy. If a family fails to file a "*Schedule EIC*", the EITC benefit will not automatically be received. The IRS will, however, send a form letter notifying a family of their potential eligibility to receive the EITC credit, as well as send them a blank copy of the "*Schedule EIC*" if, on the face of their tax return, they appear to be qualified for the credit.

While hundreds of thousands are expected to receive this mailing, how many will actually respond is unknown. Therefore, this year's campaign is particularly important. United Way of America is proud to be part of this outreach network.

Our involvement with the agencies we serve and others having daily contact with deserving low-income families is an appropriate role in carrying out our mission "to support and serve local United Ways to help increase the organized capacity of people to care for one another."



The EITC is important in working toward the Clinton Administration's goal of overhauling our welfare system by encouraging recipients to find a job after two years on public assistance, by ensuring that a family of four, with a minimum-wage income, lives above the poverty line, counting earnings as well as government benefits, such as food stamps.

United Way of America looks forward to working with Congress and the Administration to establish a respectful and responsive system for helping families with children become self-sufficient, and thereby are enabling families to remain together.

Chairman RANGEL. Thank you. The United Way does a great job, and it is really encouraging that you would take time out to support this for your constituents. We really appreciate it.

Ms. KENNEDY. Thank you, Mr. Chairman.

Chairman RANGEL. Now Mr. Glunt is not here, but Gerald Howard, the staff vice president, will be testifying.

**STATEMENT OF GERALD M. HOWARD, STAFF VICE PRESIDENT AND LEGISLATIVE COUNSEL, NATIONAL ASSOCIATION OF HOME BUILDERS**

Mr. HOWARD. Thank you, Mr. Chairman. It is a pleasure to be here, and on behalf of Mr. Glunt, I would like to extend his apologies to you and the committees.

I would like to say that the National Association of Home Builders has worked very closely and with the full committee to provide as much help for low-income people in the area of housing that the Tax Code will afford us, and we think that the targeted jobs tax credit, which has been one of the subjects of this hearing, is crucial not to the provision of housing, sir, but to the provision of jobs.

Indeed, the National Association of Home Builders, through our nonprofit educational arm, the Home Builders Institute, is actively involved with the targeted jobs tax credit.

HBI, the Home Builders Institute, helps place Job Corps graduates into positions in our industry after training them in the construction trades. Our instructors teach home building trades at 55 of the 108 Job Corps Centers nationwide. Construction and the skilled building trades include, among other items, carpentry, landscaping, building and apartment maintenance, and brick masonry.

Upon graduation from the Job Corps, HBI's national coordinators help find employment for those disadvantaged workers in our industry, the housing industry.

The TJTC has been instrumental in persuading private-sector employers to hire disadvantaged workers, despite some of the contradictory testimony you may have heard.

Indeed, Mr. Chairman, one placement coordinator reported to us that a certain large company in Houston, which had hired over 20 Job Corps graduates in the past years, stopped hiring Job Corps graduates as a result of the recent expiration of the targeted jobs tax credit.

Our industry places approximately 2,000 Job Corps graduates into jobs each year. Approximately 75 percent of such placements use the targeted jobs tax credit, and our placement coordinators in many areas report that 100 percent of their placements are targeted jobs tax credit hires.

Mr. Chairman, NAHB fully supports the Clinton administration plan for economic recovery and for the 1994 fiscal budget, including its proposal with respect to permanent extension for the targeted jobs tax credit.

However, we believe that the language of H.R. 325, your bill and the bill introduced by your colleague, Mrs. Johnson, provides for the most effective utilization of the program. Particularly we note that the administration's TJTC proposal does not include 23- and 24-year-olds, whereas H.R. 325 would make this important improvement. Accordingly, we would urge the committee upon consideration to adopt the language of H.R. 325 when you draft any legislative proposal.

That concludes my remarks, Mr. Chairman.

[The prepared statement follows:]

**STATEMENT OF THE  
NATIONAL ASSOCIATION OF HOME BUILDERS  
BEFORE THE  
HOUSE COMMITTEE ON WAYS AND MEANS  
SUBCOMMITTEES ON  
SELECT REVENUE MEASURES  
and  
HUMAN RESOURCES**

March 30, 1993

Mr. Chairman, members of the Committee:

My name is Gerald M. Howard. I am Staff Vice President and Legislative Counsel of the National Association of Home Builders. On behalf of the National Association of Home Builders (NAHB) and its 160,000 members, I congratulate you for holding this hearing and appreciate the opportunity to appear here today. My testimony will address the Targeted Jobs Tax Credit (TJTC), which federal tax incentive is designed to assist low-income individuals, and will include the Low Income Housing Tax Credit and Enterprise Zones which provisions are of direct import to achieving the legislative mission of this hearing.

**Targeted Jobs Tax Credit**

At the outset, I would like to thank and congratulate Chairman Rangel and Representative Nancy Johnson for introducing H.R. 325 which provides for the permanent restoration and improvement of the TJTC program.

As a result of President Bush's veto of H.R. 11 during the 102nd Congress, the TJTC (Internal Revenue Code Section 51) was not renewed beyond its June 30, 1992 expiration date. The TJTC encourages employers throughout the nation to hire individuals who as a result of economic disadvantage or a disability have found it difficult to enter the private workforce regardless of the overall condition of the economy. These "structurally unemployed" individuals are economically disadvantaged youth between the ages of 18 and 22; economically disadvantaged cooperative education students; vocational rehabilitation referrals; economically disadvantaged Vietnam veterans; economically disadvantaged ex-felons; certain welfare recipients; and economically disadvantaged summer youth employees.

The National Association of Home Builders (NAHB) through our nonprofit educational arm, the Home Builders Institute (HBI), is actively involved with the TJTC. HBI helps place Job Corps graduates into positions in our industry after training them in the construction trades. HBI's instructors teach home building trades at 55 of the 108 job corps centers nationwide. Instruction in the skilled building trades includes, among others, carpentry, landscaping, building and apartment maintenance, and brickmasonry. Upon graduation from job corps, HBI national coordinators help to find employment for these disadvantaged workers with employers in the building industry.

TJTC has been instrumental in persuading private sector employers to hire disadvantaged workers. Although our national coordinators contact thousands of potential employers nationally, many of these employers are reluctant to hire disadvantaged workers without additional incentive. The most common reasons given are that the trainees have little actual, on-the-job experience when, as you are no doubt well aware, thousands of experienced individuals are currently out of work in our industry. There is also a perception on the part of some employers that disadvantaged youths may be unreliable. This tax incentive allows a young person to get his or her foot in the door to sharpen their skills and to rebut any such presumptions.



Our industry places approximately 2,000 job corps graduates into jobs each year. Approximately, 75% of such job placements use the TJTC. Indeed, several HBI placement coordinators use TJTC for 100% of their job placements. Many employers have been encouraged to hire job corps graduates because of TJTC availability. Moreover, the TJTC has had a most significant impact on small business employers during the nation's recent economic difficulties.

By letter of December 22, 1992, Senators Boren and Packwood encouraged employers to continue to participate in the TJTC program by making the TJTC a major factor in their hiring decisions. In spite of such Congressional assurances as to the restoration of the program, loss of the TJTC option has removed the incentive to hire these young employees. When the TJTC expired last June 30th, job placements were directly affected. One placement coordinator reported to us that a certain large company in Houston, Texas that had hired over 20 job corps graduates in the past few years, stopped hiring job corps graduates because they could no longer receive the tax credit.

The targeted jobs tax credit is an invaluable tool to encourage employers to hire newly trained young people. Not only is this program beneficial in terms of assisting in the provision of affordable housing, but the fact that it affords the opportunity for structurally unemployed citizens to learn a marketable skill cannot be overstated.

NAHB fully supports the Clinton Administration plan, including its proposal with respect to permanent extension of the TJTC. However, we believe that the language of the Rangel-Johnson bill provides for the most effective utilization of the program. Particularly, we note that the administration's TJTC proposal does not include 23 and 24 year olds, whereas H.R. 325 would make this important improvement to the program. Accordingly, we urge you to adopt the language of H.R. 325 in drafting any legislative proposal passed by these Subcommittees concerning the TJTC.

#### Low Income Housing Tax Credit

On behalf of the NAHB, I would like to thank Chairman Dan Rostenkowski and Representative Charles Rangel for their leadership with respect to the temporary extension of the low income housing tax credit in past years and for their tireless efforts to permanently extend the program, as evidenced by their early introduction of H.R. 18 during this Congress. Chairman Rostenkowski and Representative Rangel, along with their Senate colleagues George Mitchell, John Danforth, and David Boren can take a great deal of pride in their records on this matter.

The LIHTC has established a record of unparalleled success. In 1989 alone, over 125,000 low-income housing units received tax credit allocations<sup>1</sup>. Without the LIHTC, it will not be possible to establish rent levels low enough, on most new and rehabilitated units, to make them affordable to low-income tenants. Therefore, the loss of the LIHTC will stop many low-income rental units from being built or rehabilitated.

Our analysis indicates the LIHTC supports the construction or rehabilitation of about 130,000 low income rental units each year including 60,000 to 70,000 new units. The LIHTC is responsible for more than one-third of all 1992 multifamily starts, nearly half of all rental multifamily starts, and virtually all the new rental units available to households with incomes under \$15,000<sup>2</sup>. Failure to revitalize the program would bring the multifamily sector to depression levels.

Failure to keep the credit would also eliminate the LIHTC-sponsored rehabilitation of about 50,000 to 55,000 units per year in 1993 and 60,000 in years beyond<sup>3</sup>. A permanent solution is necessary to correct the disruptions that have heretofore kept the credit from being a consistent factor in planning low-income multifamily rental projects.

Assuming the permanent extension of the LIHTC, tax credit assisted units will probably account for about eighteen percent of all multifamily completions and one quarter of multifamily rental completions over the remainder of the decade. More importantly, tax credit assisted units would account for as much as 93 percent of all low-income multifamily rentals completed in the 1990s.

If the LIHTC is not extended, we estimate a loss of 60,000 multifamily starts each year after 1992<sup>4</sup>. The reduction would cost 50,000 jobs and \$1.29 billion in wages in the new construction sector<sup>5</sup>. Another 16,500 jobs and \$430 million in wages in the remodeling industry would be lost in each future year.

Foregone taxes from a single year's LIHTC are \$313 million per year. Since the credit is taken for 10 years, the ultimate cost is \$3.13 billion.

### Enterprise Zones

The Administration proposes to designate 50 federal enterprise zones which would benefit from targeted employment and investment incentives to stimulate revitalization of these distressed areas. Chairman Rangel has introduced legislation, H.R. 15 which would, *inter alia*, create 150 zones over 5 yrs, provide an enhanced Targeted Jobs Tax Credit, an Enterprise Zone Employment Credit of 15 percent against the first \$20,000 wages (the maximum credit would be \$5,000 per worker), and encourage community development within the enterprise zone.

NAHB believes that the enterprise zone proposal should contain the language of Chairman Rangel's bill and should be further modified to include a housing component, in order to be viable. To facilitate development of affordable rental housing, the enterprise zone proposal may provide for an increase in the amount of LIHTC individuals can utilize under the passive loss rules. In this regard, the \$25,000 loss limitation should be eliminated with respect to developments located within the enterprise zone.

Further, the proposal should provide first-time home ownership incentives, creating viable communities to support the enterprise zones.

### CONCLUSION

The National Association of Home Builders is acutely aware of the continuing need to reduce the deficit. Indeed, we support all responsible attempts to do so and, therefore, have adopted policy in support of the President's economic plan. We agree with Chairman Rangel's position that failure to adequately utilize the abilities and potential of structurally unemployed citizens contributes in no small way to lost federal and state revenues and our increasing deficit.

A serious lack of economic growth exists in almost all sectors of the economy - not just housing. However, the housing market has been the engine that traditionally pulls the nation out of recession. By creating job opportunities for all Americans, the housing industry can also be the engine that leads the battle against under-employment, under-education and un-affordable housing.

The National Association of Home Builders continues to advocate the immediate enactment of economic stimulus legislation. In this regard, NAHB policy provides for a five point program to spur a recovery in the housing industry, one facet of which calls for the permanent extension of the expiring provisions with respect to the tax credits for low-income housing and targeted jobs. In the opinion of the NAHB, the proposals set out by the Administration, as modified above, are central elements of said program. NAHB looks forward to further working with you and your staff to propose and implement solutions to sustain the Nation's economic recovery.

1. National Council of State Housing Finance Agencies.
2. Approximately 65,000 LIHTC units were started in 1992, compared to 170,000 units in buildings with 2 or more units of which 129,000 were offered for rent. Incomes below \$15,000 are capable of paying \$375 per month in gross rent (including utilities) which is below the return necessary for an average market rate unit.
3. National Council of State Housing Finance Agencies.
4. *A Plan to Stimulate the Nation's Economy*, National Association of Home Builders, February 1992.
5. NAHB estimates updating a 1981 Bureau of Labor Statistics data show that 826 jobs are created for every 1,000 additional multifamily units and \$21.5 million added wages are earned per 1,000 starts.

