

GAO

United States General Accounting Office

Briefing Report to the Chairman,
Committee on Finance,
U.S. Senate

June 1996

EARNED INCOME CREDIT

Profile of Tax Year 1994 Credit Recipients



G A O
75 *years*
1921 - 1996

GAO/GGD-96-122BR



United States
General Accounting Office
Washington, D.C. 20548

General Government Division

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June 13, 1996

The Honorable William V. Roth, Jr.
Chairman, Committee on Finance
United States Senate

Dear Mr. Chairman:

This report, which follows our briefing to you, is the latest in a series of reports and testimonies responding to your interest in the Earned Income Credit (EIC).¹ The report presents information on participation in the EIC program for tax years 1990 through 1994 and the characteristics of taxpayers who received the EIC in tax year 1994.

Results in Brief

Total EIC program costs have increased dramatically in recent years as Congress has extended EIC coverage and increased credit rates. From tax year 1990 to tax year 1994, EIC program costs (in 1994 dollars²) increased by about 150 percent—from \$8.6 billion to \$21.2 billion. During that same period, the number of EIC recipients increased by about 50 percent—from 12.6 million in tax year 1990 to 19.1 million in tax year 1994. Much of the recent growth in the number of taxpayers claiming the EIC can be attributed to the extension of the credit to certain childless adults³ beginning in tax year 1994. About 15 million families with children received \$20.5 billion of EIC in tax year 1994; another 4 million childless

¹Previous work on the EIC includes Earned Income Credit: Noncompliance and Potential Eligibility Revisions (GAO/T-GGD-95-179, June 8, 1995); Earned Income Credit: Targeting to the Working Poor (GAO/GGD-95-122BR, Mar. 31, 1995) and the related testimony Earned Income Credit: Targeting to the Working Poor (GAO/T-GGD-95-136, Apr. 4, 1995); Tax Administration: Earned Income Credit—Data on Noncompliance and Illegal Alien Recipients (GAO/GGD-95-27, Oct. 25, 1994); and Tax Policy: Earned Income Tax Credit: Design and Administration Could Be Improved (GAO/GGD-93-145, Sept. 24, 1993).

²To index dollar values to constant 1994 dollars, we used the Bureau of Labor Statistics' consumer price index for all urban consumers (CPI-U), as published in the Economic Report of the President, Feb. 1996.

³The credit was extended in tax year 1994 to low-income working taxpayers who do not have a child meeting the criteria for an EIC qualifying child. In fact, these taxpayers may be non-custodial parents or may live with a child who, for some reason, cannot be claimed as an EIC qualifying child. Throughout the report, however, we refer to this new group of EIC recipients as "childless adults" as a simple means to distinguish them from EIC recipients who have one or more qualifying children. We refer to this latter group as "EIC families with children."

adults received an additional \$0.7 billion. The refundable portion of the EIC for tax year 1994 was \$16.7 billion, or 79 percent of the total EIC.⁴

Our profile of taxpayers who received the EIC in tax year 1994 showed the following:

- The majority of taxpayers claiming the credit for families with children filed as head of household, while almost 90 percent of taxpayers claiming the credit for childless adults were single. The majority of filers in both groups were age 25 to 44.
- EIC recipients were far more likely to file their returns electronically than were taxpayers not claiming the EIC. Twenty-six percent of EIC returns were filed electronically compared to 7 percent of non-EIC returns. Although 65 percent of EIC recipients used IRS' simpler forms, the 1040EZ and 1040A, 50 percent of the EIC filers used a paid preparer rather than completing the forms themselves. Some of the filers who used a paid preparer may have done so not because they needed help preparing their returns but simply as a means to file their returns electronically and thus expedite their refunds.
- The EIC is intended for low-income workers, most of whose income would come from earnings rather than investment income. As expected, wages and self-employment income accounted for nearly all of EIC recipients' total income before adjustments. Eleven percent of recipients reported income from unemployment compensation. Although 3.9 million EIC recipients (21 percent of all recipients) reported taxable interest, 60 percent of them reported less than \$100, and 86 percent reported less than \$500.
- In 1995, Congress enacted an indirect wealth test to eliminate taxpayers with investment income⁵ over \$2,350 from the EIC program. To estimate the impact of this provision, we deflated the investment income threshold to 1994 dollars and applied it to tax year 1994 EIC recipient data. Had the investment income threshold been in place in tax year 1994, about 284,000 taxpayers who claimed \$212 million of EIC would not have been able to do so.
- The EIC is structured so that the credit phases in as income rises, plateaus, then phases out as income exceeds a certain amount. About 60 percent of

⁴The refundable EIC amount comes from Statistics of Income (SOI) data and may differ from actual EIC outlays (refunds) reported from the Internal Revenue Service's (IRS) accounting system. The SOI data are reported by tax year, and IRS outlays are reported by fiscal year. In addition, IRS examinations and other actions may make the actual EIC refunded different from refund amounts reported on taxpayers' returns. The President's fiscal year 1997 budget shows actual fiscal year 1995 EIC outlays totalling \$15.2 billion (most of which would apply to tax year 1994 returns filed in 1995).

⁵Investment income includes taxable and nontaxable interest, taxable dividends, and net rents and royalties derived from sources outside the taxpayer's ordinary course of trade or business.

taxpayers receiving the EIC for families with children had incomes in the phase-out range of the credit.

Background

The EIC is a refundable tax credit available to low-income working taxpayers. Congress established the EIC in 1975 to achieve two long-term objectives: (1) to offset the impact of Social Security taxes on low-income workers with families and (2) to encourage low-income individuals with families to seek employment rather than welfare. Provisions included in the Omnibus Budget Reconciliation Act (OBRA) of 1993 extended the EIC to certain childless adults beginning with tax year 1994.

A taxpayer's eligibility for the EIC depends on the number of qualifying children who meet the age, relationship, and residency tests and the taxpayer's earned income or, in some cases, adjusted gross income (AGI). Maximum earned income or AGI for tax year 1994 was \$8,999 for taxpayers with no qualifying children, \$23,754 for taxpayers with one qualifying child, and \$25,295 for taxpayers with two or more qualifying children. In addition, taxpayers with no qualifying children had to be at least 25 but less than 65 years old.

