To: Professor Gene Nichol

From: Jared Elosta

Re: Options for Expanding EITC Eligibility in North Carolina

Date: June 11, 2010

ISSUE

Evaluate several options for expanding membership eligibility for North Carolina’s Earned Income Tax Credit (EITC), including extending the credit to noncustodial parents, seniors age 65 and over, and young workers under the age of 25.

BRIEF ANSWER

A Non-Custodial Parent EITC would be the most effective membership expansion of the North Carolina EITC program since (1) a model for such an expansion already exists in the state of New York and the District of Columbia, (2) the administration of the program would be relatively simple, (3) the program would promote tax fairness, and (4) the credit would be large enough to provide incentives to low-income noncustodial parents to work more and meet all of their child support obligations. On the other hand, extensions of the EITC at the state level to seniors ages 65 and over or to young workers under age 25 would not be as effective because these extensions would (1) involve administrative complexities and (2) not result in a large enough credit to provide work incentives.

AN EITC FOR NON-CUSTODIAL PARENTS

I. The Rationale for a Non-Custodial Parent EITC

Low-income non-custodial parents face a significant challenge escaping poverty since many are legally obligated to pay child support without gaining any of the tax breaks that custodial parents receive. Custodial parents may be eligible for the head of household filing
status, dependency exemptions, the child tax credit, the additional child tax credit, and the EITC. Non-custodial parents (NCPs), on the other hand, will receive none of these benefits, but are required to contribute a significant amount of their income to the custodial parent in the form of child support. As a result, NCPs who work and earn wages at the poverty level or just above it are often driven into poverty by the combined effect of federal taxes and child support obligations. The following chart\(^1\) clarifies the effect of current tax policies on low-wage NCPs compared with custodial parents, both working full time and earning the minimum wage:

<table>
<thead>
<tr>
<th></th>
<th>Single custodial parent with 2 qualifying children</th>
<th>Noncustodial parent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Earnings (full-time minimum wage job in 2008) As a Percent of Poverty</td>
<td>$12,775 74%</td>
<td>$12,775 114%</td>
</tr>
<tr>
<td>Payroll Tax</td>
<td>$977 $0</td>
<td>$977 $382</td>
</tr>
<tr>
<td>Federal Tax (before credits)</td>
<td>$641 $0</td>
<td>$0 $0</td>
</tr>
<tr>
<td>Refundable Child Tax Credit</td>
<td>$4,824</td>
<td>$8</td>
</tr>
<tr>
<td>Earned Income Tax Credit</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Earnings Less Taxes, Plus Credits As a Percent of Poverty</td>
<td>$17,263 100%</td>
<td>$11,423 102%</td>
</tr>
<tr>
<td>Child Support (25% of NCP’s gross wages)</td>
<td>$3,194 ($3,194)</td>
<td></td>
</tr>
<tr>
<td>Income after Taxes, Credits, and Child Support As a Percent of Poverty</td>
<td>$20,456 118%</td>
<td>$8,229 73%</td>
</tr>
</tbody>
</table>

For low-income NCPs who may have to pay up to 11 percent of their income in federal taxes while receiving a meager EITC, an EITC specifically tailored for NCPs could be a useful tool for boosting these workers’ incomes. A NCP EITC would serve the following goals, among others:

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\(^1\) Laura Wheaton & Elaine Sorenson, Urban Institute, Extending the EITC to Noncustodial Parents: Potential Impacts and Design Considerations 3 (2009), http://www.urban.org/UploadedPDF/411906_noncustodial_parents.pdf.
(1) help low-income NCPs to escape poverty, (2) enable more NCPs to meet their child support obligations, and (3) provide an incentive for NCPs to work more.²

II. The NCP EITC in New York and Washington, D.C.

In 2006, the state of New York and Washington, D.C. were the first jurisdictions in the nation to create a NCP EITC.³ Both New York and D.C. require that NCPs pay all of their child support obligations from the tax year in order to be eligible for the NCP EITC.⁴ Also, both programs require that NCPs have a child support order and participate in the IV-D program, which is the state and local child support enforcement service, overseen by the federal government.⁵ As a result of this requirement, administration of the NCP EITC is simplified in both New York and D.C. In order for a NCP to be eligible for the NCP EITC, the tax departments must receive a certification from the IV-D programs stating that the NCPs have paid all of their child support for the tax year.⁶ Both programs also do not allow NCPs to claim the NCP EITC if they are eligible for the “child-based” EITC (i.e., they have a qualifying child).⁷ Finally, whereas the “childless” federal EITC begins phases out when a worker earns $13,440 (tax year 2009), both NCP programs in New York and D.C. set the phase-out rate much higher.⁸ Both programs follow the phase-out rates set by the federal EITC for workers with qualifying children. The phase-out rate for the NCP EITC in New York is $35,463 and that of DC goes up to $40,295.⁹ This means that more workers are included in the NCP EITC in New York and D.C. than are included in the federal childless EITC.