Chairman RANGEL. Thank you, Mr. Howard.  
We will now hear from Ms. Harrison.

**STATEMENT OF CRYSTAL HARRISON, PRODUCTION LINE  
EMPLOYEE, HEWLETT-PACKARD CO., SPOKANE, WASH., ON  
BEHALF OF SECTION 127 COALITION**

Ms. HARRISON. Thank you, Mr. Chairman and members of the subcommittees. I am very pleased to have this opportunity to testify in support of section 127, employee educational assistance, and to tell you about how this provision in the Tax Code is enabling me to obtain an education that I could not otherwise receive.

My name is Crystal Harrison, and I am a process support worker on the production line at the Hewlett-Packard facility in Spokane, Wash. After I graduated from high school in 1981, I went to work in a plastics factory in Spokane. I transferred to Hewlett-Packard in 1984 because of its excellent reputation and strong benefits package. I was particularly impressed with the willingness of Hewlett-Packard to help its employees improve their skills and obtain an education.

I began work in 1984 as a custodian on the swing shift. Right away I started taking courses at the local community college with the help of section 127 benefits that Hewlett-Packard provides us.

When Hewlett Packard decided to contract out its custodial services in 1987, I moved to the production line where I am today, and I have continued to take college courses. I am three courses away from obtaining an A.A., associates's degree, from Spokane Community College.

Through my work at Hewlett-Packard, I have discovered an interest in engineering. I plan to complete my education at either Gonzaga University or Eastern Washington University. I will be going for a bachelor of science degree in business or mechanical engineering. At this point, I have not totally decided upon which option.

What is making all of this possible is section 127. Through employee educational assistance, I can get up to \$5,250 per year in tuition, books, and fees tax-free for nonjob-related education. When I worked as a custodian, and even now where I am on the production line, there isn't much in the way of college courses I can take that is related to my job. Without section 127, all of the educational benefits Hewlett-Packard provides would be taxable. I now make \$1,800 per month. If I had to pay Social Security, Federal, State, and local taxes on the value of my educational benefits, I just couldn't do it.

I want to assure you that I am not alone. There are literally hundreds of workers across the country and many of my colleagues at Hewlett-Packard in Spokane who are going to school under the same circumstances that I am. We are dedicated to our work and to getting an education. According to a study done by Coopers & Lybrand, more than 70 percent of section 127 recipients earn less than \$30,000 per year, and more than a third of us make less than \$20,000 per year. We are taking business-related courses, as well as courses in engineering, health sciences and nursing, education, and computer sciences.



As you know, the founders of Hewlett-Packard Co. believe in the concept of life-long learning. Furthermore, you know that American companies and workers are facing a very competitive environment. Major companies, including Hewlett-Packard, are restructuring. If you are not trained, if you don't keep learning, you aren't going to have a job. You won't be able to support yourself and your family.

In this demanding time, it is important for employers and employees to work together. Section 127 is an essential part of that strategy for developing and keeping a world-class force. It is essential for people like me who are striving to support ourselves and our family.

If you can only do one thing, I ask you to make sure that section 127 becomes a permanent part of that Tax Code, so that I can keep on going to school.

On behalf of the workers at Hewlett-Packard Company in Spokane, Washington, I want to thank you.

[The prepared statement and attachment follow:]

**STATEMENT OF CRYSTAL HARRISON  
Hewlett-Packard Co., Spokane, Wash.**

Mr. Chairmen and members of the subcommittees, I am very pleased to have this opportunity to testify in support of Section 127, employee educational assistance, and to tell you about how this provision in the tax code is enabling me to obtain an education I could not otherwise receive.

My name is Crystal Harrison and I am a process support worker on the production line at the Hewlett-Packard facility in Spokane, Washington. After I graduated from high school in 1981, I went to work in a plastics factory in Spokane. I transferred to Hewlett-Packard in 1984 because of its excellent reputation and strong benefits package. I was particularly impressed with the willingness of Hewlett-Packard to help its employees improve their skills and obtain an education.

I began work in 1984 as a custodian on the swing shift. Right away I started taking courses at the local community college with the help of the Section 127 benefits Hewlett-Packard provides us.

When Hewlett-Packard decided to contract out its custodial services in 1987, I moved over to the production line where I am today. And I've continued to take courses. I'm about 3 courses away from obtaining an A.A., Associate's degree, from Spokane Community College.

Through my work at Hewlett-Packard, I've discovered an interest in engineering. I plan to complete my education at either Gonzaga University or Eastern Washington University. I'll be going for a Bachelor of Science degree in business or mechanical engineering. At this point, I have not totally decided on which option.

What is making all of this possible is Section 127. Through employee educational assistance I can receive up to \$5,280 per year in tuition, books and fees tax-free for nonjob-related education. When I worked as a custodian, and even now where I am on the production line, there isn't much in the way of college courses I can take that's related to my job. Without Section 127, all of the education benefits H-P provides would be taxable. Now I make \$1,800 per month. If I had to pay Social Security, federal, state, and local taxes on the value of my education benefits, I just couldn't do it.

I want to assure you that I'm not alone. There are literally hundreds of workers at the Spokane facility — and thousands more across this country — who are going to school under the same circumstances that I am. We are dedicated to our work and to getting an education. According to a study done by Coopers & Lybrand using federal government data, more than 70% of Section 127 recipients earn less than \$30,000 per year and more than one-third of us make less than \$20,000 per year. We are taking business-related courses as well as courses in engineering, health sciences and nursing, education and computer science. The executive summary of that study, "Section 127: Who Benefits? At What Cost?" is attached to my testimony.

As you know, the founders of Hewlett-Packard believed in the concept of life-long learning. Furthermore, you know that America's companies and workers are facing a very competitive business environment. Major companies, including Hewlett-Packard, are restructuring. If you're not trained, if you don't keep learning, you aren't going to have a job. You won't be able to support yourself and your family.

In this demanding time, it's important for employers and employees to work together. Section 127 is an essential part of that strategy for developing and keeping a world-class workforce. It's essential for working people like me who are striving to support ourselves and our families.

If you can do only one thing, I ask you to make sure that Section 127 becomes a permanent part of the tax code so that I can keep on going to school. On behalf of all the workers at the Hewlett-Packard facility in Spokane, Washington, I thank you.

Coopers  
& Lybrand

**Section 127  
Employee Educational  
Assistance**

*Who Benefits?  
At What Cost?*

A study prepared by  
Coopers & Lybrand's  
National Tax Policy Group  
for  
The Employee Educational Assistance Coalition

June 1989

Executive Summary

"Section 127, Employee Educational Assistance: Who Benefits? At What Cost?" is designed to respond to frequently asked questions about the utilization of employer-provided educational assistance.

This report analyzes two Department of Education data sets, the National Post-Secondary Aid Study (NPSAS) for 1986 and the Triennial Adult Education Survey which has been conducted since 1969.

Its findings are as follows:

- Section 127 benefits appear to be distributed in a manner closely paralleling earnings among the labor force as a whole. Benefits do not accrue disproportionately to higher paid employees. Nearly 99% of Section 127 recipients earn less than \$50,000, 71% less than \$30,000 and 36% less than \$20,000.
  
- Over ninety percent of Section 127 benefits are for less than \$2,000. Average payments are concentrated well below \$1,000 and generally correlate to costs of tuition, fees, books and supplies. The mean assistance level is \$621.



- Benefit payments on the average are higher for those attending private universities (\$1,200) vs. those attending public institutions (\$300).
- Those attending professional schools--law, medicine, architecture/environmental design--account for less than one-half of one-percent of all Section 127 recipients.
- Nearly half of those with identified majors and using Section 127 benefits are taking business-related courses with the remainder taking, in descending order, courses in engineering, health science/nursing, education and computer science.
- To reinstate Section 127 benefits for both graduate and undergraduate courses would cost the Treasury a little more than \$100 million in 1990.

Chairman RANGEL. Thank you, Ms. Harrison. You can't beat success, and you have proven that it works by being here with your eloquent testimony.

Mr. Howard, the building trades industry doesn't get high points for outreach to minorities, and you have been tremendous not only with the targeted jobs credit in getting nationwide support, but also with the low-income housing credit. How do you explain the reputation of the construction industry generally and the home building industry, specifically, in terms of minorities?

Mr. HOWARD. Well, Mr. Chairman, let me say that NAHB represents the building companies rather than the specific building trades and the subcontractors.

I will say that to the—and I am not sure exactly what statistics you have that would show that our industry has been less than perfect in its performance in this area—the Home Builders Institute is something that we formed a few years back to try and improve the quality of the work force and the training that goes to younger Americans and to minorities and to the disadvantaged, and that is something that our association takes a great deal of pride in. It is one of the ways that we, as successful entrepreneurs, would like to reach back into those communities.

Chairman RANGEL. Well, it makes sense to me, but what relationship do you have with the actual workers? I mean, you support the targeted jobs credits, but you don't hire the people yourself, do you?

Mr. HOWARD. What we do, sir, through the HBI is when the people who are being trained at the Job Corps centers have graduated, they come to the Home Builders Institute, which is our educational branch, and our coordinators then take them to construction sites in various areas to work with various of our members who, through their projects, have committed to working with HBI, and we bring those newly trained employable people into the work force through that system.

So, as directly as we can, we try through the Home Builders Institute to become involved with minorities and some of the disadvantaged people.

Chairman RANGEL. OK. But it is not shocking to you that the construction trade unions have a record of racism in the past and today. I mean, that is not news to you.

Mr. HOWARD. Mr. Chairman, I am not sure that it would be appropriate for me to comment on the trade union's reputation. I can only speak for NAHB and its members, sir.

Chairman RANGEL. But I thought that your members were actually training people in order to do the work.

Mr. HOWARD. Yes, sir, and then we work with the people that are actually doing the employment to try and get them to hire them for the specific projects.

Chairman RANGEL. And in most of those cases, these are unions that have to?

Mr. HOWARD. No, sir. Most of the Home Building sites are non-union sites.

Chairman RANGEL. I see. Could you share with me, if you know, the number of minorities that are being trained by the Home Builders for the nonunion work?

Mr. HOWARD. I don't have those numbers available, sir, but I will be happy to respond in writing.

[The following was subsequently received:]

April 6, 1993



# HOME BUILDERS INSTITUTE

## JOB CORPS ENROLLMENT

	TOTAL		MINORITY					
1991 - 1992	5,527	3,009	1,784	536	87	65	46	3,743
1992 - 1993	3,234	2,092	688	328	53	43	29	2,545

*1 thru Feb-93*

(1991 - 1992)

(1992 - 1993)

- |                 |     |       |
|-----------------|-----|-------|
| Black           | 55% | 65%   |
| White           | 26% | 20.5% |
| Hispanic        | 14% | 10%   |
| Native-American | 2%  | 2%    |
| Asian           | 2%  | 1.5%  |
| Other           | 1%  | 1%    |



Chairman RANGEL. Good, because if it is something that you feel proud of, then I certainly think that we should have you disassociate it where we have the problem, and I will do all that I can to laud the work that you are doing in your outreach program.

Continued success, Ms. Harrison and United Way, and, certainly, the military has made its position clear, and it makes a lot of sense to us. We apologize for the length of time you had to stay here. It was not our doing, but we appreciate the fact that you did stay.

This committee will stand adjourned, subject to the call of the Chair. Thank you.

[Whereupon, at 3 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

STATEMENT OF CHIEF MASTER SERGEANT NORM PARNES, USAF  
(RETIRED), AIR FORCE SERGEANTS ASSOCIATION

Mister Chairman and distinguished members of the Subcommittees on Select Revenue Measures and Human Resources, Committee on Ways and Means, thank you for the opportunity to present views today on behalf of the 167,000 members of the Air Force Sergeants Association (AFSA) regarding the Earned Income Tax Credit (EITC).

Mr. Chairman, AFSA is very pleased that the administration has proposed a major expansion of the EITC to an amount that is intended to lift working low-income families out of poverty. We understand that the proposed changes are intended to offset the regressive effect of the proposed energy tax on families with certain income limits, and we certainly support that. Our association believes these changes are great enhancements to the EITC program; however, we also believe that we must first correct a terrible injustice that has been with us for quite some time.

Visualize a young airman stationed at Andrews Air Force Base, Maryland, if you will. This young airman is married, has one child and lives in an apartment in Suitland, Maryland. His wife works part-time, and with their combined salary, they just barely make it in the runaway inflation arena that we have experienced in the last few years. They do have a couple of things going for them though. First, they qualify for food stamps. Yes, Mr. Chairman, I said food stamps! Can you imagine being a member of the military service in the greatest democracy in the world and qualifying for food stamps? Well it's true; actually, \$24.5 million in food stamps were redeemed by lower ranking enlisted personnel in military commissaries in 1992, but that is not why we are here today. This couple also qualifies for the Earned Income Tax Credit (EITC) — and we are agreed that certainly helps those that so badly need the credit, or why would we be here today? However, changes in this young couple's budget-planning, such as the administration-proposed military pay freeze and this young airman's assignment to Ramstein AB, Germany, devastate their lifestyle. Upon arrival in Germany, they learn that the Food Stamp Program does not exist on foreign soil, even in the base commissary; his wife cannot work off-base; and they no longer qualify for the Earned Income Tax Credit because they are outside of the United States. That's right, Mr. Chairman and members of the committee — they are now not eligible for EITC (even though they still qualify, based on their disposable income) as they were back in Maryland.