OBRA of 1993 also increased, over a period of 3 years, the maximum credit amounts available to families with children. To better target the EIC to the working poor, Public Law 104-7, enacted in 1995, adds another EIC eligibility test based on investment income. Beginning in tax year 1996, taxpayers with investment income over \$2,350 will no longer be eligible for the EIC, regardless of their earned income.

Objectives, Scope, and Methodology

Our objectives were to provide data on (1) trends in EIC costs and participation for tax years 1990 through 1994, (2) characteristics of tax year 1994 EIC recipients, and (3) characteristics of recipients with income in the credit phase-out range who claimed the credit for families with children.

To summarize data on EIC recipients, we obtained and analyzed IRS' SOI databases for tax years 1990 through 1994.⁶ Each SOI database contains tax return information for a stratified, random sample of taxpayers. All of the

⁶The database we used for tax year 1994 is SOI's advance file, the most recent available. The database includes the complete sample of 1994 tax returns filed from January to late September 1995. The sample is weighted to represent a full year of taxpayer reporting.

EIC participation, cost, and profile data in this briefing report are estimates based on the SOI samples.⁷

We did our work from October 1995 through May 1996 in accordance with generally accepted government auditing standards.

We requested comments on a draft of this report from officials at IRS and the Department of the Treasury. Written comments from IRS and oral comments from Treasury were technical in nature and involved definitional issues. We made changes to the report and the underlying analyses where appropriate.

As agreed with your office, unless you publicly release its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies to interested congressional committees, the Secretary of the Treasury, the Commissioner of Internal Revenue, and other interested parties. We will also make copies available to others on request.

Major contributors to this report are listed in the appendix. Please contact me on (202) 512-5594 if you have any questions.

Sincerely yours,

A handwritten signature in black ink that reads "James R. White". The signature is written in a cursive style with a large, stylized "J" and "W".

James R. White
Associate Director, Tax Policy
and Administration Issues

⁷Because the data we report are estimates, we calculated confidence intervals at the 95-percent confidence level. In most cases, the confidence intervals were within +/- 10 percent of the reported values. Confidence intervals exceeding that amount are noted.

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Abbreviations

AGI	Adjusted Gross Income
CPI-U	consumer price index for all urban consumers
EIC	Earned Income Credit
IRS	Internal Revenue Service
OBRA	Omnibus Budget Reconciliation Act
SOI	Statistics of Income

Introduction

GAO Objectives

Provide the most recent data available on

- Trends in EIC costs and participation
 - Characteristics of tax year 1994 taxpayers claiming the EIC for families with children, and childless adults
 - Characteristics of tax year 1994 taxpayers with income in the credit phase-out range who claim the EIC for families with children
-

GAO Basic Structure of the EIC

- The EIC is a refundable tax credit established in 1975 to aid low-income working taxpayers.
 - Eligibility and credit amounts are based on income and the number of qualifying children who meet age, relationship, and residency requirements.
-

Source: Congressional Research Service.

GAO Changes in the EIC for Tax Year 1994

- Repeal of special credits for health insurance costs and for families with young children took effect.
 - Credit for childless adults became available for filers
 - age 25 to 64 who cannot be claimed as a dependent on another return, and
 - with incomes below \$9,000.
-

Source: Congressional Research Service.

EIC Structure and Eligibility Changed in Tax Years 1991 and 1994

The EIC was originally established as a work bonus designed to offset payroll taxes and was not designed to vary by family size; the taxpayer merely had to have at least one qualifying child.¹ In the 1990 Omnibus Budget Reconciliation Act (OBRA), however, Congress adjusted the credit structure to grant different credit amounts to taxpayers with one qualifying child and taxpayers with two or more qualifying children. OBRA of 1990 also added two supplemental credits—one going to taxpayers with a child under 1 year of age and another to taxpayers who paid health insurance premiums on policies covering their children. These changes, in addition to a general increase in credit rates, took effect in tax year 1991.²

OBRA of 1993 made two changes in the credit's structure that took effect in tax year 1994. First, to simplify EIC filing, the act repealed the supplemental young child and health insurance credits. Second, the act expanded EIC eligibility to include certain taxpayers without a qualifying child. To receive the EIC for childless adults, taxpayers (1) must be at least 25 but less than 65 years old, (2) must have income of less than \$9,000, and (3) cannot be claimed as a dependent on another return. OBRA of 1993 also increased, over a 3-year period beginning in tax year 1994, the maximum credit amounts for families with children.

¹A qualifying child (1) is an EIC claimant's son, daughter, adopted child, grandchild, stepchild, or foster child; (2) is under age 19, or under age 24 and a full-time student, or any age and permanently and totally disabled; and (3) lives in the claimant's home in the United States for more than half of the year (or all of the year if a foster child). Beginning with tax year 1994, the EIC was denied for wages earned by prison inmates. Beginning with tax year 1995, the EIC was (1) extended to taxpayers living outside of the United States because of a military assignment if they meet all other criteria and (2) denied to anyone who spent part of the tax year as a nonresident alien.

²Increases in the credit rates were to be phased-in over a 4-year period from 1991 to 1994.

GAO Calculation of the EIC for Tax Year 1994

	Families with one child	Families with two or more children	Childless adults
Phase-in			
Income range	\$1 - \$7,749	\$1 - \$8,399	\$1 - \$3,999
Phase-in rate	26.3%	30.0%	7.65%
Plateau			
Income range	\$7,750 - \$10,999	\$8,400 - \$10,999	\$4,000 - \$4,999
Maximum credit	\$2,038	\$2,528	\$306
Phase-out			
Income range	\$11,000 - \$23,754	\$11,000 - \$25,295	\$5,000 - \$8,999
Phase-out rate	15.98%	17.68%	7.65%

Source: IRS data.

How the Credit Was Calculated in Tax Year 1994

EIC credit amounts are determined according to taxpayers' number of qualifying children and earned income³ or, in some cases, AGI.⁴ The credit gradually phases in with increasing income, plateaus at a maximum amount, and then phases out until it reaches zero. If a taxpayer's earned income or AGI exceeds the maximum qualifying income level, they are not eligible for the credit. When taxpayers' AGI falls in the credit's phase-out range, they receive the lesser amount resulting from using their earned income or AGI in calculating the credit.