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² See id. at 1.
³ See id.
⁴ Id. at 4.
⁵ Id. at 11.
⁶ Id.
⁸ See id. at 5.
⁹ These figures follow the 2009 tax year phase out rate for the federal EITC for an unmarried taxpayer. See EITC Income Limits, Maximum Credit Amounts and Tax Law Updates, supra note 2.
The NCP EITC programs in New York and D.C. have important differences. Whereas in D.C., only NCPs between the ages of 18 and 30 are eligible, New York makes the credit available to all NCPs who are 18 and above.\textsuperscript{10} Also, New York’s NCP EITC allows NCPs to claim the greater of 2.5 times the federal EITC for childless workers or 20 percent of the federal EITC for a single taxpayer with one qualifying child.\textsuperscript{11} For tax year 2009, a NCP in New York earning $6,000 would receive an estimated maximum NCP EITC of $1,143, and the credit continues to decline as a NCP earned more; at $33,000, the NCP would receive a credit of $78.\textsuperscript{12} In contrast, D.C.’s NCP EITC offers NCPs the same amount of the D.C. EITC that custodial parents receive, and the D.C. EITC matches 40 percent of the federal EITC.\textsuperscript{13} So, in 2009, a NCP paying child support for one child and earning $16,500 would receive a maximum credit of $1,214, and the credit would continue to diminish as the worker earned more, up until an income of around $35,000, where the NCP would receive $31 in NCP EITC.\textsuperscript{14} Because D.C.’s NCP EITC matches the custodial parents’ EITC, it allows a NCP to claim the credit for more than one non-resident child. Thus, a NCP in D.C. paying child support for two children earning $16,450 would receive a maximum credit of $2,011.\textsuperscript{15}

III. Evaluation and Application to North Carolina

1. Evaluation of the NCP EITC

Because the NCP EITC programs are so new, there is little research available on the success of the programs in New York and D.C. Nonetheless, there are several issues to consider in evaluating whether New York and D.C.’s NCP EITC programs would be effective strategies.

\textsuperscript{10} Id. at 4.
\textsuperscript{11} Noncustodial Parent New York State Earned Income Tax Credit (EITC), http://www.dads.ny.gov/main/workingfamilies/noncustodial.asp (last visited June 8, 2010).
\textsuperscript{12} Id.
\textsuperscript{13} DC Earned Income Tax Credit, http://otr.cfo.dc.gov/otr/site/default.asp (last visited June 8, 2010).
\textsuperscript{15} See id.
to provide tax relief to low-income NCPs and encourage child support payments. First, both New York and D.C. have shown that the administration of a NCP EITC is possible without creating an overly complicated program. Because child support enforcement agencies in both jurisdictions must certify that a NCP has paid the entire amount of child support due in the tax year in order to be eligible for the NCP EITC, it should be simple for the tax agencies to administer, rendering significant errors unlikely.

A second issue is whether a NCP EITC should require that NCPs pay 100 percent of the child support due during the tax year in order to be eligible for the credit. In its first year in 2006, only 5,100 NCPs received the credit in New York.\(^16\) Besides of the novelty of the program, one reason why participation was low is that the percentage of NCPs who pay all of their child support in a given year is only 16 percent for NCPs who earn $10,000 to $20,000 a year, and only 25 percent for NCPs earning $20,000 to $30,000 a year.\(^17\) Despite the low number of participants in New York’s program during its first year, it is yet to be determined how effective the program was in increasing incentives for the NCPs who did participate.\(^18\) As the program becomes more well-known, a greater number of NCPs who have not paid all of their child support in the past may be motivated to do so.

Analysts have leveled several criticisms at the NCP EITC. First, some have argued that a federal NCP EITC is impractical because of the complexity of coordinating 50 different child support enforcement systems with the IRS.\(^19\) While this criticism of the NCP EITC has force with a federal version, it does not apply to state NCP EITCs, which may be a useful supplement.