Mr. Chairman, before we make the changes requested by the administration — and we do support those changes — this travesty needs to be corrected. This committee can't fix the food stamp problem or the pay problem — but it can fix the EITC problem, and that will be a start. Please don't ignore this problem as so many others have before you.

The Earned Income Tax Credit for all military personnel who qualified was included in last year's H.R. 11, which was vetoed by then President Bush. Mr. Chairman, AFSA is asking that you include EITC for military personnel stationed overseas in any changes that are effected to the tax laws this year. Fairness and equity are required in this case, and we ask the committee to please support this issue.

Thank you for allowing us the opportunity to provide this testimony on behalf of our membership.

## AMERICAN SOCIETY FOR PAYROLL MANAGEMENT

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The Honorable Charles B. Rangle  
Chairman, Subcommittee on Select Revenue Measures

&  
The Honorable Robert T. Matsui  
Chairman, Subcommittee on Human Resources  
U.S. House of Representatives  
Washington, DC 20515

Dear Chairman Rangle and Chairman Matsui:

Although we are unable to appear before your March 30 joint hearing on welfare reform, we are pleased to submit these suggestions for your consideration and for the record. We will not review the arguments for employer-provided non-job-related educational assistance as we believe you and the members of the subcommittees agree that the merits of the program are evident and that the program must be stabilized by making it permanently retroactive to July 1, 1992. Our comments below explain the need for special procedures for Form W-2 corrections, tax refunds and penalty waivers, to allow employers to correct reporting and withholding mistakes created by the confusion over whether Sec. 127 would be extended again.

Correcting for H.R. 127 - Educational Assistance

The 1992 status flip-flop bred non-compliance. When the tax break expired on July 1, 1992 many employers did nothing because they expected a repeat of prior years' experience when taxfree status would be restored before year end. When the veto of H.R. 11 in November settled the issue, some employers scrambled to recharacterize their tuition reimbursements, others didn't. Anecdotal evidence suggests an even split between compliance and non-compliance.

ASPM conducted a survey in March 1993 among a stratified sample of our members to provide empirical evidence as to employer reaction to the 1992 lapse in educational assistance. Respondents were people in charge of payroll at firms ranging from 110,000 to 140 employees and handled educational assistance for a total of 41,442 employees. Of 50 respondents, 24 reported that they deemed educational assistance to be taxable income last year (15 in July plus another nine by December), but 26 did not act on the tax status change because they expected Congress to extend Sec. 127.

Thus employers are caught in a 50/50 split between compliance and non-compliance. If the tax break for educational assistance be restored retroactively, employers who were non-compliant in 1992 will be made whole but employers who complied with the status change during 1992 will become non-compliant. If the tax break be restored prospectively in 1993, the tables are turned. Under

either alternative, the number of corrections that will be required is tremendous. There would be a flood of corrected 1992 W-2s, amended 1040 returns and corrected 941 tax returns resulting in administrative disaster not only for employers but for employees, the Internal Revenue Service and the Social Security Administration. We therefore urge Congress to provide special, one-time-only, relief from normal procedures for making corrections to 1992 educational assistance reports. Penalties also should be waived because of the circumstances that were so confusing that one half of all employers reported and withheld incorrectly (reporting income for income tax, social security tax, and medicare tax, respectively) whether Sec. 127 is extended retroactively, prospectively, or not at all.

Alan Herkowski, Eaton Corporation, Cleveland, Ohio suggests on behalf of the members of ASPM that compliant employers make 1992 adjustments on their information reports and tax returns for tax year 1993 by (1) reporting 1992 educational assistance reimbursements after June 30, 1992 as a negative number in Box 14 of the W-2 for 1993 earnings, and (2) by reducing 1993 wages by the same amount in Boxes 1, 3 and 5. The payroll system would make all computations from the net amount of wages in the usual manner so by the end of 1993 employer's and employees' wage and tax reports and returns would be correct. There would be no need to issue corrected 1992 information reports and tax returns except for 1992 recipients no longer on the 1993 payroll.

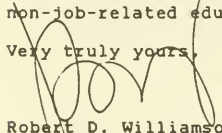
Example: The 1993 W-2 for an employee who received \$1,000 educational assistance deemed taxable in 1992 and who earns \$40,000 in 1993 would show \$1,000 1992 educational assistance as a negative figure in Box 14 and \$39,000 in Boxes 1, 3 and 5.

If educational assistance is not restored, or is restored only prospectively, the 1992 compliant employer need do nothing but the non-compliant must correct its records by adding educational assistance (not formerly reported) to Box 14 and to taxable wages.

Example: The 1993 W-2 for an employee who received \$1,000 educational assistance that was not deemed taxable income in 1992 and who earns \$40,000 in 1993 would show \$1,000 1992 educational assistance as a positive figure in Box 14 and \$41,000 in Boxes 1, 3 and 5.

We most emphatically urge you and the members of the subcommittees to include authorization of these correcting mechanisms in the legislation that restores the tax break for non-job-related educational assistance.

Very truly yours,



Robert D. Williamson  
President

RDW/ja



American Society for Payroll Management  
P.O. Box 1221, New York, NY 10025  
212-662-6010

Survey on Educational Assistance

ASPM conducted a blind survey among a stratified sample of its members in March to determine members' reactions to the 1992 change in tax status of employer-provided non-job-related educational assistance. Such payments were deemed taxable income after June 30, 1992 when the IRC sec. 127 exclusion expired. Fifty respondents took part in the survey, which is tabulated on page 2. The number of employees on the respondent's payrolls ranged from 110,000 to 140 and totalled 788,982 employees. The results of the survey showed that:

1. Educational assistance is widely available. Out of the total number of employees represented in the survey, 677,991 (86%) were eligible for all types of educational assistance [Question I.1]. Reimbursements were made to 41,442 employees, representing 6% of all eligible employees [QI.2].
2. Educational assistance isn't restricted to job-related courses. Only 8 (16%) of respondents reported this as their company's policy [QI.3.a-c.]. Respondents reported that tuition reimbursement for courses taken in 1992 amounted to \$13.6 million [QI.4] but that \$2.7 million (19%) was deferred for payment in 1993 when, presumably, they expected the tax status would be stabilized [QI.5].
3. Compliance with the tax status change was poor. The division between employers who complied with the tax status change and those who did not was 23 (46%) and 27 (54%) respectively [QI.6]. Compliance was not immediate, as 8 of the 23 compliant respondents (35%) reported that they waited for relief until November and December and then complied [QI1.11.a-b].
4. Educational assistance to higher-paid employees is not the rule. Respondents reported on average that 90% of their reimbursements went to employees who earned less than the 1992 \$55,500 social security taxable wage base, and 97% earned less than the \$130,200 Medicare taxable wage base [QI1.12.a-b.].

###

American Society for Payroll Management  
March 1993 Survey

Tot Empls	Covered		Particips		Job-only		Non-job		No restrict		1992 Reva	defer	1.5	1.6	1.7	11.7	11.8	11.9	12.0	12.1	12.2	12.3	12.4	12.5	12.6	12.7	12.8	12.9	13.0
	1.1	1.2	1.3	1.4	1.5	1.6	1.7	1.8	1.9	2.0																			
11000	10000	10000	Y	Y	6.4	0	Y	75	Y	Y	7/1/92	7/1/92	85	98															
87500	87500	12500	Y	Y	1000000	0	Y	75	Y	Y	7/1/92	7/1/92	100	100															
50000	50000	600	Y	Y	300000	0	Y	70	Y	Y	9/1/92	9/1/92	90	90															
20000	20000	10000	Y	Y	500000	10	Y	70	Y	Y	1/1/93	1/1/93	90	90															
41118	41118	1711	Y	Y	191100	0	Y	95	Y	Y	7/1/92	7/1/92	85	98															
35500	35500	300	Y	Y	2000000	0	Y	80	Y	Y	7/1/93	7/1/93	80	95															
35500	35500	1000	Y	Y	1000000	0	Y	85	Y	Y	11/1/92	11/1/92	75	100															
28000	28000	2303	Y	Y	255327	25	Y	100	Y	Y	11/1/92	11/1/92	95	100															
32000	32000	276	Y	Y	70000	0	Y	75	Y	Y	7/1/92	7/1/92	90	100															
30000	30000	300	Y	Y	50000	0	Y	75	Y	Y	7/1/92	7/1/92	100	100															
36000	36000	500	Y	Y	200000	30	Y	70	Y	Y	12/1/92	12/1/92	50	90															
21000	21000	1500	Y	Y	2000000	20	Y	80	Y	Y	7/1/92	7/1/92	95	100															
16500	16500	900	Y	Y	850000	90	Y	80	Y	Y	7/1/92	7/1/92	100	100															
10700	10700	133	Y	Y	48366	0	Y	80	Y	Y	7/1/92	7/1/92	100	100															
10700	10700	2183	Y	Y	46763	5	Y	80	Y	Y	7/1/92	7/1/92	82	98															
10000	10000	1000	Y	Y	135000	0	Y	100	Y	Y	12/1/92	12/1/92	95	100															
10000	10000	55	Y	Y	19810	0	Y	100	Y	Y	12/1/92	12/1/92	95	100															
10000	10000	60	Y	Y	48000	0	Y	80	Y	Y	1/1/93	1/1/93	95	100															
9000	9000	425	Y	Y	235000	0	Y	75	Y	Y	7/1/92	7/1/92	90	100															
9000	9000	100	Y	Y	30000	0	Y	75	Y	Y	7/1/92	7/1/92	90	100															
6185	5888	184	Y	Y	378100	90	Y	70	Y	Y	7/1/92	7/1/92	95	100															
6100	6100	625	Y	Y	685000	0	Y	70	Y	Y	7/1/92	7/1/92	95	100															
6000	6000	300	Y	Y	175000	0	Y	70	Y	Y	7/1/92	7/1/92	98	100															
4783	4600	189	Y	Y	183777	15	Y	95	Y	Y	1/1/93	1/1/93	95	100															
4000	4100	27	Y	Y	18451	100	Y	100	Y	Y	12/1/92	12/1/92	100	100															
4000	4000	50	Y	Y	4000	0	Y	95	Y	Y	1/1/92	1/1/92	100	100															
3980	3980	263	Y	Y	662375	75	Y	100	Y	Y	1/1/92	1/1/92	100	100															
3500	3500	49	Y	Y	58000	0	Y	100	Y	Y	1/1/92	1/1/92	100	100															
2500	2500	400	Y	Y	15000	0	Y	80	Y	Y	11/1/92	11/1/92	100	100															
3500	3500	50	Y	Y	35000	100	Y	50	Y	Y	7/1/92	7/1/92	100	100															
2500	2500	50	Y	Y	21000	0	Y	90	Y	Y	11/1/92	11/1/92	75	100															
2500	2500	48	Y	Y	21000	0	Y	90	Y	Y	11/1/92	11/1/92	100	100															
2500	2000	135	Y	Y	25000	15	Y	100	Y	Y	11/1/92	11/1/92	100	100															
2375	200	18	Y	Y	4300	0	Y	100	Y	Y	7/1/92	7/1/92	95	95															
2100	2100	7	Y	Y	180000	0	Y	100	Y	Y	7/1/92	7/1/92	75	100															
2000	2000	600	Y	Y	50000	30	Y	25	Y	Y	7/1/92	7/1/92	100	100															
2000	2000	35	Y	Y	31840	0	Y	25	Y	Y	7/1/92	7/1/92	100	100															
7000	7000	340	Y	Y	300	0	Y	90	Y	Y	11/1/92	11/1/92	100	100															
1750	1750	15	Y	Y	50000	0	Y	90	Y	Y	7/1/92	7/1/92	100	100															
1500	1500	150	Y	Y	44053	0	Y	90	Y	Y	7/1/92	7/1/92	100	100															
1470	1470	50	Y	Y	34982	30	Y	75	Y	Y	7/1/92	7/1/92	95	100															
1111	870	44	Y	Y	50000	100	Y	50	Y	Y	11/1/92	11/1/92	95	100															
1000	1000	100	Y	Y	15000	0	Y	100	Y	Y	12/1/92	12/1/92	94	100															
900	900	30	Y	Y	19464	15	Y	100	Y	Y	12/1/92	12/1/92	100	100															
300	300	0	Y	Y	62958	10	Y	30	Y	Y	7/1/92	7/1/92	100	100															
300	300	10	Y	Y	14462	50	Y	100	Y	Y	7/1/92	7/1/92	100	100															
140	140	10	Y	Y	13847458	18.5	23	75.5	22	73	7/1/92	7/1/92	100	100															
788932	677981	41447	40	31									96.1	91.0															

**Statement of Louis Núñez, President  
The National Puerto Rican Coalition**

**Hearings on Selected Aspects of Welfare Reform  
Committee on Ways and Means  
Subcommittees on Select Revenue Measures and Human Resources  
April 30, 1993**

Congressman Rangel, Congressman Matsui, and members of the Subcommittees on Select Revenue Measures and Human Resources, I wish to thank you for allowing me the opportunity to provide you with the National Puerto Rican Coalition's (NPRC) views on selected aspects of welfare reform, the effectiveness of the Earned Income Tax Credit (EITC) and the Targeted Jobs Tax Credit (TJTC) in helping to reduce the high poverty rate within the Puerto Rican community, and the need for job-related incentives to distressed areas. The National Puerto Rican Coalition is a membership association composed of over five hundred Puerto Rican community-based organizations and leaders. NPRC's goal is to further the social, economic and political well-being of the more than six million Puerto Ricans throughout the United States and Puerto Rico.