The table shows the credit as structured for tax year 1994. The credit phased in at different rates for families with one qualifying child, families with two or more qualifying children, and childless adults. For example, taxpayers with one qualifying child got an earned income credit of 26.3 cents for each dollar of earned income up to \$7,749, and taxpayers with two or more qualifying children got an EIC of 30 cents per dollar of earned income up to \$8,399.

The maximum credits for tax year 1994 (the amount going to all taxpayers with income in the plateau range) were \$2,038, \$2,528, and \$306 for recipients with one, two or more, or no qualifying children, respectively.

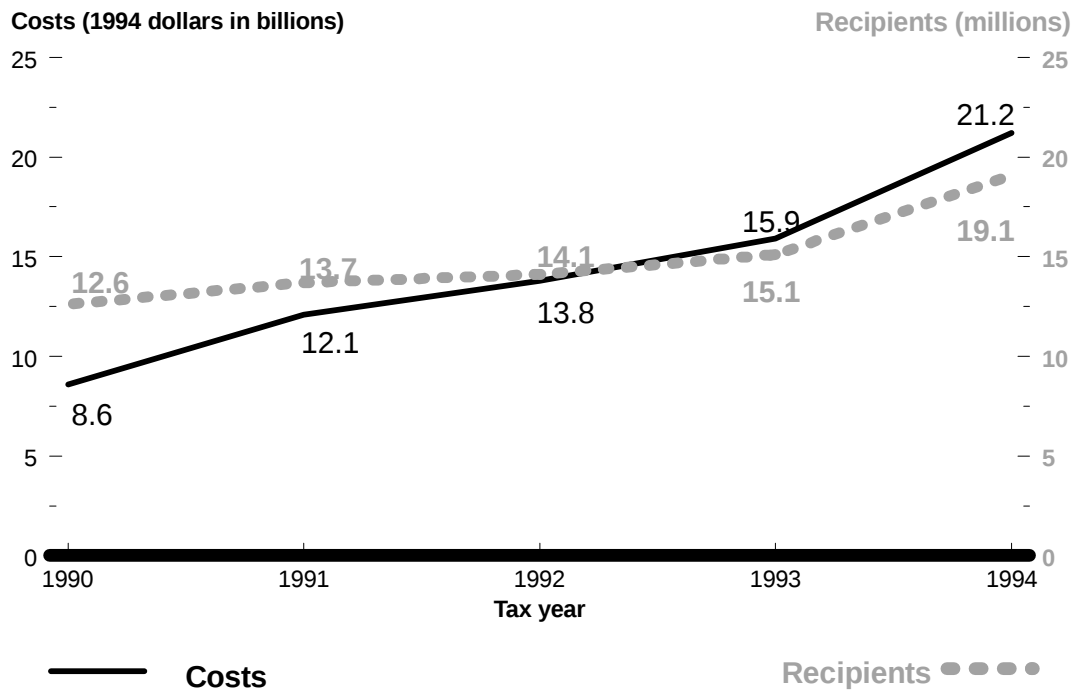
Like the credit phase-in, phase-out rates also varied by number of qualifying children. For example, taxpayers with one qualifying child lost 15.98 cents from the maximum credit amount (\$2,038) for each dollar of income over \$11,000 until their credit reached zero at income of \$23,755. Taxpayers with two or more qualifying children lost 17.68 cents per dollar of income over \$11,000; their EIC reached zero at income of \$25,296.

³Earned income for the purpose of calculating the EIC includes both taxable and nontaxable earned income. For the EIC, taxable earned income includes (1) wages, salaries, and tips, (2) union strike benefits, (3) long-term disability benefits received prior to minimum retirement age, and (4) net earnings from self-employment. Among the earned income items that are nontaxable are (1) voluntary salary deferrals, such as 401(k) plans or the federal thrift savings plan; (2) pay earned in a combat zone; (3) basic quarter and subsistence allowances from the U.S. military; (4) housing allowances or rental value of a parsonage for the clergy; and (5) excludable dependent care benefits.

⁴In addition to taxpayers' earned income, AGI includes their taxable income from other sources such as investments, alimony, and unemployment compensation.

Trends in EIC Costs and Participation

GAO EIC Costs and Recipients, Tax Years 1990 - 1994



Source: GAO analysis of IRS' SOI data.

Expanding EIC Eligibility
and Benefits Have
Increased Program Costs

EIC costs, in constant 1994 dollars, grew from \$8.6 billion in tax year 1990 to \$21.2 billion in tax year 1994, about a 150 percent increase. Over that same period, the number of taxpayers claiming the EIC increased by about 50 percent—from 12.6 million recipients in tax year 1990 to 19.1 million in tax year 1994.

The figure reflects the impact of eligibility and benefit changes implemented in 1991 and 1994. In tax year 1991, the addition of the supplemental young child and health insurance credits, separate credit rates for larger families, and an increase in the basic credit amount took effect. In tax year 1994, the repeal of the supplemental credits, addition of childless adult credit recipients, and another general increase in credit amounts for families with children took effect.

Excluding taxpayers who received the credit for childless adults in 1994, EIC costs for families with children (in 1994 dollars) increased by 140 percent from 1990 to 1994, and the number of recipients increased by 19 percent.

GAO EIC by Family Type, Tax Years 1991 - 1994

EIC amounts are in constant 1994 dollars

Tax year	Families with one qualifying child		Families with two or more qualifying children	
	Millions of recipients	EIC amount in billions	Millions of recipients	EIC amount in billions
1991	8.1	\$7.0	5.6	\$5.0
1992	7.9	7.6	6.2	6.1
1993	8.4	8.8	6.7	7.1
1994	8.1	10.4	6.8	10.1

Note: Tax year 1991 was the first year in which the EIC included separate credit amounts by family size.

Source: GAO analysis of IRS' SOI data.