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\(^17\) Wheaton & Sorenson, supra note 1, at 6.

\(^18\) It would be worth reviewing more recent data to determine if more NCPs have claimed the NCP EITC since 2006. It would also be useful to examine whether the percentage of NCPs in New York who paid all of their child support in a tax year increased after the creation of the NCP EITC.

to efforts at the federal level to expand the childless EITC for younger workers. Another criticism of a NCP EITC is that it may be “unfair or unwise to single out non-custodial fathers for special rewards.” The idea here is that a broader group of childless workers needs additional income support, and that an increase in the EITC for these workers should include all of them, and not just NCPs. However, the creation of a NCP EITC at the state level provides a targeted incentive for NCPs to pay all of the child support that is due. This program would not exclude efforts at the federal level to increase the EITC for childless workers, which is a goal that may be worth pursuing for different reasons.

2. Creating a NCP EITC in North Carolina

Since two jurisdictions in the U.S. have already created a NCP EITC, it would be possible to follow their lead in North Carolina. First, North Carolina could require NCPs to be in the IV-D program in order to be eligible for the NCP EITC, as New York and D.C. do. North Carolina could also require that the Division of Social Services’ Child Enforcement Services provide a certification to the tax departments that NCPs have paid the necessary amount of child support to qualify for the NCP EITC.

Second, North Carolina should follow D.C.’s formula for determining the amount of the NCP EITC, rather than New York’s formula. As stated already, whereas D.C. simply gives NCPs the same amount of the D.C. EITC that custodial parents would receive, the New York credit is set at the greater of 2.5 times the federal EITC for childless workers or 20 percent of the federal EITC for workers with one qualifying child. A major problem with following New York’s approach is that it may be complex for the North Carolina Department of Revenue (DOR) to administer, and difficult for taxpayers and tax preparers to understand. A taxpayer and

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20 Peter Edelman et. al., Expanding the EITC to Help More Low-Wage Workers 11, Georgetown Center on Poverty, Inequality and Public Policy (2009).
DOR would have to calculate both the childless EITC and the EITC for a worker with one qualifying children and compare them to see which is greater. This has the potential to produce errors in administering the credit.\textsuperscript{21} Further, in advocating to create a NCP EITC in North Carolina, simplifying the explanation of how the credit would work is likely to produce the best results.

Because of the administrative challenges involved in New York’s formula for determining the amount of a NCP EITC, North Carolina should set the NCP EITC to match the amount of the North Carolina EITC that low-income families with qualifying children receive. So, for example, a NCP earning $13,500 a year who pays child support for one child would receive a NCP EITC of $152 at the current level that North Carolina matches the federal EITC. If this NCP paid child support for two children, the NCP would be $283. Without a NCP EITC in North Carolina, this low-income NCP would receive zero dollars from both the federal tax code and North Carolina’s tax code because the NCP’s income would be too high for the federal EITC. Assuming that the effort to increase North Carolina’s EITC to 10 or 15 percent is successful, the NCP EITC would increase accordingly. The following chart illustrates the effect of a low-income NCP in North Carolina that an NCP EITC could have, taking into account potential increases in the matching level of the state’s EITC.

\textbf{A North Carolina NCP EITC Adjusted for Potential Increases of North Carolina’s EITC}\textsuperscript{22}

\begin{center}

<table>
<thead>
<tr>
<th>Annual Income</th>
<th>Poverty Level\textsuperscript{23}</th>
<th>Current Federal</th>
<th>Current state EITC</th>
<th>NCP EITC at 5% of Federal</th>
<th>NCP EITC at 10% of Federal</th>
<th>NCP EITC at 15% of Federal</th>
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\textsuperscript{21} The claim of a high risk of error is speculative, so data from New York State’s Department of Taxation and Finance is needed to verify it.

\textsuperscript{22} This chart does not include the temporary expansion of the EITC under the American Recovery and Reinvestment Act, which extends the EITC to families with up to three qualifying children. This extension of the EITC is temporary, and it is only for tax years 2009 and 2010, unless it is renewed or made permanent. The NCP EITC was determined by multiplying 5\%, 10\%, and 15\% by the EITC for each level of income. The two figures in each NCP EITC column reflect the EITC for one qualifying child on the left and the EITC for two qualifying children on the right. For the EITC amounts listed here, see IRS, supra note 17 at 46-54.
This chart shows that a NCP EITC in North Carolina would significantly increase a NCP’s total EITC (state and federal), and it would allow more low- and moderate-income NCPs to claim the EITC.