To begin, I would like to make three brief comments about the Puerto Rican community:

1. As United States citizens, Puerto Ricans migrate freely between the mainland and the Island — maintaining close familial and economic ties to each;
2. Ninety five percent of all mainland Puerto Ricans live in urban areas and 75% live in central cities, representing the most urbanized ethnic group in the US; and
3. Puerto Ricans are nearly three times as likely to live in poverty, drop out of high school at a rate exceeding 50% in some major cities such as New York and Boston, have home ownership rates that are one-third the national average, and suffer from AIDS and substance abuse in extremely high numbers when compared to the general population.

**POVERTY WITHIN THE PUERTO RICAN COMMUNITY**

Although significant numbers of Puerto Ricans in the United States have entered the economic mainstream, the fact still remains that the current poverty rate of 40% among Puerto Ricans is nearly three times the national average. The unemployment rate for Puerto Ricans is also higher than that of any other Hispanic communities. This social phenomena deserves national attention and special concern.

Concentrated in cities that have suffered a collapse of the industries that employed them; the breakdown of family and community links, as well as the ensuing isolation of individuals in increasingly smaller family units and the deterioration of their living environment; circulatory migration to and from the island of Puerto Rico, coupled with the parallel economic and social crisis there; and the lack of institutions to perform the binding role that the Churches performed in the African-American communities — all these factors have contributed to the deterioration of our social and economic network, and makes the Puerto Rican case specially troubling and deserving of attention.

A demographic profile of the Puerto Rican community reveals the following sobering statistics: Puerto Rican labor force participation is the lowest when compared to other Hispanics and the general population; during 1990, the unemployment rate for Puerto Ricans rose by 2.3 percentage points; Puerto Rican youth experience a particularly high rate

of unemployment; in 1990, the median money income for mainland Puerto Ricans was \$16,200, the lowest in the nation; and finally, Puerto Rican children are the poorest in the nation.

Puerto Ricans also have the highest rate of families living below the poverty line. In 1991, the rate for Puerto Rican families was 39.7%, an increase of 2.2 percentage points from the previous year. The high poverty rate among Puerto Rican families may be related, at least in part, to the high proportion of families maintained by females without a spouse present. In 1990, 64.4% of the Puerto Rican families maintained by a female without a spouse present lived in poverty.

#### THE IMPORTANCE OF THE EITC FOR THE PUERTO RICAN COMMUNITY

The President's proposed expansion of the Earned Income Tax Credit (EITC) would raise millions of Puerto Rican working families closer to, or above, the poverty line because it is one of the single largest anti-poverty initiatives in recent memory. In fact, families of up to four people that have a full-time worker would no longer be poor if the family also receives food stamps<sup>1</sup>. The proposal also would help offset the effects of the proposed energy tax on low-income working Puerto Rican families, ensuring that the tax does not push those families deeper into poverty.

Low-income Puerto Rican families who are working will be assisted by the EITC because it is a tax credit for families that work, live with their children, and have low or moderate incomes. The EITC is a "refundable" credit, which means that even working families whose incomes are too low to owe income tax receive it.

Because only working families qualify for the EITC, it will encourage Puerto Ricans to work more and will reward such achievements. Moreover, for those Puerto Rican families who earn little, EITC benefits rise with earnings, thereby encouraging more work. Welfare eligibility rules are considerably more restrictive for two-parent families than for single-parent families. Because with the EITC no such differential treatment exists, in recent years, the EITC has become increasingly important for poor and near-poor working Puerto Rican families.

One very important consideration, however, is the need for federally sponsored EITC outreach in low-income Puerto Rican/Hispanic communities. The federal government must target its outreach efforts on the Spanish-speaking population, many of whom are eligible to receive the EITC. Particularly in Puerto Rican communities where a large number of the population live below the poverty line, EITC outreach is essential.

#### THE IMPORTANCE OF THE TJTC FOR THE PUERTO RICAN COMMUNITY

Similar to the expansion of the EITC, the proposed permanent extension of the Targeted Jobs Tax Credit (TJTC) and expansion of the credit to include youth apprenticeships and enterprise zone residents would help ameliorate high levels of poverty in the Puerto Rican community. Because the TJTC encourages employers to hire persons from targeted groups with special employment needs, Puerto Rican workers have benefitted from the program since its inception in 1979.

According to the 1990 census, the median age of Puerto Ricans is 23.7. Coupled with the highest family poverty rates in the United States, an expansion of coverage of TJTC to 23 and 24 year old workers is of critical importance.

In order to lift the Puerto Rican community from poverty, NPRC urges Congress and

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<sup>1</sup>The proposal assumes that the minimum wage will be indexed so it keeps pace with inflation, a step President Clinton proposed during his campaign.



the Clinton administration to permanently continue and expand the TJTC so that it remains true to its purpose: providing job opportunities for the most disadvantaged workers.

#### **JOB-RELATED INCENTIVES TO DISTRESSED PUERTO RICAN AREAS**

The National Puerto Rican Coalition supports a proposal which aims at using Section 936 funds presently invested in Puerto Rican financial institutions (approximately \$12 billion) to support mainland community development activities. NPRC maintains that a 936 lending program could ease the economic devastation of the proposed reform of Section 936 on Puerto Rican/Hispanic communities. The special provision would allow for the investment of earnings from companies operating in Puerto Rico to finance qualified projects in economically distressed areas in the United States.

Such a program would have objectives congruent with the President's national economic plan which aims to foster community economic development and job-creation. Because of the high levels of poverty in the Puerto Rican community, the 936 lending program should focus its efforts on Congressional districts with 5% or more Puerto Rican/Hispanic populations. According to a recent report based on 1990 Census data, there are at least 43 districts that meet this criteria in states such as Connecticut, Florida, Illinois, Massachusetts, New Jersey, New York, and Pennsylvania. (See Table 1)

It is essential, therefore, that changes in Section 936 be made based on a recognition of the unique status of Puerto Rico and the continued need for the retention of Section 936 funds on the Island.

#### **ADDITIONAL RECOMMENDATIONS REGARDING WELFARE REFORM**

To ease the transition from welfare to work, additional reforms are needed with regard to the welfare system. The following recommendations are to compliment any changes in the current tax laws which provide work incentives for low-income families:

- The number of bilingual welfare counselors, social workers, and educators who are sensitive to the Puerto Rican culture must be increased so that they can provide better quality services to Puerto Ricans in need of assistance.
- Counseling and psychological support are essential for most participants in JOBS programs, especially for AFDC mothers born in Puerto Rico as well as for those mothers facing impediments in moving toward self-sufficiency.
- To ensure that Puerto Ricans falling within federally targeted groups for participation in welfare-to-work programs fully benefit from services, two things are essential:
  1. Programs must be marketed in an honest and straightforward manner. In order to make participants understand the relationship between program provisions and program practice, programs must be described in ways that provide participants with realistic expectations of outcomes, yet do not undermine their enthusiasm.
  2. Programs must be offered to participants who are physically and mentally ready to participate. A participant with severe human capital deficits and acute personal problems who does not feel ready for intervention, will not be receptive to change. Thus, prior to the provision of services, programs might need to overcome the reluctance and even hostility of participants whose attitudes are reinforced by bureaucratic modes of operation.
- JOBS participants should be allowed to choose among various child-care options,

including family-based care. This is critical for Puerto Ricans, who often prefer to leave their children with relatives or in other home-based settings.

- Asset limits for AFDC recipients must be increased. This can be achieved by allowing individuals receiving welfare benefits to keep whatever assets they might have accumulated, thus ultimately making the transition from welfare to work easier.
- Child support payments should be paid directly to the family so that the parent would directly see the amount of support being provided.
- Educational services must be improved to provide more qualified bilingual instructors who recognize that Spanish-speaking participants need additional training and time to overcome barriers due to limited-English-proficiency and limited job skills.

Congressman Rangel, Congressman Matsui, and members of the Subcommittees on Select Revenue Measures and Human Resources, Puerto Ricans in the United States are law-abiding citizens who care about their families. To provide equal opportunities for all Puerto Ricans, quality investments must be made. The National Puerto Rican Coalition and the Puerto Rican community expect no more or no less from the federal government.

Once again thank you for the opportunity to submit a written statement. Any questions would be welcomed.

Please direct questions to:  
Susan Monaco  
Policy Analyst  
National Puerto Rican Coalition, Inc.  
1700 K Street, NW, Suite 500  
Washington, DC 20006  
(202) 223-3915, ext. 29

TABLE 1

REPRESENTATIVES OF THE DISTRICTS WITH THE LARGEST  
 PUERTO RICAN/HISPANIC CONCENTRATIONS (5% & OVER)  
 APRIL 1, 1993

STATE	NAME	DISTRICT	% HISP.	% PR
Connecticut	Barbara B. Kennelly (D)	1	10	8
	Rosa DeLauro (D)	3	5	3
	Christopher Shays (R)	4	11	7
	Gary A. Franks (R)	5	6	4
Florida	John L. Mica (R)	7	6	3
	Bill McCollum (R)	8	11	6
	Sam M. Gibbons (D)	11	14	4
Illinois	Luis V. Gutiérrez (D)	4	65	15
	Dan Rostenkowski (D)	5	13	3
Massachusetts	John W. Olver (D)	1	5	4
	Richard E. Neal (D)	2	6	6
	Martin T. Meehan (D)	5	8	5
	Joseph P. Kennedy II (D)	8	11	4
	Joe Moakley (D)	9	5	2
New Jersey	Robert E. Andrews (D)	1	6	5
	William J. Hughes (D)	2	7	5
	Christopher H. Smith (R)	4	5	3
	Frank Pallone, Jr. (D)	6	6	3
	Herbert C. Klein (D)	8	18	8
	Robert G. Torricelli (D)	9	11	3
	Donald M. Payne (D)	10	12	5
	Robert Menéndez (D)	13	41	17
New York	George Hochbrueckner (D)	1	5	2
	Rick A. Lazio (R)	2	10	5
	Gary L. Ackerman (D)	5	7	2
	Floyd H. Flake (D)	6	17	6
	Thomas J. Manton (D)	7	21	8
	Jerrold Nadler (D)	8	13	6
	Charles E. Schumer (D)	9	8	4
	Edolphus Towns (D)	10	20	13
	Major R. Owens (D)	11	12	5
	Nydia M. Velázquez (D)	12	58	29
	Susan Molinari (R)	13	7	4
	Carolyn B. Maloney (D)	14	11	5

STATE	NAME	DISTRICT	% HISP.	% PR
New York	Charles B. Range! (D)	15	46	17
	José E. Serrano (D)	16	60	43
	Eliot L. Engel (D)	17	29	19
	Nita M. Lowey (D)	18	10	3
	Hamilton Fish, Jr. (R)	19	5	2
	Benjamin A. Gilman (R)	20	6	3
Pennsylvania	Thomas M. Foglietta (D)	1	10	8
	Robert A. Borski (D)	3	5	3
	Paul McHale (D)	15	5	4

National Puerto Rican Coalition, Inc.  
Source: Bureau of the Census, 1990.



Parents for Justice, 3 Pleasant St., Concord, N.H. 03301 • (603)746-4817  
 Advocacy for Low Income Single Parents in N.H.

Testimony  
 of  
 Sara Austin  
 Co-director, Parents for Justice  
 for

The Sub-Committee on Select Revenue Measures  
 Committee on Ways and Means, U.S. House of Representatives  
 on  
Selected Aspects of Welfare Reform

I will address myself to two of the issues identified by the committee, the expansion of the EITC to lift families with one full time worker earning minimum wage above the poverty line; and the interaction of the EITC with other federal programs and policies which effect the disposable income of low-income workers and their incentives to work, especially the AFDC program.

Expanding the EITC and Economic Realities in N.H.: The President's proposal that the Earned income tax credit be expanded so that, combined with the income from a minimum wage job, it brings a family with one full-time worker above the federal poverty line, is of course most welcome to us. Since the average single parent family in N.H. contains three people, two children and a mother, and the income of a minimum wage job, approximately \$770 a month, is about \$200 a month short of the poverty line for a family of that size, a rough doubling of the basic maximum EIC credit from the current 1384 per year to \$2400 per year would suffice to accomplish that goal, if the credit were also properly indexed to reflect the higher poverty line levels for larger families. Unfortunately, while this would certainly help, it would still leave us with serious problems of single parent poverty in N.H., if poverty is measured on a real scale rather than the official one.

