

# Discussion of “Moving Towards a Unified Credit for Low Income Workers”



Rosanne Altshuler  
Urban-Brookings Tax Policy Center  
raltshuler@urban.org

Prepared for the AEI Conference, “How to Simplify the Code for Low-Income Taxpayers”

May 12, 2009



**Tax Policy Center**

Urban Institute and Brookings Institution

# Goal of paper

---

- Draw on optimal tax literature to derive options for reform of tax credits for low-income individuals
  - Argue that optimal credit is one with a very high phase-out rate
  
- Propose unified credit plans aimed at creating less dramatic skylines by removing phase-outs
  - Problem with current law: layers of complexity and high MTRs
  - Solution: trade fairness for simplicity (credit does not differ by family size or circumstance), create cliffs (extremely high MTRs), provide no work incentive (in some cases)

# Comments

---

## □ Previous work on unified credits

### ■ Ellwood and Liebman (2000)

- ✦ Five options including “Working Family Tax Credit” to replace the child credit and additional child credit, dependent exemption, and EITC
- ✦ Available to all taxpayers with children whose income derives from employment

### ■ Cherry and Sawicky (2000)

- ✦ “Universal Unified Child Credit” combines dependent exemption with EITC, child credit and additional child credit
- ✦ Available to all taxpayers with children whose income derives from employment

# Comments

---

- Previous work on unified credits (continued)
  - Carasso, Rohaly, Steuerle (2003)
    - ✦ Integrates EITC and CTC into a Earned Income Child Credit
  - Carasso, Rohaly, Steuerle (2004)
    - ✦ Integrates EITC, CTC and dependent exemption into Unified Child Credit
  - President's Advisory Panel on Federal Tax Reform
    - ✦ Will discuss in detail at end of talk
  
- Open question: How do the Hassett, Lindsey, Mathur options improve upon these plans?

# Comments

---

- Choice of credits to unify
  - Why EITC, CDCC, Education Credit, Savers Credit, and CTC?
    - ✦ CDCC not refundable so not available to low-income taxpayers
    - ✦ Same with Savers Credit (Obama would make refundable)
    - ✦ Same with education credits (Obama's AOTC would be refundable)
  - Why include subsidies for certain types of activities?
  - What about the MWP credit?
  - Why only tax credits? What about standard deduction, personal exemptions, H of H filing status?

# Comments

---

- Structure of unified credit
  - Why no work requirements for some of the options?
  - Why double the amount of the credit for married taxpayers? None of the credits being unified does this
  - Why no adjustment for number of children?
- Hasset, Lindsey, Mathur options
  - Which do you recommend? Why?
  - Do you prefer phase-outs to cliffs? Why?
  - Why consider phase-out of 10 percent in one of your options when we know the 21.06 percent phase-out has small effects?

# Comments

---

- Winners and losers? Distributional analysis?
  - Important focus of previous work
- What about secondary earners?
  - Huge disincentive to work
- What about the details?
  - Do they not matter? What is income? What about investment income? Available to those with social security income?

# Comments

---

- Can you draw conclusions on behavior in presence of cliffs from the empirical literature on the EITC?
  - Literature considers phase-outs not cliffs and finds disincentive effect for married taxpayers only
  - Cliffs considered in some of the options are extremely drastic
  - Hard to imagine that recipients will not understand the cliff and adjust behavior

# Comments

---

- What do the budget constraints look like for your options? Are there other changes to the code such as standard deduction, marginal tax rates, personal exemptions, etc.?
- Why do you consider lump-sum credits with no work requirement? Why do you consider any credit with no work requirement?
- **What are the goals of the policy???**

# President's Advisory Panel on Federal Tax Reform

---

- Family Credit
  - Consolidate standard deduction, personal exemptions, CTC, and H of H filing status into a single Family Credit
- Work Credit
  - Consolidate EITC and refundable child tax credit into a single Work Credit
  - Phases out with income
  - Rate and maximum credit higher for workers living with qualifying children
  - Requirements for claiming Family Credit are foundation for Work Credit eligibility
  - Can claim child dependents who are 18 years old or younger (or permanently disabled). Can also claim full-time students who are 19 or 20 years old. Full-time students age 21 to 23 can be claimed as dependents for Family Credit.

# Family Credit

---

- ❑ Provides tax benefit comparable to current system
  - Also replicates benefit of current-law 10% tax bracket
  - Does not phase out with income
- ❑ Easy computation
  1. Figure base amount of Family Credit
  2. Add amounts for children (\$1,500 each) and other dependents (\$500 each)
  3. Subtract the Family Credit from tax due

Household Type	Base Credit
Married Couples	\$3,300
Single Taxpayers With Dependent Children	\$2,800
Unmarried Taxpayers	\$1,650
Dependent Taxpayers	\$1,150

### Schedule A—Family Credit

**Part I Child Dependents.** If you have more than four child dependents, attach a statement to your return with the required information.

(a) First name	Last name	(b) Dependent's social security number	(c) Dependent's relationship to you	(d) <input checked="" type="checkbox"/> if child lived with you in the United States for more than half of 200X
				<input type="checkbox"/>
				<input type="checkbox"/>
				<input type="checkbox"/>
				<input type="checkbox"/>

**Part II Other Dependents.** If you have more than two other dependents, attach a statement to your return with the required information.