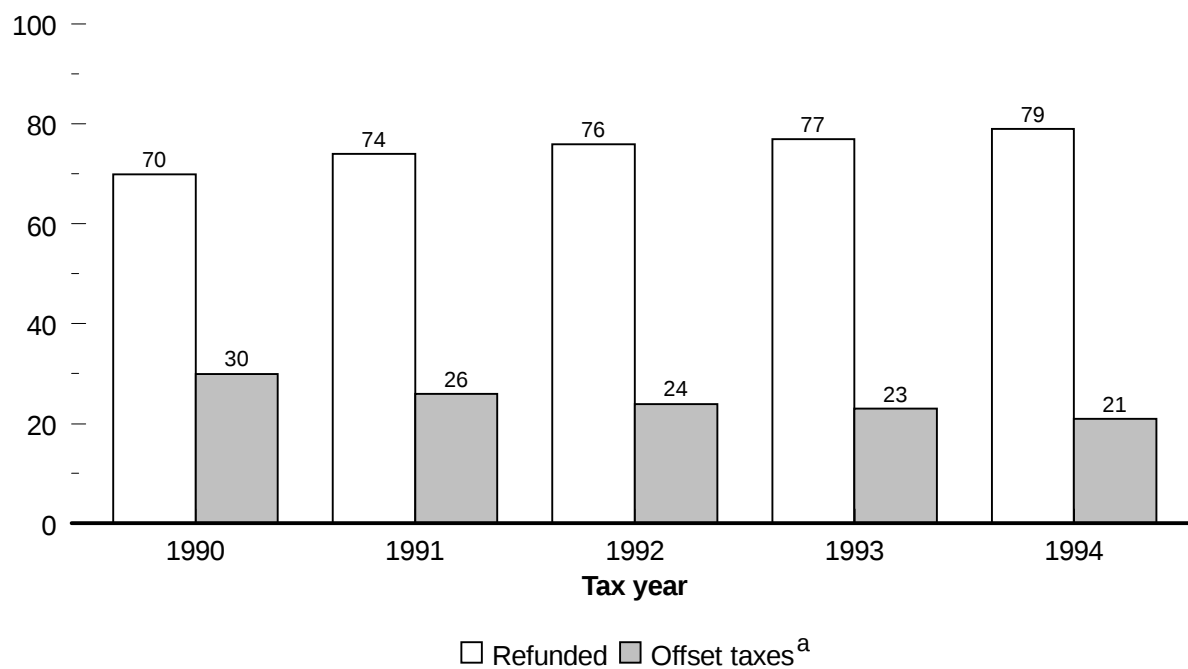
**Changes in 1994 Gave
Largest Benefit Increases
to EIC Families With Two
or More Children**

The total number of EIC families with children actually declined from 15.1 million recipients in tax year 1993 to 14.9 million in tax year 1994,⁵ and the total EIC awarded to families with children (in constant 1994 dollars) increased from \$15.9 billion to \$20.5 billion. The average credit for families with one qualifying child was \$1,023 for tax year 1993 and \$1,283 for tax year 1994. The average credit for families with two or more qualifying children increased from \$1,033 to \$1,474.

⁵IRS attributes at least a portion of this 1993 - 1994 decline in the total number of families with children claiming the credit to IRS' EIC compliance efforts during the 1995 filing season. We plan to issue a separate report later this year on IRS' EIC compliance efforts in 1995.

GAO Portion of EIC Offsetting Taxes and Refunded, Tax Years 1990 - 1994

Percentage of EIC dollars



^a"Offset taxes," as defined by IRS, refers to tax liabilities reported on recipients' individual income tax returns. In addition to income tax obligations, individuals' tax liabilities from tax year 1994 returns may also have included any of the following other taxes: self-employment tax, alternative minimum tax, social security and medicare taxes on tip income not reported to an employer, recapture taxes, and tax on qualified retirement plans.

Source: GAO analysis of IRS' SOI data.

**Refundable Portion of the
EIC Has Increased**

The EIC is a refundable tax credit. As such, the portion of the credit that offsets taxes owed by EIC recipients and reported on individual income tax returns is considered a tax expenditure, or a reduction in taxes due to a preferential provision in the federal tax law. The remaining, refunded portion of the EIC is considered a federal outlay.

In tax year 1990, \$2.6 billion of EIC offset recipients' tax liabilities, while \$6.0 billion were claimed by taxpayers as refunds (both figures in 1994 dollars). In tax year 1994, \$4.5 billion of EIC offset taxes, and \$16.7 billion were claimed as refunds.

Characteristics of Tax Year 1994 EIC Recipients

GAO Total EIC by Type of Recipient, Tax Year 1994

	Number of recipients (in millions)	Percentage of all recipients	Credit amount (in billions)	Percentage of total credit	Average credit
Families with one qualifying child	8.1	43%	\$10.4	49%	\$1,283
Families with two or more qualifying children	6.8	36	10.1	48	1,474
Childless adults	4.1	22	0.7	3	168
Total	19.1	100%	\$21.2	100%	\$1,111

Note: Totals may not add due to rounding.

Source: GAO analysis of IRS' SOI data.

As shown in the table, 19.1 million taxpayers claimed total EIC of \$21.2 billion for tax year 1994. Childless adult recipients accounted for 22 percent of the recipients, but only 3 percent of the total EIC amount.

GAO Amount of EIC Used to Offset Taxes and Amount Refunded, Tax Year 1994

Dollars in billions

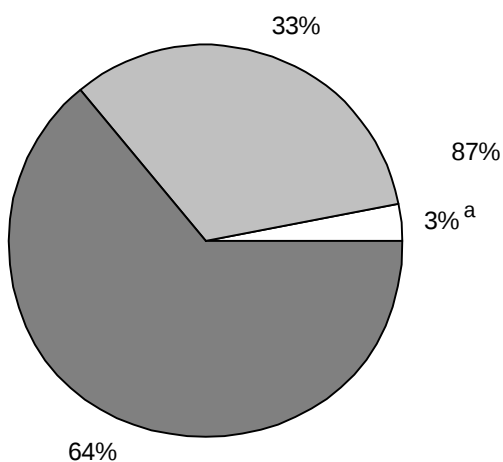


Source: GAO analysis of IRS' SOI data.