We do have minimum wage jobs in N.H., but they are rarely held, for very long, by single parents because the wage is grossly inadequate to support children. They are primarily held by teenagers and other single persons who live in supportive situations, especially the handicapped. What is available, and filled by working class single parents in N.H., is a wide variety of jobs which pay \$6.50 an hour, or 1,118 a month, \$13,416 a year, somewhat above the poverty line, but also widely recognized as inadequate to meet the fundamental needs of a N.H. family. One member of my Board who is a high school educated working parent finds she has to work 60 hours a week at this wage to meet the minimal needs of her family of two daughters, 10 and 17, grossing \$1,677 a month. Her experience reflects quite accurately the findings of the state legislature's Committee for SB 153, which concluded in 1991, on the basis of the study of minimal family budgets which they commissioned, that a family of three with one full-time working parent and no child care expenses at all would have to gross approximately \$1743 a month, if it were not to go without some essential items.

In fact, at \$1677 a month, this family does go without something the study considers essential, health insurance for the children. She buys, through her employer, a partially subsidized policy for herself which costs her \$40 a month. This is essential to her, because, at fifty, her health is increasingly uncertain. However it does not make sense to go short on food, car repairs, heating oil, or the mortgage payment to buy the same coverage for her daughters, especially since the \$40 is needed to pay for medical services not covered under the deductible provisions of the policy. And, at this level of income, the family is still unstable, primarily because of the long hours she must put in. She does not feel that her body will be able to sustain a 7:30 AM to 7:30 PM five day a week schedule indefinitely in a job that entails considerable heavy lifting (she takes care of people incapacitated by retardation or disease). There is not enough recuperation time. She privately predicts to me that the family will be back on AFDC sometime next year.

It is evident that if the goal of the president's family policy is to make sure that families with one parent working full time do not live in poverty in the real meaning of that word, the EIC would have to be much higher than

\$2400 a year. forty hours a week at \$6.50 an hour grosses \$1118 a month. The N.H. minimal budget figure for a family of three, adjusted for the 6% inflation we have experienced since the budgets were compiled in 1990, is \$1847 a month, more than \$700 higher. A realistic EIC which was designed to make sure that single parents raising children in N.H. were not living in real poverty or forced into unsustainable work schedules, would need to top out at something like \$8400 a year, not \$2400, and be applied through a spectrum of incomes which centered at about \$13,416 a year (the yearly income of a \$6.50/hr worker). At the very least, an EIC maximum of \$2400 should be applied fully to incomes up to \$19764 for a family of three (the yearly gross of a family making \$1847 a month, less \$2,400), and adjusted upward in families where there are more than two children.

It should be noted that if national health insurance is established, these cost can be reduced significantly. The N.H. study budgets included approximately \$200 a month for medical care. The subtraction of this figure reduces the gap between a 6.50/hr earners monthly income and monthly minimal family budget to \$500 a month, and the optimal EIC to \$6000/year. It should also be noted that the figures I am working with above do not contain any money for child care whatsoever. The minimal family budgets in the N.H. study contain an extra \$130 a month for families with children young enough to require after school care, and approximately \$635 a month for a family of three with two preschool children requiring full time care. In as far as child care is not subsidized (and in N.H. we subsidize it heavily), a realistic EIC would have to be correspondingly higher. In fact, the costs of properly subsidizing a mother with pre-school children so she can afford to hold down a \$6.50 an hour job are staggering; a \$700 a month income subsidy plus a \$635 a month child care subsidy is \$1335 a month, or more than she can make. Possibly it is time to take an unbiased look at the value of her work as a child rearer during her children's pre-school years to us and our society, and try to make the AFDC system work for her instead. We could accomplish this by combining work and welfare for mothers with pre-school children, rather than attempting to push them towards an illusory and unobtainable self-sufficiency.

#### The Incentive to work and AFDC Program Earned Income Disregards:

One of the most serious disincentives to working outside the home which faces the low income single parent population we represent is the treatment of earned income by the AFDC program. As you are undoubtedly aware, four months after a mother raising very young children on AFDC takes on a part-time job, all but \$30 of her earnings, over and above a \$90 "work expense disallow" designed to cover her payroll deductions, are deducted from her grant, and at the end of a year, even this \$30 take-home is no longer permitted. In addition, if the father of her child is paying the AFDC agency child support, the young mother wishing to increase her children's prosperity by taking on a part-time job, encounters a very complicated and tricky situation indeed. If his payments are reasonably high, \$400 or \$500 a month, earning as little as \$25/month gross may be enough when added to his support payment, to disqualify her from AFDC altogether. Immediately she loses access to JOBS benefits and with them her capacity to continue her education or to train for a more skilled occupation, to Emergency Assistance, and shortly enough thereafter, her families medical insurance. She will be receiving her child support directly, but her family will be worse off.

The N.H. AFDC grant is \$516 a month for a family of three, fairly high-end as grants go in this nation, but severely inadequate to meet even the most minimal needs of a family in this rural northern state where home heating oil and a functioning vehicle are both necessities, and in which the saga of Seabrook has saddled us with one of the highest utility rates in the country. At this level of income, families are subjected to deprivations which are both dangerous and crippling, as I detailed in testimony submitted to the Human Resources Committee on 3/26/93 on the subject of "Trends in Spending and Caseloads for AFDC". The deprivations are of a nature to severely handicapp the attempts of the AFDC caseheads to enter education and job training programs when their youngest child reaches three, or subsequently to move into the work force. The capacity to do both these things in N.H. depends upon a certain minimal level of health in the mother and the child (N.H. employers do not have much patience with employees who need to take

frequent days off to care for a sick child), and the financial ability to maintain a working car. The mothers I have talked to this year haven't even been able to buy soap after they paid the rent and begged the utility payment from town welfare.

I talked to many AFDC parents this year about the possibility of working part-time jobs, because I needed to search out individuals who would testify in favor of an AFDC work incentive bill which is progressing through the state legislature this spring. Even though they were often the mothers of very young children indeed, they were universally enthusiastic about the prospect. The Division of Human Services, however, does not encourage them to utilize the current earned income disregard structure, partly at least, because sympathetic administrators are worried about what will happen to the families whose child support awards put them very close to the edge of being knocked off of AFDC altogether. They want these families to have the benefits of the JOBS program.

Local District Welfare Offices line personnel seem to be ignorant of the disregards' existence, and in a number of cases which have reached me and other advocates, earned income disregards have been improperly applied or not applied at all. One of the mothers I spoke with reported that she had called up her local district office to find out if she could take a small job in order to provide her infant with diapers and extra formula. (At four months, he was exceeding her capacity to supply him his bottle from food stamps, and her WIC assistance.) She was referred to the office supervisor, who told her she couldn't; they would simply take any extra money she made out of her grant.

In practice, that is not strictly true, even under the current income disregard structure. By carefully choosing forms of work that do not evoke payroll deductions, like caring for children in one's home, cleaning other mother's homes, or fleamarketeering, it is possible to add the best part of \$120 (for one year) or \$90 (indefinitely) to one's disposable income. However, none of these occupations provide particularly promising career tracks. If the earned income disregards were increased to make it possible for an AFDC parent engaged part time in a mainstream job to add take-home income to her grant even after payroll deductions, then these young women could acquire job experience and contacts while their children were very young, which would enable them to command higher paying and more promising full-time jobs later on. And, acting on their own initiative, without requiring further aid from local or state taxpayers, they would be able to add that margin to their family income which will enable them to buy soap and laundry detergent to wash the diapers in, provide food at the end of the month after the food stamps have run out, and possibly even keep the car running. This is important not only to the parent, but to us, because we need her to be able to deliver a healthy child to first grade, and we need her to be in sufficient good health and sufficiently mobile to be able to profit from the job training opportunities available in N.H., and to succeed in the work force at that point in her family's development.

In N. H., we have a broadly supported bill requiring the state to follow the example of three other states in the nation and petition the federal Department of Health and Human Service to grant a waiver permitting us to replace the temporary \$30 and 1/3 earned income disregard with a permanent \$200 disregard plus 50% of all earnings above that level until the client has worked herself and her family off of AFDC. It has passed the N.H. Senate, been recommended by its House policy committee unanimously, approved without debate by the full House, and only awaits a funding decision from the House Appropriations Committee to complete its journey through the legislative gauntlet successfully. It has been unusual among AFDC bills in that it has won strong support from conservatives in the legislature as well as liberals.

One of the reasons it has garnered conservative support is that the bill specifies that the extra disregard shall not only apply to the earned income of parents on the AFDC program, but to applicants as well. This means that we could supply a mother struggling to support children on the \$6.50 an hour job, with a medicare card for herself and for any children she may have older than nine (the age at which the N.H. medicare program for poor children living at 135% of poverty cuts off), and we could help stabilize the family of the mother who can not earn more than minimum wage or can only work part time, with a small grant as well. Such families, caught, like my working Board member

between the twin horns of overwork or inadequate income, or sometimes on both, are very vulnerable to AFDC recidivism. The N.H. Office of Economic Services, which administers the AFDC program here, feels that it is less expensive over the long haul to try to stabilize them with a continuous low level support than to pay for lengthy periods of complete dependency punctuated by intermittent, marginally successful, attempts at total self-sufficiency. There is also the broader issue of fairness. It has been a source of great frustration and anger to conservative state legislators that it has been impossible for them to leverage any state help whatsoever for hardworking single parents in their district who are struggling virtuously to support their children alone, without state help, and are going under because they can't get medical attention for themselves or their children, or emergency assistance to prevent eviction because they have had to use the rent money to put a new engine in the car so they can keep getting to their job. Under the proposed plan, which I hope the federal agency will approve, the woman who is doing it the hard way can get this help, if she applies for it, via the AFDC program.

Recommendations: Any increase in the Earned Income Credit will be an important contribution to the health and stability of low wage earning, working, single parent families in N.H. However, I hope you will not use as your sole guideline and goal the official federal poverty guidelines. These figures may be comforting, because they are low enough to be attainable. However, if your goal is a true alleviation of the poverty of America's children and helping their mothers to provide them with the necessities of life, and not just a paper success, it will be necessary to look at the minimal budgets necessary to sustain healthy family life, as N.H. has done, everywhere in the country, and to base policy goals on the findings.

Mothers raising very young children on welfare cannot benefit from the EIC unless they move into the workforce. The current earned income disregard structure discourages the part-time work that is compatible with the raising of very young children by making it unprofitable, while the enormous difficulty of becoming self supporting through full time work makes that option an extremely poor choice, as well. A N.H. single parent of ordinary skills with two pre-school children would have to work twenty hours a week simply to pay for their child care, and then another 60 hours to support the children and herself in a minimally decent fashion. Short of that, there is not enough food in the house, essential bills go unpaid, and the car stops running. Even if her child care is fully subsidized, very young children do not do well when they have already lost the presence of one parent and the other is occupied most of the time elsewhere. Moreover, the mother loses access to the education and job training available under the AFDC program which can prepare her to command a wage sufficient to support her family on the proceeds of a forty hour week later on, when child care is less.

One hundred percent after payroll deductions is a very high tax against earnings. Please, while you consider altering the structure of the tax system to provide more support for working single parents and low-wage intact families, consider changing the AFDC earned income disregard rules as well, so that the single parents of very young children can benefit from the EIC as well.