(a) First name	Last name	(b) Dependent's social security number	(c) Dependent's relationship to you

**Part III Family Credit**

1 Enter: \$1,650;  
\$2,800 if single and you had at least one child dependent in 200X;  
\$3,300 if married;  
\$1,150 if you can be claimed as a dependent on someone else's 200X return. 1

2 Number of child dependents from Part I: \_\_\_\_\_ × \$1,500 + 2   
Enter the result

3 Number of other dependents from Part II: \_\_\_\_\_ × \$500 + 3   
Enter the result

4 Add lines 1 through 3 4

5 Enter the amount from 1040-SIMPLE, line 19 5

6 Enter the **smaller** of line 4 or line 5 **Family credit =** 6

Enter this amount on 1040-SIMPLE, line 20.



You may be able to take the **work credit** on 1040-SIMPLE, line 26, if either of the following applies.

- The amount on line 4 above is more than the amount on line 5, or
- You had at least one child dependent who lived with you in the United States for more than half of 200X and your taxable income on 1040-SIMPLE, line 16, is less than \$41,800.



IF...	AND...	THEN...
you want the IRS to figure your work credit for you	all of the following apply: <ul style="list-style-type: none"> <li>You and your spouse have a social security number that allows you to work.</li> <li>You and your spouse lived in the United States for more than half of 200X.</li> <li>You were a U.S. citizen or resident alien for all of 200X or you are filing your return with your spouse.</li> </ul>	<b>just check here.</b> <input type="checkbox"/> and enter your tax-exempt interest and dividends Then leave line 26 blank.

### Part III Family Credit

<p><b>1</b> Enter: \$1,650;          \$2,800 if single and you had at least one child dependent in 200X;          \$3,300 if married;          \$1,150 if you can be claimed as a dependent on someone else's 200X return.</p>	<div style="border: 1px solid black; width: 100px; height: 30px; display: flex; align-items: center; justify-content: center;"> <span style="width: 20px;">1</span> <input style="width: 80px; height: 25px;" type="text"/> </div>
<p><b>2</b> Number of child dependents from Part I: _____ × \$1,500          Enter the result</p>	<p style="text-align: center;">+</p> <div style="border: 1px solid black; width: 100px; height: 30px; display: flex; align-items: center; justify-content: center;"> <span style="width: 20px;">2</span> <input style="width: 80px; height: 25px;" type="text"/> </div>
<p><b>3</b> Number of other dependents from Part II: _____ × \$500          Enter the result</p>	<p style="text-align: center;">+</p> <div style="border: 1px solid black; width: 100px; height: 30px; display: flex; align-items: center; justify-content: center;"> <span style="width: 20px;">3</span> <input style="width: 80px; height: 25px;" type="text"/> </div>
<p><b>4</b> Add lines 1 through 3</p>	<div style="border: 1px solid black; width: 100px; height: 30px; display: flex; align-items: center; justify-content: center;"> <span style="width: 20px;">4</span> <input style="width: 80px; height: 25px;" type="text"/> </div>
<p><b>5</b> Enter the amount from 1040-SIMPLE, line 19</p>	<div style="border: 1px solid black; width: 100px; height: 30px; display: flex; align-items: center; justify-content: center;"> <span style="width: 20px;">5</span> <input style="width: 80px; height: 25px;" type="text"/> </div>
<p><b>6</b> Enter the <b>smaller</b> of line 4 or line 5</p>	<p style="text-align: center;"><b>Family credit =</b></p> <div style="border: 1px solid black; width: 100px; height: 30px; display: flex; align-items: center; justify-content: center;"> <span style="width: 20px;">6</span> <input style="width: 80px; height: 25px;" type="text"/> </div>

Enter this amount on 1040-SIMPLE, line 20.



You may be able to take the **work credit** on 1040-SIMPLE, line 26, if either of the following applies.

- The amount on line 4 above is more than the amount on line 5, or
- You had at least one child dependent who lived with you in the United States for more than half of 200X and your taxable income on 1040-SIMPLE, line 16, is less than \$41,800.



IF...	AND...	THEN...
you want the IRS to figure your work credit for you	all of the following apply: <ul style="list-style-type: none"> <li>• You and your spouse have a social security number that allows you to work.</li> <li>• You and your spouse lived in the United States for more than half of 200X.</li> <li>• You were a U.S. citizen or resident alien for all of 200X or you are filing your return with your spouse.</li> </ul>	just check here. <input type="checkbox"/> <b>and enter your tax-exempt interest and dividends</b> <input type="text"/> Then leave line 26 blank.

# No phase out option

---

- ❑ Panel considered no phase out option for Work Credit
- ❑ Argued that phase outs add complexity and create sharp increases in MTRs
- ❑ Developed option with no phase-out and an additional tax rate that provides MTRs that increase steadily as taxpayers earn more
- ❑ All taxpayers eligible but would be required to separately compute credit amount
- ❑ Rejected because of compliance costs and additional burden on all taxpayers outweighed potential benefits of simplicity and smoother increases in MTRs for eligible Work Credit recipients
- ❑ Some panel members rejected this option because it would increase the number of individuals who would not pay income tax

# Suggestions for future work

---

- Compare to previous work
- Justify choice of credits to unify
- Justify structure of credit
- Analyze budget constraints
- Study winners and losers