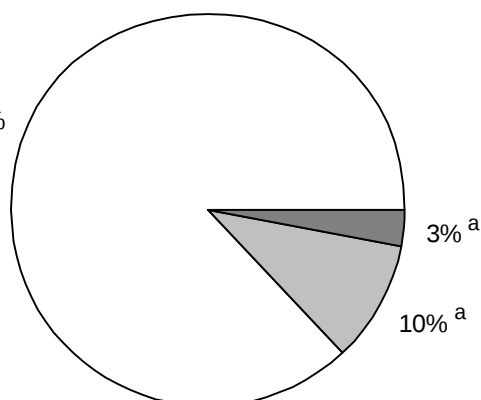
The refundable portion of the EIC accounted for \$16.7 billion, or 79 percent of the total EIC awarded in tax year 1994. The remaining 21 percent of the total credit amount was used to offset income tax (\$2.8 billion) and other taxes (\$1.7 billion) reported on recipients' income tax returns. These other taxes include self-employment tax, social security and medicare taxes on tip income not reported to an employer, recapture taxes, alternative minimum tax, and tax on qualified retirement plans.

GAO Filing Status of EIC Recipients, Tax Year 1994

Families With Children



Childless Adults



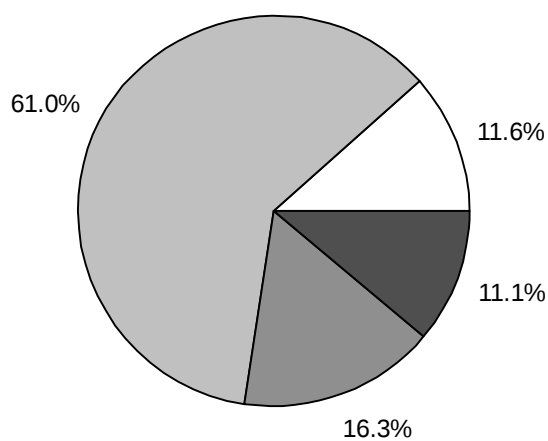
□ Single ■ Married ■ Head of household

^aConfidence intervals are +/- 15 to +/- 30 percent of reported values.

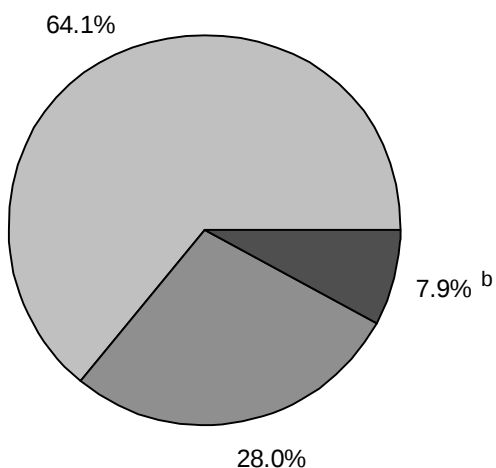
Source: GAO analysis of IRS' SOI data.

GAO Age of Primary Filer, EIC Recipients, Tax Year 1994

Families With Children



Childless Adults^a



□ Under 25 ■ 25 to 44 ■ 45 and older ■ Age unknown

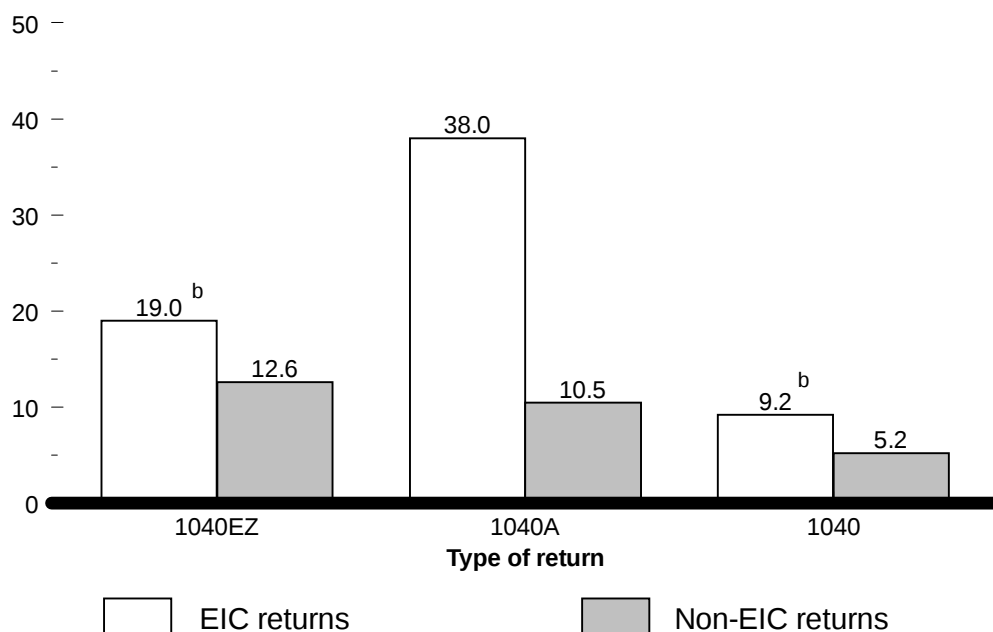
^aTaxpayers claiming the EIC for childless adults must be at least 25 but less than 65 years old. There are no age limits on the EIC for families with children.

^bConfidence interval is +/- 22 percent of the reported value.

Source: GAO analysis of IRS' SOI data.

GAO Use of Electronic Filing, EIC and Non-EIC Returns, Tax Year 1994

Percentage filed electronically ^a



^aPercentages are based on the number of taxpayers filing each type of return. For example, 38.0 percent of 1040A filers who claimed the EIC used electronic filing compared to 10.5 percent of 1040A filers who did not claim the EIC.

^bConfidence intervals are +/- 22 percent and +/- 12 percent of reported values for EIC 1040EZ and 1040 returns, respectively.

Source: GAO analysis of IRS' SOI data.