Tables from the "Report of the Committee for Senate Bill 153" of the N.H. State Legislature, July 1991

## Exhibit 1

MINIMALLY ADEQUATE MONTHLY BUDGET  
FOR A FOUR-PERSON FAMILY IN NEW HAMPSHIRE BY COMPONENT

ITEM	NOT EMPLOYED		EMPLOYED PARTTIME		EMPLOYED FULLTIME	
	Low	High	Low	High	Low	High
Food	\$ 372	\$ 372	\$ 372	\$ 372	\$ 372	\$ 372
Housing/Utilities	\$ 626	\$ 715	\$ 626	\$ 715	\$ 626	\$ 715
Telephone	\$ 21	\$ 21	\$ 21	\$ 21	\$ 21	\$ 21
Clothing	\$ 113	\$ 152	\$ 113	\$ 152	\$ 113	\$ 152
Medical	\$ 141	\$ 215	\$ 141	\$ 215	\$ 141	\$ 215
Transportation	\$ 62	\$ 62	\$ 124	\$ 124	\$ 165	\$ 165
Child Care	---	---	\$ 134	\$ 335	\$ 200	\$ 500
Other Expenses	\$ 160	\$ 160	\$ 192	\$ 192	\$ 192	\$ 192
Subtotal	\$ 1,495	\$ 1,697	\$ 1,723	\$ 2,126	\$ 1,830	\$ 2,332
Retirement/ Taxes	---	---	\$ 314	\$ 387	\$ 333	\$ 425
Total Monthly	\$ 1,495	\$ 1,697	\$ 2,037	\$ 2,513	\$ 2,163	\$ 2,757
Annual Amount	\$17,940	\$20,364	\$24,444	\$30,156	\$25,956	\$33,084
Hourly Wage Equivalent	\$ 8.97	\$ 10.18	\$ 12.22	\$ 15.08	\$ 12.98	\$ 16.54

## Exhibit 2

OVERVIEW OF THE  
MINIMALLY ADEQUATE MONTHLY BUDGETS  
FOR DIFFERENT SIZE NEW HAMPSHIRE FAMILIES

	NOT EMPLOYED		EMPLOYED PARTTIME		EMPLOYED FULLTIME	
	Low*	High*	Low*	High*	Low*	High*
<u>TOTAL BUDGET</u>						
<u>Family Size</u>						
1	\$ 748	\$ 849	\$ 952	\$1,090	\$ 982	\$1,130
2	\$1,055	\$1,197	\$1,437	\$1,772	\$1,526	\$1,944
3	\$1,294	\$1,469	\$1,763	\$2,175	\$1,872	\$2,386
4	\$1,495	\$1,698	\$2,038	\$2,514	\$2,164	\$2,758
5	\$1,676	\$1,902	\$2,283	\$2,816	\$2,424	\$3,089
6	\$1,832	\$2,080	\$2,497	\$3,080	\$2,651	\$3,379
7	\$1,982	\$2,250	\$2,700	\$3,331	\$2,867	\$3,654
<u>PER CAPITA BUDGET</u>						
<u>Family Size</u>						
1	\$ 748	\$ 849	\$ 952	\$1,090	\$ 982	\$1,130
2	\$ 528	\$ 599	\$ 719	\$ 886	\$ 763	\$ 972
3	\$ 431	\$ 490	\$ 588	\$ 725	\$ 624	\$ 795
4	\$ 374	\$ 425	\$ 510	\$ 628	\$ 541	\$ 690
5	\$ 335	\$ 380	\$ 457	\$ 563	\$ 485	\$ 618
6	\$ 305	\$ 347	\$ 416	\$ 513	\$ 442	\$ 563
7	\$ 283	\$ 321	\$ 386	\$ 476	\$ 410	\$ 522

\*Differences between high and low budgets are primarily due to the increased child care costs associated with pre-school children, although other factors, such as the sex of children also contribute (same sex children can share bedrooms = lower rent.)

STATEMENT OF PAUL E. SUPLIZIO, PRESIDENT, TARGETED JOBS TAX CREDIT COALITION

Mr. Chairman and Members of the Subcommittee:

I am Paul E. Suplizio, president of the Targeted Jobs Tax Credit Coalition. I appreciate the opportunity to submit this statement on behalf of our Coalition, which consists of more than 800 employers, workers organizations, trade associations, and public interest groups who support H.R. 325 (the Rangel-Johnson bill) and advocate permanent extension of TJTC. A complete list of Coalition members has been provided to your office and is available to the public.

We appreciate the opportunity to submit testimony on the extent to which current tax laws provide work incentives for low-income families and help create alternatives to welfare. We will discuss the important role played by the targeted jobs tax credit in reducing poverty and welfare, and the opportunities for more widespread use of tax-based employment and training strategies to draw more of the poverty population into the work force, and to raise the earnings and skill levels of economically disadvantaged workers.

President Clinton has taken a major step forward by including in his economic program a permanent extension of the targeted jobs tax credit, retroactive to last June 30th, and expansion of the credit to youth apprenticeships and enterprise zone residents. We support these initiatives, and also call upon Congress to restore eligibility for 23 and 24-year old economically disadvantaged youth, and to modify the Act so that any economically disadvantaged veteran who served on active duty and was discharged under other than dishonorable conditions may be eligible.

Tax-Based Employment and Training Strategies: A New Course for Manpower Policy

President Clinton and Secretary Reich appear to be open to new solutions to our labor force problems. We believe that tax-based employment and training strategies provide an important new departure for manpower policy and the task of reinventing government. To illustrate the President is requesting \$1 billion more for summer youth jobs this year. This money will be spent to subsidize jobs in non-profit organizations and government agencies. In our view, both the government and the worker would be better served if as many summer jobs as possible were provided by the private sector.

Workers would receive more relevant work experience, employers would be encouraged by the tax credit to create more jobs, and expenditure of taxpayer dollars would be more cost-effective. These results could be achieved by the Department of Labor taking steps to better promote and enlarge the TJTC summer youth program. Legislative changes may be in order to rework the program's design to significantly expand participation by employers and workers.

Tax-based employment and training strategies depend upon proper design of the tax credit to achieve the desired end. In the case of TJTC, the aim is to give employers an incentive to reach out to and hire individuals in the target groups. On the other hand, the newly proposed credit for youth apprenticeships has unique goals. The credit applies to participants in an approved work-study program carried out in the 11th and 12th grades. The object is to curb school dropouts, raise skills, and ease the transition from school to work. We question why the credit is limited to first-year wages only, when the objective is to keep a young person in the work-study program for two years. Congress should give serious consideration to designing a second-year credit for this new program.

We know from the TJTC experience that a properly-designed tax credit can elicit the desired kind of employer response, that a tax credit is a powerful incentive capable of shaping employer behavior.

The question is how limited Federal dollars can be spent most efficiently, directly or through the tax code. Consider the possibilities:

- TJTC could be expanded to include economically disadvantaged older workers, single-parent families, and displaced homemakers; in fact, it should be expanded to all economically disadvantaged workers;
- a companion tax credit could be devised to help the working poor escape from poverty by targeting the credit on higher-wage jobs;
- a companion tax credit could be devised to ensure that displaced workers are re-trained for real jobs and not nonexistent jobs;

- a companion tax credit could be devised to cover all or part of the training costs of on-the-job or apprenticeship training, and on-site or off-site schooling;
- a companion tax credit could be devised to stimulate literacy training as an adjunct to employment.

When it comes to hiring policies and training, companies may not be willing to hazard their economic survival on various sorts of direct subsidies that are perceived to bring unwanted government interference. In the largest pilot youth demonstration project of the Carter years, only 18 percent of private employers were willing to participate even when offered 100 percent wage subsidies. Jobs for the school dropouts in this program had to be found in the public sector. Providing indirect incentives through the tax code may turn out to be the most workable approach.

As an example of how the concept of a targeted credit might be applied, a targeted training credit could be used not only to stimulate more training, but to direct training activity where it is needed most.

In a study for the National Bureau of Economic Research, Lisa M. Lynch found that company-provided on-the-job training is concentrated among white, married, unionized males with greater work experience. Those participating in apprenticeship training are primarily white, unionized, and male,<sup>6</sup> although minorities and females are entering apprenticeships in greater numbers than in earlier years. The targeted training credit could be designed to focus private sector efforts on target populations most in need of additional skills, rather than on traditionally favored groups.

The Conference Board study, Literacy in the Work Force, predicts that up to one-third of today's workers will be unable to perform tomorrow's work tasks. One quarter of our youth are dropping out of school, and nearly one-fifth of the firms in the Board's survey reported problems finding workers who read well enough to qualify for entry-level jobs. Nearly half said that 15-35 percent of their work force weren't capable of handling more complex tasks than they were performing. The vast majority of firms said they did not know how many of their workers were illiterate. "It seems to employers that each succeeding high school class is less employable than its predecessor."<sup>1</sup>

Low employability of the unskilled is compounded by declining real earnings. Many labor market economists are convinced that one of the most significant trends of the past two decades is the ever-widening earnings gap between skilled and unskilled workers. Real earnings per worker fell substantially for both black and white school dropouts in the 1970's and 1980's.<sup>2</sup> The poverty rate for two-parent families where the husband was under 25 doubled from 10.5 percent in 1979 to 21.5 percent in 1986.<sup>3</sup> Real earnings of 20-24 year old male dropouts declined 42 percent between 1973 and 1984. The decline for Hispanics was 39 percent, for blacks 61 percent.<sup>4</sup>

These problems are concentrated among youth and minorities. The fact is, young workers are a declining portion of the labor force, and the nation can ill-afford to lose any of them if we want a competitive workforce in the year 2000.

\* Some 4 million young school dropouts, 4 million young people with disabilities, 4 million single-parent families, 5.6 million urban underclass, and 23 million functionally illiterate workers are included in an economically disadvantaged population of about 25 million (after allowing for overlaps among these categories). According to the Hudson Institute, two million persons a year from these groups should have their skills upgraded to overcome a serious human capital deficit that will retard productivity growth and could lead to declining living standards by the year 2000. According to the American Society for Training and Development, "In a comparison among countries, the more educated and trained half of the American workforce competes well with the white-collar and technical elites of its economic rivals. But the other half of the workforce is not as well prepared, and this is where the U.S. is losing the competitive race."<sup>5</sup>



### The TJTC Program Has Proven Effective

The TJTC experience can shed important light on how a tax-based employment and training strategy would work. We have learned that a tax credit can be powerfully effective in directing an employer's labor market behavior. According to the Macro Systems study performed for the Department of Labor, "The case studies of large corporations and industries that were heavy users of TJTC found that 55 percent of these companies had implemented financial incentives for their own staff to encourage the certification of TJTC eligibles....The primary response to TJTC seems to have been to add TJTC eligibles to the pool of applicants considered for the job. In 1982, about half of the eligibles hired were referrals from agencies, probably in response to specific requests for TJTC eligibles."<sup>6</sup> Outreach to fill hiring intake channels with target group members clearly illustrates how the tax credit harnesses employer energies.

Macro Systems also found TJTC to be administratively cost-effective. It stated, "TJTC was cost-effective in assisting target group members in obtaining jobs. This conclusion held both for funds allocated to provide TJTC program services, and for the amount of actual staff services expended on target group members....Persons receiving TJTC vouchers needed equal or fewer employment services per job obtained than other ES applicants."

We have learned from TJTC that targeting ensures cost-effectiveness, because it focuses resources on priority needs. CBO has estimated that TJTC costs \$700-\$1,000 per participant, but that estimate was made before the 1986 tax act reduced the credit from 50 to 40 percent. Today, this cost roughly would be \$560-\$800 per participant, and a Price Waterhouse study has estimated that welfare savings would further reduce this figure by 20 percent, bringing the net average cost to \$448-\$640. The Macro Systems study found that for every 100 TJTC jobs, 15-30 net new jobs were created in the economy. If the taxes paid by the workers in these new jobs were considered, TJTC would essentially be revenue-neutral.

In its study of TJTC, GAO examined two principal issues, first, the extent to which employers are making special efforts to reach out to and hire members of target groups; and second, whether TJTC workers benefitted from their work experience, as measured by future increases in real earnings.

The first issue deals with the longstanding concern of some members of Congress that TJTC may be a windfall, that is, paying employers for doing what they would do anyway. We have long held that TJTC induces employers to reach out to target group members and seek referrals from community agencies, thereby "stocking the pool" of job applicants with a greater number of TJTC eligibles than could be expected with normal hiring intake. Employers would increase their credits and more disadvantaged workers would obtain jobs, which was the congressional intent underlying the program. We believe that in such circumstances TJTC is not a windfall, because employers are actively seeking target group members for job openings.

GAO found that about half the employers in its sample were engaged in outreach to target populations. Moreover, employers with large numbers of entry-level jobs account for the largest proportion of TJTC placements, and these employers are most likely to have special outreach programs. Thus, the 50 percent of employers who are making special efforts probably account for 70-80 percent of the TJTC jobs—something GAO does not address.

GAO compared the earnings experience of a group of workers after leaving their TJTC job with a control group of eligibles who did not obtain TJTC employment but did obtain other jobs. GAO found the TJTC group significantly increased their future earnings, and the control group did likewise. GAO concluded that future earnings were a positive function of work experience. This is consistent with our view that TJTC draws economically disadvantaged workers into the work force where they gain valuable work experience which increases their future earnings. This confirms the findings of previous studies by the National Commission for Employment Policy and the Department of Labor.

Now that the Administration supports an extension of TJTC, the Department of Labor has an opportunity to actively promote the advantages of greater voluntary efforts by employers to list TJTC job orders with state Job Services, and to mount a coordinated referral program for disadvantaged workers utilizing JTPA, welfare, vocational rehabilitation, and community-based organizations. TJTC will not achieve its full potential until the program is more broadly promoted to businesses and referral sources.

### Restore Eligibility for 23 and 24 Year-Old Economically Disadvantaged Youth

The 23 and 24 year-old youth who have not secured a permanent job are typically persons with low test scores from poor families who dropped out of school and have worked only sporadically. Many are discouraged workers, or work part-time, and a large number have started families, which threatens to repeat the cycle of poverty (the typical dropout has a parent who dropped out). Today, one in every three poor children under the age of six lives in a family headed by a person under age 25. Families headed by persons under 25 suffered the greatest decline in real earnings since 1973--60 percent. In 1986, 32.6 percent of families headed by a person under age 25 was poor. One in eight young married couple families with children was poor that year, while two-thirds of young female-headed families lived in poverty in 1986.