Third, as for whether age restrictions are appropriate for a NCP EITC, D.C.’s limitation of the program to NCPs between the ages of 18 and 30 is likely based on limiting the cost of its program. However, D.C. matches the federal EITC at 40 percent, which is the highest level in the nation, so the cost of expanding the eligibility of its program may be high. North Carolina, by contrast, currently matches the federal EITC at 5 percent, so the cost should not be prohibitive to extend the NCP EITC to all eligible taxpayers 18 and over, as New York does. During its first year, New York’s program cost $2 million.\textsuperscript{24} That figure would count as .01% of North Carolina’s 2010-11 budget\textsuperscript{25}, and would likely be smaller considering that New York is a much larger state. Furthermore, since a significant number of NCPs are over the age of 30\textsuperscript{26}, following D.C.’s age restriction would severely limit eligibility for the NCP EITC in North Carolina. Thus, following New York’s rule of allowing all eligible NCP’s over 18 to claim the credit would be more effective.

\begin{tabular}{|c|c|c|c|c|c|}
\hline
Income & EITC & EITC & EITC & EITC & EITC \\
\hline
$7,000 & 63\% & $457 (max) & $23 (max) & $119/$140 & $238/$280 & $357/$420 \\
$11,161 & 100\% & $173 & $9 & $152/$222 & $304/$444 & $456/$666 \\
$13,500 & 121\% & $0 & $0 & $152/$283 (max) & $304/$566 (max) & $456/$849 (max) \\
$22,322 & 200\% & $0 & $0 & $104/$189 & $208/$387 & $112/$567 \\
$33,483 & 300\% & $0 & $0 & $15/$71 & $30/$142 & $45/$213 \\
\hline
\end{tabular}

\textsuperscript{24} Klempin, supra note 16 at 2.
\textsuperscript{26} See Wheaton & Sorenson, supra note 1, at 9.
Finally, North Carolina should follow New York and D.C. in requiring that NCPs must pay 100 percent of the child support due during the prior tax year in order to claim the NCP EITC. This strategy has the best chance of winning over legislators, it rewards NCPs who meet their child support obligations, and it will provide the strongest possible incentive for NCPs to work more in order to pay their child support in full. Another benefit of this approach is that it will be less costly than lower child support minimums, and easier for the relevant agencies to administer.

**REMOVING AGE RESTRICTIONS**

The federal EITC allows low-income workers under the age of 25 and over the age of 65 to claim the credit only if they have qualifying children.\(^{27}\) Many analysts have observed that non-student workers ages 21 to 25 should be able to claim the federal childless EITC, and that this credit should be increased.\(^{28}\) On the other hand, there is very little research that addresses the question of whether the EITC should be made available to seniors without qualifying children. None of the 24 states that have created a state EITC have extended the credit to workers without qualifying children under age 25 or over age 65, since they follow the federal rules for the credit.\(^{29}\)

The AARP has argued that the federal EITC should be extended to low-income seniors without qualifying children in order to encourage these seniors to continue working as long as they are able to do so.\(^{30}\) The AARP estimates that 300,000 seniors over age 65 in the United

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\(^{28}\) See Edelman et. al., supra note 20 at 8; Gitterman, Gorham & Dorrance, supra note 19 at 26.

\(^{29}\) Center on Budget and Policy Priorities, State Earned Income Tax Credits: Legislative Update 5 (2009), http://www.cbpp.org/files/11-10-10sfp.pdf. The one exception is Minnesota, which uses different income levels for the phase-in and phase-out points. Id.

States would be eligible to claim the childless EITC. Labor force participation among seniors over 65 has increased from 2.7 million workers in 1977 to 6.1 million workers in 2009, an increase of 126 percent. Furthermore, the full retirement age for seniors continues to rise—it is currently 66 for people born after 1942 and continues to rise up to 67 for people born after 1959.

Although an argument exists for expanding the federal childless EITC to reach seniors, there is a less compelling rationale for North Carolina changing its rules to allow seniors to claim the credit. First, only a small number of seniors in North Carolina would be eligible for a childless EITC. In 2008, there were 140,360 seniors in North Carolina living below the poverty line, which is $10,289 for a single person and $12,986 for a married couple without children. Since the EITC requires income from wages to be eligible and only 7.5 percent of poor seniors over the age of 65 received any income from wages in 2008, an estimated 23,232 seniors would qualify for the childless EITC.