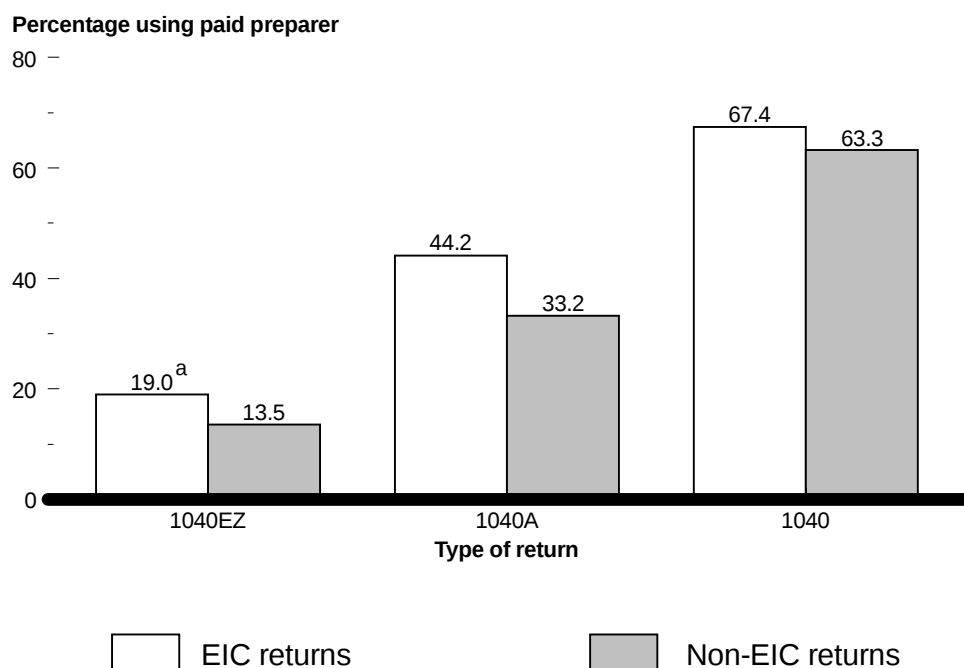
**EIC Recipients Used
Electronic Filing More
Often Than Did Other
Taxpayers**

As a group, taxpayers claiming the EIC used electronic filing more frequently than did taxpayers who did not claim the EIC. Overall, 26 percent of returns with an EIC were filed electronically compared to 7 percent of returns with no EIC claim. The figure shows the use of electronic filing by type of tax return.⁶

For tax year 1994, 56 percent of EIC recipients (families with children and childless adults) filed form 1040A, and 34 percent filed form 1040. Among taxpayers not claiming the EIC, 16 percent filed form 1040A, and 62 percent filed form 1040.

⁶Taxpayers claiming the EIC for childless adults may do so using forms 1040EZ, 1040A, or 1040; taxpayers claiming the credit for families with children may only use forms 1040A and 1040.

GAO Use of Paid Preparers, EIC and Non-EIC Returns, Tax Year 1994



^aConfidence interval is +/- 22 percent of the reported value.

Source: GAO analysis of IRS' SOI data.

Although 65 percent of EIC recipients filed IRS' simpler individual tax forms (the 1040EZ and 1040A), they used paid preparers about as often as filers who did not claim the EIC. Some of the taxpayers who used paid preparers may have done so simply as a means to file their returns electronically. Overall, paid preparers completed about half of EIC and non-EIC returns.

GAO EIC Recipients Reporting Occupation as Disabled, Retired, or Student, TY 1994

Self-reported occupation ^a	Number of recipients (in thousands)	Percentage of all EIC recipients	EIC dollars (in millions)
Disabled	220	1.2%	\$229
Retired	231	1.2	141
Student	394	2.1	240

^aOccupation information is self-reported by taxpayers on their tax returns, and IRS does not verify this information when it creates the SOI databases. In the 1994 sample, 87 percent of returns included information on the primary taxpayer's occupation; however, we do not know the extent to which self-reporting of occupations is subject to inconsistencies or biases. For example, taxpayers report their occupations at the time of filing in 1995, but their occupations may have been different in 1994. The data reported in this table does not account for spouses' occupations. Confidence intervals on this data, assuming no biases or inconsistencies, are +/- 17 to +/- 29 percent of reported values.

Source: GAO analysis of IRS' SOI data.

GAO EIC Recipients and the Child and
Dependent Care Credit, TY 1994

- 1.2 million EIC recipients (8 percent of all EIC families with children) also claimed a child and dependent care credit.
- Total child and dependent care credits to EIC recipients were \$507 million;^a the average was \$421 per family.

^aConfidence interval is +/- 12 percent of the reported value.

Source: GAO analysis of IRS' SOI data.

**Some EIC Recipients Were
Also Able to Claim the
Child and Dependent Care
Credit**

Taxpayers who claim the EIC for families with children may also file for the child and dependent care credit. Any taxpayer who incurs child or dependent care expenditures in order to work may claim this credit. The child and dependent care credit is not refundable; it goes only to taxpayers with a tax liability.

For tax year 1994, 1.2 million EIC recipients (8 percent of all EIC families with children) claimed \$507 million in child and dependent care credits in addition to \$1.2 billion of EIC. For these families, the average child and dependent care credit was \$421, and the average EIC was \$1,007.

GAO Major Sources of Income, All EIC Recipients, Tax Year 1994

Type of income	Number of recipients (in millions)	Percentage of all EIC recipients	Percentage of total income
Salaries & wages	17.7	92.6%	90.0%
Taxable interest	3.9	20.6	0.7 ^b
Schedule C ^a	2.9	15.2	7.3
Schedule C profits	2.6	13.4	8.0
Schedule C losses	0.3 ^b	1.7 ^b	-0.7 ^b
Unemployment compensation	2.2	11.4	2.0
Taxable dividends	0.7 ^b	3.9	0.2 ^b
Taxable pension	0.7	3.7 ^b	1.1
Schedule E ^a	0.7	3.7	-0.2 ^b
Schedule E profits	0.4 ^b	2.1 ^b	0.8 ^b
Schedule E losses	0.3 ^b	1.5 ^b	-1.0 ^b

Note: Percentages do not add to 100. Recipients report more than one type of income, and not all income types are shown in the table.

^aSchedule C is used to report business income/losses from self-employment. Schedule E is used to report income/losses from rental real estate, royalties, partnerships, S corporations, estates, and trusts.

^bConfidence intervals are +/- 11 to +/- 25 percent of reported values, except for Schedule E percentage of total income, which is +/- 100 percent.

Source: GAO analysis of IRS' SOI data.