Table 2 updates and extends this data. It shows that if a married-couple family under 25 with children included a high school drop out, the poverty rate is 35 percent. For a female-headed family under 25 where the parent is a dropout, the poverty rate rises to an astronomical 89 percent. Restoring 23-24 year olds to TJTC will help break the cycle of poverty and illiteracy and is well worth the cost--roughly \$70 million for each year of TJTC extension.

Many young men in this age group remain single because they do not earn enough to support a family. From 1973 to 1984, the percentage of males in their early 20's earning enough to lift a family of three out of poverty fell from 60 to 42 percent. The percentage of such men who were married plummeted from 40 to 20 percent, contributing to a large increase in births out of wedlock.<sup>8</sup> TJTC is not a solution to low wages, but it should certainly be available to ensure some wages.

When Congress was considering termination of eligibility for 23 and 24 year old economically disadvantaged youth, it based its decision on the fact that unemployment rates for those groups was lower than for youth age 18-22. That the economically disadvantaged and the unemployed are two entirely different groups may be readily seen from the following:

- Of the economically disadvantaged population 16 and over in 1980, only 6.1 percent were unemployed. The vast majority, 62.7 percent, were out of the labor force. This means that 68.8 percent of the population in this age group did not have a job.
- Of the unemployed population in 1980, less than 20 percent were classified as economically disadvantaged.
- The economically disadvantaged population, 16-21, is heavily female (61 percent) and poor (over 60 percent had family incomes lower than 75 percent of the poverty level). In contrast, the unemployed population is predominantly male and nearly three-quarters had family incomes in excess of 125 percent of the poverty level.<sup>9</sup>

Thus, elimination of eligibility for 23 and 24 year olds was detrimental to some of the weakest members of society, poor male and female workers, many with children, most of whom had such bleak employment opportunities that they were not even in the workforce. The unemployment figures simply did not tell this story.

### TJTC's Role in Reducing Poverty and Welfare

According to poverty researchers Sheldon Danziger and Peter Gottschalk, one in seven Americans was poor in 1991, as was one in five children. The real income of the poorest fifth of families was lower than in 1973. Danziger and Gottschalk found that only about half the poverty population can be expected to work, and it is only this group that can be directly affected by increases in the demand for labor or inducements to supply more labor, as occurs with TJTC. Those they classify as "not expected to work" include persons over age 65, the disabled, students, and women with a child under age six.

Danziger and Gottschalk found that the poor who are able to work have substantial labor market attachments, refuting the common notion that people are poor because they are unwilling to work. They found that about half of poor able-bodied mothers whose youngest child is over age six work at least some time during the year, as do 80 percent of men who head poor households with children.<sup>14</sup>

TJTC relies on jobs as the route of escape from poverty. The earnings from the job may not be adequate to lift a person or family above the poverty line because of low wages, too few work hours, or both. But a job provides some wages and is the avenue to greater skill development, higher wages, and eventual independence.

It can be seen from Tables 4 and 5 that TJTC workers are mostly young people earning less than \$5 an hour. They are essentially minimum wage workers in entry-level jobs, due to their low skills or handicaps. Those in this group who are married or single heads of families naturally have greater earnings expectations and needs. About a quarter of a high-school class is married within four years of completing school.<sup>12</sup> The decline in manufacturing has eliminated many job opportunities for young people, and the proportion of employed young persons who work part-time involuntarily has increased.<sup>13</sup> What should public policy be when a person works, but has inadequate earnings?

In the Coalition's view, the answer is not to interfere with the labor market and legislate higher wages, because this only increases an employer's costs and reduces demand for labor. We believe the appropriate answer is the earned income tax credit and similar proposals, such as converting the personal exemption to a refundable credit, and the child care tax credit. Philosophically, the earned income tax credit is a version of the negative income tax proposed by conservative economist Milton Friedman. At one time, it drew support from both conservatives and liberals. We consider it a more effective policy for reducing poverty than labor market intervention to set wages.

TJTC can help workers in poverty find a job, but it cannot shoulder the entire burden of moving them out of poverty. For this, it needs to interact with the earned income tax credit to augment family income, and with education and training to acquire greater skills that will lead to increased wages.

It should be noted that low earnings by themselves cannot be considered a sign of economic distress. For example, many teenagers with low earnings continue to be supported by their families. Danziger and Gottschalk found that 60 percent of low earners escape poverty because they live in households where there is another wage-earner.<sup>14</sup>

As shown in Figure 1, at least 60 percent of today's children have mothers in the work force, and one in five children live in poverty. The poverty rate for single women in the labor force who maintain families was 17.4 percent in 1990. This rises to 89 percent for a family headed by a female high school drop-out who is not in the labor force (Table 2). TJTC helps to reduce the feminization of poverty in two ways. First, it can make a difference between having a job and not having one for a female head of family who is actively looking for work. Second, by increasing job opportunities, it can help draw female heads who are not in the labor force into the job market, where they will be eligible for the earned income tax credit and may be able to leave the welfare rolls.

Finally, since AFDC and general assistance recipients are target groups, TJTC has a direct impact on employment of those on welfare. In 1989, more than 99,000 AFDC recipients found jobs through TJTC. Twice that number were vouchered, that is, certified as TJTC-eligible to prospective employers. The data are recorded in Table 3.

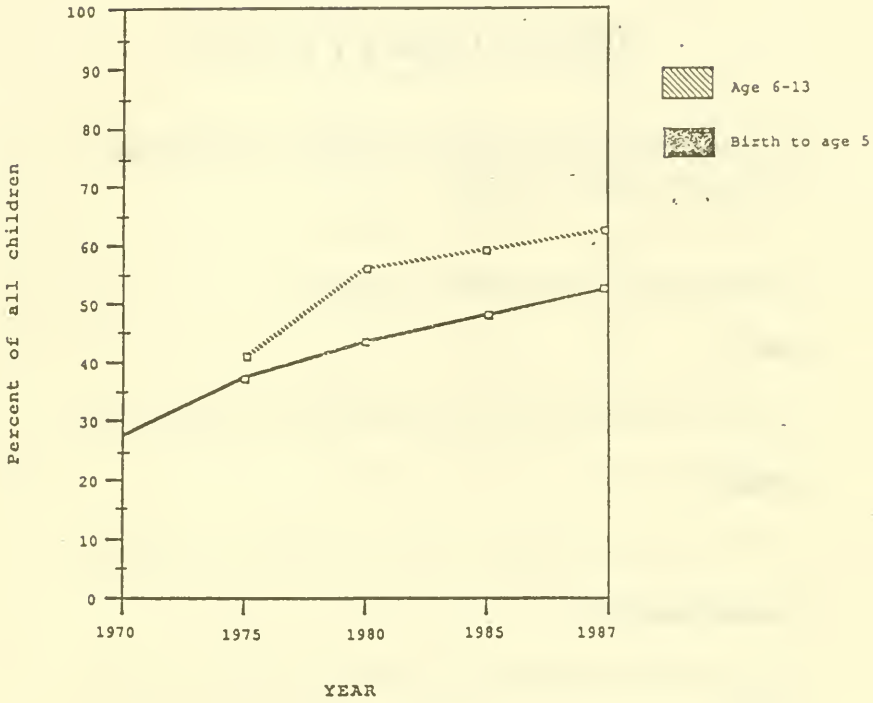
Mr. Chairman, this concludes my testimony. Are there any questions?

## Footnotes

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10. Sheldon Danziger and Peter Gottschalk, "Work, Poverty, and the Working Poor: A Multifaceted Problem," Monthly Labor Review, September, 1986.
11. Ibid.
12. Thomas Nordone, "Decline in Youth Population Does Not Lead to Lower Jobless Rates", Monthly Labor Review, June, 1987, p. 37.
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14. Danziger and Gottschalk, op. cit., p. 21.
15. Jennifer M. Gardner and Diane E. Herz, "Working and Poor in 1990", Monthly Labor Review, December 1992, p. 23.



FIGURE 1. Most of today's children have mothers in the workforce



Sources: Bureau of Labor Statistics, "BLS News," August 12, 1987, and unpublished data.

Taken from Raising America's Children: How Should We Care, by Sar. A. Levitan and Elizabeth A. Conway, George Washington University, 1988. p.3.

Table 2

## THE POVERTY GULF

*Poverty rates of families whose head of household is younger than 25 (1989)*

Married couple, attended college, no children

■ 6%

Married couple, high school graduate, with one or more children

■ 12%

Married couple, high school drop-out, with one or more children

■ 35%

Female-headed family, high school drop-out, with one or more children

■ 89%

Source: Bureau of Census

Source: The New York Times, March 4, 1991

Table 3  
TJTC Vouchers and Certifications, 1988-1989

	Vouchers		Certifications	
	<u>1988</u>	<u>1989</u>	<u>1988</u>	<u>1989</u>
Summer youth, 16-18	27,105	24,634	17,769	17,450
Youth	405,833	316,238	282,640	230,998
Veterans	31,856	26,403	16,366	14,570
Ex-offenders	58,919	69,802	22,404	24,745
Handicapped	70,058	75,342	36,619	40,652
SSI	8,251	11,641	5,994	7,433
AFDC	203,754	198,005	97,278	99,127
TOTAL	842,436	755,330	497,312	452,453

**Table 4. Age Distribution of  
Certifications, 1988 and 1989  
(In Percent)**

	<u>1988</u>	<u>1989</u>
Age 16-18	15.0	15.4
Age 19-24	57.5	51.6
Age 25-34	17.5	19.6
Age 35+	10.0	12.4

Source: U.S. Department of Labor



**Table 5. Number of TJTC Workers, by  
Wages Earned, 1988 and 1989**

	<u>1988</u>	<u>1989</u>
Under Minimum	14,914	10,792
Minimum to \$3.99	269,224	192,762
\$4 to \$4.99	135,791	144,987
\$5 to \$5.99	53,535	56,752
Over \$6	45,725	46,172

**NOTE:** Totals do not agree with Table 3, as wage information is from a separate data base.

**Source:** U.S. Department of Labor

**Table 6. Number of TJTC Workers by  
Occupation, 1988 and 1989**

	<u>1988</u>	<u>1989</u>
Professional and technical	12,612	10,717
Clerical	166,138	151,749
Services	214,480	195,438
Farming and Fishing	4,562	3,901
Processing	19,175	13,678
Machine Trades	15,503	10,330
Bench Work	27,369	19,633
Structural	12,731	10,522
Miscellaneous	47,429	43,727

**NOTE:** Totals do not agree with Table 3, as occupational information is from a separate data base.

**Source:** U.S. Department of Labor

## Testimony of

NANCY MOHR KENNEDY  
CHIEF OF STAFF  
UNITED WAY OF AMERICA

hearing on  
Selected Aspects of Welfare Reform

before  
The Subcommittee on Select Revenue Measures  
and  
The Subcommittee on Human Resources  
Committee on Ways and Means  
U.S. House of Representatives

The Honorable Charles B. Rangel, Chairman  
The Honorable Robert T. Matsui, Acting Chairman

Tuesday, March 30, 1993

Chairman Rangel, Chairman Matsui, and Members of the Subcommittees on Select Revenues Measures and Human Resources, my name is Nancy Mohr Kennedy. I am Chief of Staff of United Way of America (UWA).

Thank you for the opportunity to appear here today in support of the Earned Income Tax Credit (EITC) as a means to provide work incentives for low-income families and help create alternatives to welfare.

United Way of America, along with local United Ways located across the country, support efforts to reform the nation's welfare system. Our shared goal is to create a compassionate, rational system to assist individuals and families in their quest for self-sufficiency.

Recently, United Way of America's Public Policy Committee met and reaffirmed it's commitment to work toward overcoming welfare dependency, as well as removing barriers to independence and self-sufficiency. Toward that end, our testimony focuses on the importance of the Earned Income Tax Credit in achieving those goals.

The EITC is a refundable tax credit from the IRS to working families earning less than \$22,370 with at least one child living with them, and is a worthwhile tax credit that helps strengthen and stabilize the American family by helping put food on the table and pay the bills. It is an important economic development effort because most benefits are spent locally, infusing over \$11 billion into state and local economies. The money is spent to pay bills, purchase food, and cover other family necessities.

Originally enacted in 1975, the Earned Income Tax Credit was greatly expanded in 1990 by President Bush and the Congress to reward and encourage work and also to help offset the growing burden that payroll taxes place on low-income working families. Almost 14 million families now qualify for the credit, which provides \$10.7 billion annually in benefits to low-income working families.

The EITC provides a dollar-for-dollar reduction in the taxes an eligible family owes the Federal Government. Unlike most tax credits, the EITC is refundable. If the amount of the credit exceeds the taxpayer's tax liability, the balance is payable to the taxpayer. Therefore, families with very low incomes and who may not owe any taxes can receive at least a partial credit.

Additionally, under an advance payment system, eligible taxpayers may elect to receive the benefit of the credit in their periodic paychecks, rather than waiting to claim a refund on their return filed by April 15 of the following year.