In addition to the low number of seniors in North Carolina who would be eligible for a childless state EITC, the amount of money seniors would receive from such a credit would also

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31 Id. at 2.  
33 Social Security Administration, The Full Retirement Age is Increasing, http://ssa.gov/pubs/ageincrease.htm (last reviewed or modified, Jan. 26, 2010).  
34 See U.S. Census Bureau, State and County Quick Facts: North Carolina, http://quickfacts.census.gov/qfd/states/37000.html (last visited June 10, 2010); Center on Budget and Policy Priorities, Social Security Lifts 13 Million Seniors Above the Poverty Line (last visited June 10, 2010), http://www.cbpp.org/cms/?fa=view&id=1111. The number 140,360 was calculated by multiplying the number of seniors over 65 living in North Carolina by the percentage of seniors living in poverty in the state.  
36 This number is calculated by multiplying the percentage of poor seniors over 65 who receive wages by the number of seniors living below the poverty line in North Carolina: 140,360 X .075. Added to it is the number of seniors with incomes between $10,000 and $15,000 who receive wages, since this income group is also eligible for the childless EITC. Approximately 15.4 percent of seniors have an income between $10,000 and $15,000, and in North Carolina that comes to 169,400 seniors. See Social Security Administration, Income of the Aged Chartbook (2008), http://www.ssa.gov/policy/docs/chartbooks/income_aged/2008/iac08.html#money. However, only 7.5 percent of this number receives income from wages, so only 12,705 of seniors in this income range would be eligible for the EITC (169,400 X .075).
be low. North Carolina only matches 5 percent of the federal EITC, so the maximum amount that a senior could receive from a childless state EITC would be $22.85. If the North Carolina EITC was expanded to 10 percent or 15 percent, the maximum credit for seniors would still be relatively low: $45.70 and $68.55 respectively.

Finally, there are administrative challenges if the state of North Carolina extended its EITC program to childless workers over age 65. The federal program does not count social security benefits as income\(^{37}\), so in calculating a state EITC for seniors the Department of Revenue (DOR) would have to separate the wages a senior earns from the income he or she receives in social security. Since seniors would not simply be receiving a percentage of the federal childless EITC, the DOR would have to do the verification of income itself. This would create an administrative burden for the agency and potentially increase the cost of the program. Unlike the case of a NCP EITC, where DSS would simply have to send a letter to DOR certifying that a NCP has paid his or her child support in full for the year, extending the EITC to seniors would require DOR to create new rules and verification processes to check each senior’s income for eligibility.

The same problems in extending the North Carolina EITC to seniors without qualifying children apply to extending the state’s EITC to non-student workers under 25 without qualifying children. There are strong arguments for increasing the federal EITC for childless workers and extending it to workers between the age of 21 and 25.\(^{38}\) However, without a significant increase in the amount of the childless EITC at the federal level, an extension of the state EITC to these workers would result in a very small credit. North Carolina’s current match of 5 percent of the federal EITC provides a maximum credit a $22.85 for workers without qualifying children.

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\(^{38}\) See Edelman et. al., supra note 20.
Even more problematic, however, are the administrative challenges in creating a credit for young workers that does not follow the rules of the federal EITC. The EITC was originally designed so that it would be targeted to reach poor families rather than all low-income workers, since some low-income workers are college students or from wealthy families. Thus, a way to separate college students from the working poor would be needed in order to create a targeted EITC for those between the age of 21 and 25. While this could be done at the federal level using Form 1098-T, which states whether a student is part-time or full-time, it would be burdensome and costly to require the North Carolina DOR to verify that young taxpayers who are eligible for the state’s EITC are not also students.

CONCLUSION

The most effective membership expansion of the North Carolina EITC would be to create a Non-Custodial Parent EITC. Since the state of New York and D.C. have already created a NCP EITC that is relatively simple to administer, North Carolina has models it can learn from in creating its own program. A NCP EITC in North Carolina would be large enough to promote tax fairness, increase the payment of child support obligations, and provide work incentives for low-income workers without qualifying children. On the other hand, extending the state’s EITC to workers without qualifying children under the age of 25 or over the age of 65 would result in a very small credit that would be complicated to administer.

39 See Gitterman, Gohram & Dorrance supra note 19 at 8. The problem of separating the working poor from college students would be even more difficult, of course, if the EITC was extended to all low-income workers age 18 and up.