**Salaries, Wages, and
Self-Employment Income
Accounted for Most of EIC
Recipients' Total Income**

The EIC is intended to be claimed by low-income workers, and, as expected, salaries, wages, and self-employment income accounted for about 97 percent of EIC recipients' total income, before adjustments, in 1994. The table shows the types of income by descending order of the number of recipients reporting each type.

Although 21.6 percent of recipients reported investment income from either taxable interest or dividends,⁷ this income accounted for less than 1 percent of total income before adjustments. Of the 3.9 million recipients reporting interest income in 1994, 60 percent reported an amount less than \$100, and 86 percent reported less than \$500. Of the 0.7 million recipients reporting dividend income, 44 percent⁸ reported an amount less than \$100, and 75 percent reported less than \$500.

⁷The percentage of recipients reporting interest **or** dividends is not equal to the sum of the percentages for interest (20.6) and dividends (3.9) reported in the table because recipients can have both types of income.

⁸Confidence interval is +/- 12 percent of the reported value.

GAO 1996 EIC Investment Income Threshold Applied to Tax Year 1994

- Investment income, as defined for the EIC threshold taking effect in 1996, includes taxable and nontaxable interest, taxable dividends, and net rents and royalties (from Schedule E).
 - The threshold for 1996 is \$2,350; deflated to 1994 dollars, the threshold would have been \$2,210.
 - About 284,000^a EIC recipients (1.5 percent^a of all recipients) in tax year 1994 had investment income over \$2,210. The total credit for these recipients was \$212 million.^a
-

^aConfidence intervals are +/- 15 to +/- 19 percent of the reported values.

Source: GAO analysis of IRS' SOI data.

Investment Income
Threshold Would Have
Eliminated a Small
Percentage of 1994
Recipients

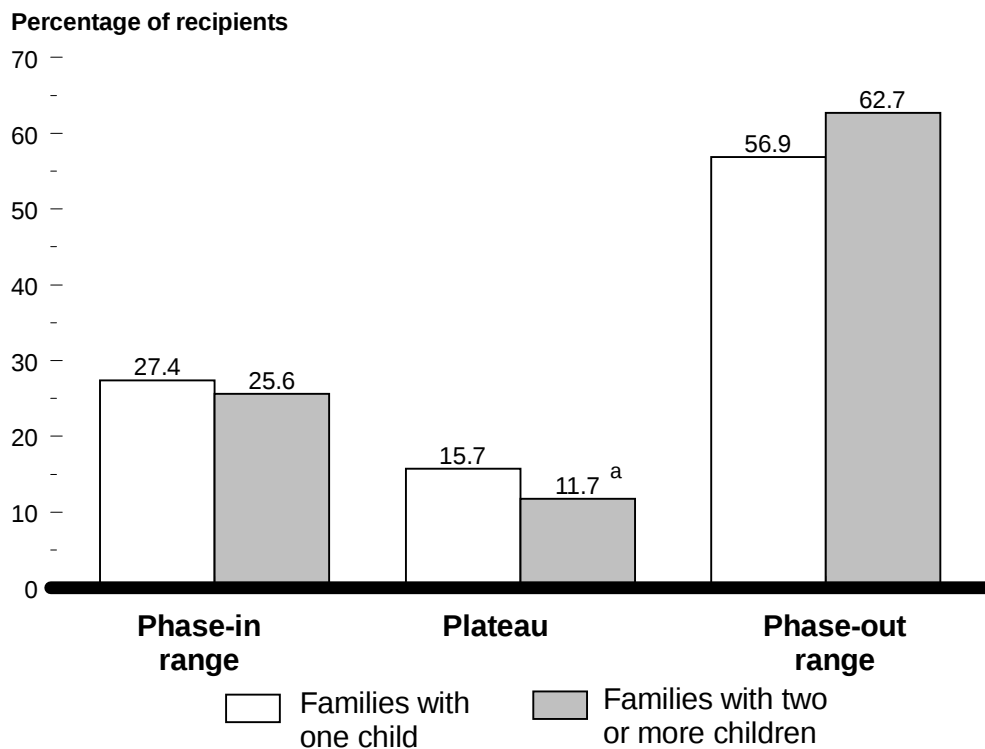
In 1995, Congress enacted an indirect wealth test to eliminate certain taxpayers from the EIC program. Beginning with tax year 1996 returns, taxpayers with investment income greater than \$2,350 will no longer be eligible for the EIC, regardless of their earned income or AGI. Investment income includes taxable and nontaxable interest, taxable dividends, and net rents and royalties derived from sources outside the taxpayer's ordinary course of trade or business.

To estimate the impact of this provision, we deflated the 1996 investment income threshold to 1994 dollars (\$2,210)⁹ and applied it to all tax year 1994 EIC recipients (with and without qualifying children). Had the investment income threshold been in place in tax year 1994, about 284,000 taxpayers who claimed the EIC (1.5 percent of all recipients) would not have been able to do so. The total EIC awarded to these individuals was \$212 million, or 1.0 percent of the total EIC awarded that year.

⁹We used the CPI-U as projected by the Congressional Budget Office in The Economic and Budget Outlook: An Update, Aug. 1995.

Families With Children and Income in the Credit Phase-Out Range

GAO EIC Families With Children, by Credit Range, Tax Year 1994



^aConfidence interval is +/- 11 percent of the reported value.

Source: GAO analysis of IRS' SOI data.

Of the 15 million taxpayers claiming the EIC for families with children, more than half have income in their respective credit phase-out range. For tax year 1994, 8.9 million families with children had income in the phase-out range; the remaining 6.1 million had income in the phase-in or plateau ranges.