As a result of changes in the law in 1991, those taxpayers who receive public assistance can still receive the credit without risk of losing those benefits as long as they have "earnings." Unlike welfare which often has the perverse effect of penalizing work, the EITC provides additional dollars to a low-income working family.

Currently, the basic credit is 18.5 percent of earned income for families with one child and 19.5 percent for those with two or more children. In 1994, because the basic credit is indexed for inflation, that amount is scheduled to rise to 21 percent and 25 percent, respectively. The Omnibus Budget Reconciliation Act of 1990 established two small supplemental credits: one for children 1-year-old and younger, and one for health-care costs.

Last year United Ways and State Organizations played a key role in helping three million additional low-income families receive the Earned Income Tax Credit, which is often referred to as the "working family's rebate."

For the past several years, United Way of America has worked with the Center on Budget and Policy Priorities and over 40,000 locally funded agencies to coordinate a national EITC campaign to alert eligible low-income working families to the credit and to explain how to receive it.

This year, alerting low-income families to the EITC is more important than ever because:

- Millions of working parents lost their jobs in 1992. As a result, many workers earned far less in 1992, than they previously did in their working lives. Consequently, many newly eligible workers may not know about the EITC.
- Eligible families must file a tax return (not the 1040 EZ -- also known as the short form), and they must also file a form called "Schedule EIC." Last year IRS had a flexible policy toward families that filed a tax return but did not attach the "Schedule EIC". If they appeared to be eligible from the face of the return they were awarded the credit.

This year IRS has rescinded this policy. If a family fails to file a "Schedule EIC", the EITC benefit will not automatically be received. The IRS will, however, send a form letter notifying a family of their potential eligibility to receive the EITC credit, as well as send them a blank copy of the "Schedule EIC" if, on the face of their tax return, they appear to be qualified for the credit.

While hundreds of thousands are expected to receive this mailing, how many will actually respond is unknown. Therefore, this year's campaign is particularly important. United Way of America is proud to be part of this outreach network.

Our involvement with the agencies we serve and others having daily contact with deserving low-income families is an appropriate role in carrying out our mission "to support and serve local United Ways to help increase the organized capacity of people to care for one another."

The EITC is important in working toward the Clinton Administration's goal of overhauling our welfare system by encouraging recipients to find a job after two years on public assistance, by ensuring that a family of four, with a minimum-wage income, lives above the poverty line, counting earnings as well as government benefits, such as food stamps.

United Way of America looks forward to working with Congress and the Administration to establish a respectful and responsive system for helping families with children become self-sufficient, and thereby are enabling families to remain together.

STATEMENT OF  
GEORGE K. YIN  
PROFESSOR OF LAW  
UNIVERSITY OF FLORIDA  
BEFORE THE SUBCOMMITTEES ON  
SELECT REVENUE MEASURES AND HUMAN RESOURCES  
U.S. HOUSE COMMITTEE ON WAYS AND MEANS  
April 30, 1993

**Redesigning the Earned Income Tax Credit Program  
to Provide More Effective Assistance  
for the Working Poor**

Summary

There are three serious defects with the existing earned income tax credit (EITC) program: (1) many eligible families don't get the benefit; (2) many who do receive it may not be eligible; and (3) almost none of the recipients obtain the benefit incrementally during the course of the year. To increase both the rate of participation and compliance and to ensure most of the assistance is received in a timely fashion throughout the year, the EITC should be broken into its two principal components, a benefit for the working poor and a family allowance benefit. The "working poor" benefit would be provided by exempting a base amount of wages from the payment of Social Security taxes. The "family allowance" benefit would be furnished through a refundable income tax credit based in part upon the number of children living in the home.

Introduction

The existing EITC program, intended to provide cash assistance for the working poor, contains a number of deficiencies. Many eligible, low-income families receive no benefit whatsoever because they are unaware of the program, cannot cope with the tax forms necessary to claim the benefit, or are fearful of interacting with the IRS. Moreover, almost none of the recipients obtain the benefit incrementally during the year. As CBO Director Reischauer recently commented, the assistance is therefore more like a winning lottery award at the end of the tax year than a meaningful income support payment for poor people or an incentive for work. Finally, the program is beset by opportunities and incentives for noncompliance. The proposed expansion of the program by the Clinton Administration may well exacerbate all of these inadequacies.

Together with Jon Forman, a law professor at the University of Oklahoma, I have been working on a project commissioned by the American Tax Policy Institute to develop a series of proposals for improving delivery of the EITC benefit to the low-income families it is intended to assist. In an article to appear in a forthcoming issue of Tax Notes magazine, Jon and I describe one method of doing so. In this testimony, I am pleased to summarize our findings for the subcommittees.

The proposal is to split the existing credit into its two principal components, a benefit for the working poor and a family allowance benefit. The "working poor" benefit, designed in large part to offset the Social Security tax liability of low-income workers, would be provided by simply not collecting those taxes in the first instance. It makes no sense, and is difficult administratively, to collect such taxes and then refund them by means of the EITC. The proposal would therefore establish an exempt amount of wages below which no Social Security taxes would be due. The "family allowance" benefit would be furnished through a refundable income tax credit based in part upon the number of children living in the home. Taken together, the



proposal should enhance the rate of participation and compliance and ensure most of the assistance for low-income families is received throughout the year.

#### The "working poor" benefit

The "working poor" benefit should be provided regardless of the family responsibilities of the worker, and should be large enough to ensure that a family unit without children but headed by a full-time worker is pulled above the poverty line. This general goal would be consistent with the income security, work incentive, and federal tax offset objectives for the existing EITC as well as the Clinton plan to extend the EITC for the first time to low-income workers without children.

A major step towards providing approximately this benefit would be to exempt low-income workers from paying the employee's portion of their Social Security taxes as well as any income taxes. Currently, a childless two-person household supported by a single worker who is employed full-time for the full year and paid the minimum wage has \$8,840 in annual earnings (52 wks x 40 hrs/wk x \$4.25/hr). Even apart from the EITC, the household is already exempt from paying any income taxes. If the worker were also exempt from paying the employee's share of Social Security taxes, the household would be within \$350 of the 1992 poverty guideline for a two-person family unit, \$9,190. A slight adjustment to the minimum wage to compensate for the continuing failure to index that figure for inflation, and indexing the figure for inflation in the future, would easily make up the difference. Alternatively, no adjustment may be needed once the benefits of other federal welfare programs, such as food stamps, are taken into account.

For ease of administration, we recommend creation of a flat exemption amount, indexed to inflation, for all workers from the payment of the employee's portion of Social Security taxes. The benefit would then be recaptured from higher paid workers through imposition of a higher Social Security tax rate on earnings in excess of the exemption amount, a raising of the current earnings cap for the old-age and survivors and disability insurance (OASDI) portions of the tax, or both. Either of those two alternatives, as well as the savings in general revenues from removal of a portion of the EITC benefit from the income tax system, could be used to pay for the exemption.

Providing the "working poor" benefit in the manner just described offers many advantages over the current system. First, it would automatically be received by all eligible families in a timely manner in each paycheck. Beneficiaries would not need to obtain information, determine or assert eligibility, or even file a return. Low-paid workers would not suffer any stigma from obtaining this federal subsidy. Employers would not be burdened except for the slight change to adjust for the exemption amount in calculating the amount of Social Security taxes to withhold. Finally, the simplicity of the proposal and the relative absence of any self-certifying features would almost assure a high level of compliance. Unlike present law, there would be no incentive to report superfluous or fictitious work.

Of particular note is the ability of the proposal to improve both the rate and timeliness of participation and the compliance rate. Not uncommonly, those two goals are in conflict with one another.

The proposal would modify the taxable wage base for Social Security tax purposes but would not take those modifications into account in the calculation of benefits. Thus, workers benefiting from the exemption would not suffer any reduction in benefits paid to them, and those paying Social Security taxes on wages in excess of the current OASDI earnings cap

would not obtain any increase in benefits. Critics might charge that the proposal would thereby decouple the link between taxes and benefits so essential to the view of Social Security being a retirement program.

Of course, the link between Social Security taxes and benefits is actually quite tenuous and can vary dramatically depending on factors such as family status, income level, and age. Accordingly, most analysts have come to view the Social Security system as consisting of both pension and welfare components. Indeed, the Clinton Administration's proposal to tax a greater portion of the Social Security benefits of middle- and upper-income recipients, but to continue refraining from taxing any of the benefits of lower-income recipients, indicates additional acknowledgement of the part-pension, part-welfare nature of the system.

More importantly, however, for purposes of this proposal, there would be no justification for any change in Social Security benefits. The existing system requires all wage earners to pay a flat Social Security tax on all wages up to the current earnings cap. But the Social Security tax liability of low-income wage earners is subsidized with general revenues through the EITC. They, in effect, receive reimbursement of their Social Security taxes but still get to count their wages in calculation of their benefits. Thus, the EITC has already decoupled the link between Social Security taxes and benefits. Roughly the same result as current law could be replicated under the proposal by exempting an initial amount of an individual's wages from payment of Social Security taxes, recapturing that benefit from those earning wages in excess of the exemption amount through an increase in the tax rate or a raising of the cap, and subsidizing the benefit for low wage earners by a transfer from general revenues.

The proposal would not be as finely targeted as the current EITC program in that families with low wage income but high, non-wage income could nevertheless benefit from the Social Security tax exemption. One way to address much of this problem would be to implement the exemption on a weekly (or periodic) basis rather than on an annual one. For example, the exemption might be limited to the first \$170 in wages per week (\$4.25/hr minimum wage x 40 hrs/wk) rather than an annual exemption amount. A weekly exemption of this sort would tend to prevent much of the benefit from going to high-paid workers who, nevertheless, have low annual wages because they only work a portion of the year (e.g., high-paid summer employees). It would also be easier for employers to implement than an annual exemption. Other changes to the taxation of high, non-wage income could also be effected to offset any remaining advantage.

#### The "family allowance" benefit

The "family allowance" benefit would provide additional income security for low-income families with children. The theory of the benefit would be to take account of the extra, non-consumption, expenses incurred by families with children living in the home. The benefit would be consistent with the theory of current poverty guidelines which take into account family size. Both this benefit and the working poor subsidy, without any recapture, would be available to a low-income working family with children.

The simplest method of delivering the family allowance benefit would be to provide a refundable income tax credit to any family with children living in the home, regardless of its work or income status. Up to some level, the size of the credit might vary with the number of children in the family living at home. Such a credit would be universally available to



both low- and high-income families. If provided as a substitute for the existing dependent's exemption, however, the credit would produce a shift in benefits from current law in favor of lower-income families. Various legislators, groups, and commentators have advocated similar proposals on policy grounds quite apart from administrability concerns, and a number of industrialized nations already have such a benefit in place. If desired, the benefit could be packaged with, and provided in lieu of, other existing tax and welfare benefits for children, such as the child care credit, the exclusion for employer-administered child care assistance, AFDC, and food stamps.

The universal availability of the family allowance credit should make it far easier to administer than the EITC, which is targeted for only a portion of the population. Any working family could obtain the benefit simply by completing a form, similar to the existing IRS Form W-4, indicating the number of children in their household. The family allowance benefit would then automatically be provided to middle- and upper-income taxpayers during the year through adjustments to the withholding amount.

Low-income working families would also receive the benefit during the course of the year through advance payments. The difficulties under current law with the advance payment mechanism would be avoided because all employees would be required to fill out the same form. Thus, there would not be any problem of employees' being unaware of the option or confused or stigmatized by the process. Noncompliance issues would be limited to exaggerations of family responsibilities and the possible double claiming of the benefit by those with more than one job. The former would be alleviated by continuing the practice of requiring Social Security numbers for all children claimed. The latter could be addressed by calculating the advance payment amount in a very conservative manner. That procedure would also assuage the concerns of those taxpayers fearful of owing taxes at the end of the year due to excess advance payments received.

#### Avoiding work disincentives and marriage penalties

Although the focus of our study has been on improving the administrability of the EITC program, it is noteworthy that the proposed redesign would also have two positive economic effects. The first is to reduce work disincentives associated with the high effective marginal tax rates of low-income workers who currently find themselves in the phase-out range of the EITC. The second is to eliminate the marriage penalty present in the existing EITC where marriage causes an increase in family income beyond the threshold for EITC eligibility. The proposal accomplishes both of these results by avoiding any phase-out.

#### Conclusion

Some legislators might be concerned with the proposed redesign of the EITC program because it would provide some federal benefits to non-working families with children. Others might object to benefits being directed towards those who work but who have no family responsibilities. Much of the strength and durability of the EITC program may well be attributable to its ability to satisfy many different political constituencies at the same time.

Policymakers with these concerns need to face the hard reality, however, that the EITC program as presently structured doesn't work very well. Furthermore, expansion of the program may well exacerbate its inadequacies. The ineffectiveness of the current structure, and the attractiveness of the proposal described in this article, must therefore also enter into the calculus in deciding whether and how to broaden the size and scope of the program.

Rarely is there an opportunity to adopt a policy proposal that so clearly improves the status of current law. Policymakers should seriously consider the alternative outlined here before they move ahead with plans to enlarge the size and scope of the EITC program.



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