GAO Distribution in the Phase-Out Range, EIC Families With Children, TY 1994

Families with one qualifying child			Families with two or more qualifying children		
Quarter of the phase-out range	Millions of recipients	EIC amount in billions	Quarter of the phase-out range	Millions of recipients	EIC amount in billions
\$11,000 - \$14,188	1.5	\$2.6	\$11,000 - \$14,573	1.2	\$2.5 ^a
\$14,189 - \$17,377	1.3	1.6 ^a	\$14,574 - \$18,147	1.2	1.8 ^a
\$17,378 - \$20,566	0.9 ^a	0.7 ^a	\$18,148 - \$21,721	1.0	1.0
\$20,567 - \$23,754	0.9 ^a	0.2 ^a	\$21,722 - \$25,295	0.9 ^a	0.3 ^a
Total	4.6	\$5.1	Total	4.3	\$5.6

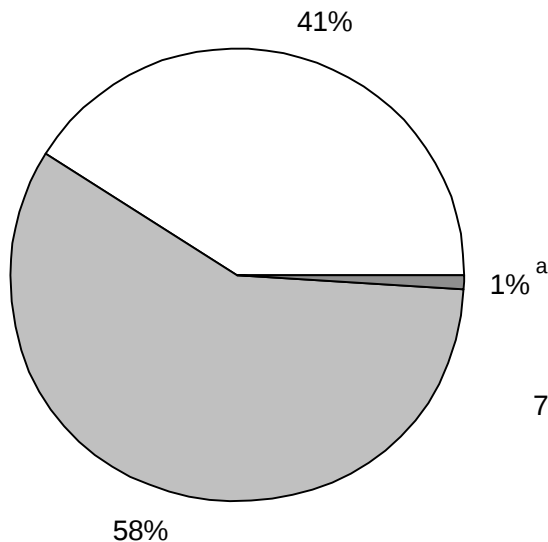
^aConfidence intervals are +/- 11 to +/- 15 percent of the reported values.

Source: GAO analysis of IRS' SOI data.

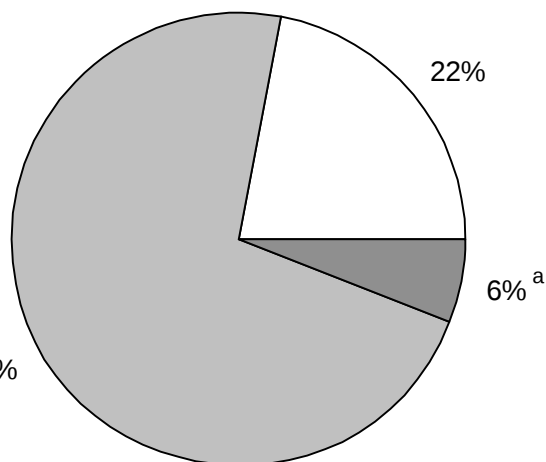
To determine the distribution within the phase-out range of EIC recipients with children, we divided the ranges for both family sizes into quarters. As shown in the table, recipients were distributed a bit more heavily in the lower half of the phase-out ranges.

GAO Filing Status by Credit Range, EIC Families With Children, Tax Year 1994

Families in the phase-out range



Families in the phase-in and plateau ranges



□ Married ■ Head of household ■ Single

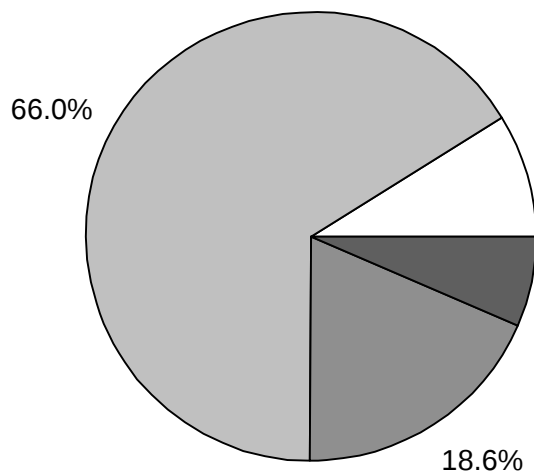
^aConfidence intervals are +/- 36 percent and +/- 19 percent of the reported values for single filers in the phase-out and phase-in/plateau ranges, respectively.

Source: GAO analysis of IRS' SOI data.

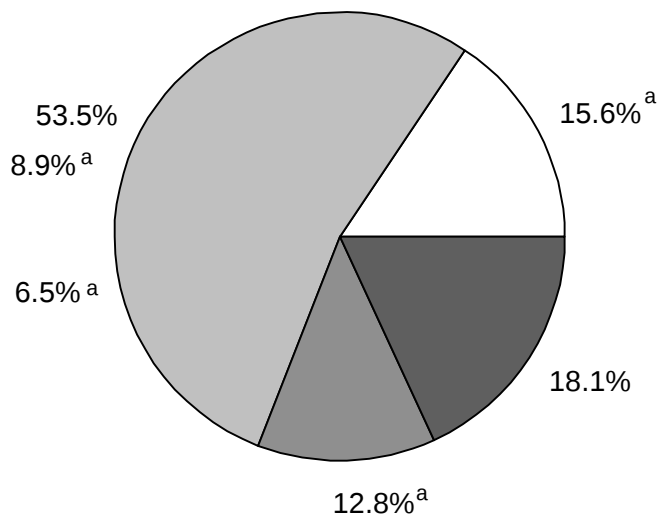
Among EIC families with children, those in the phase-out range had a higher proportion of married filers. Within the phase-out range, 59 percent of filers were single or head of household, and 41 percent were married. In contrast, 78 percent of recipients in the phase-in and plateau ranges were single or head of household, and 22 percent were married.

GAO Age of Filer by Credit Range, EIC Families With Children, Tax Year 1994

**Families in the
phase-out range**



**Families in the phase-in
and plateau ranges**



□ Under 25 ■ 25 to 44 ■ 45 and older ■ Age unknown

^aConfidence intervals are +/- 11 to +/- 14 percent of the reported values.

Source: GAO analysis of IRS' SOI data.

GAO Income Sources by Credit Range, EIC Families with Children, Tax Year 1994

	Phase-out range recipients (total = 8.9 million)		Phase-in & plateau range recipients (total = 6.1 million)	
Type of income	Percentage of recipients	Percentage of total income	Percentage of recipients	Percentage of total income
Salaries & wages	95.9%	90.8%	92.0%	88.4%
Taxable interest	24.7	0.5 ^b	10.1 ^b	0.6 ^b
Schedule C ^a	13.9	5.6 ^b	13.7	10.8 ^b
Schedule C profits	11.8	6.3	12.6	11.7 ^b
Schedule C losses	2.0 ^b	-0.6 ^b	1.1 ^b	-0.9 ^b
Unemployment compensation	12.7	1.6 ^b	11.6 ^b	2.9 ^b
Schedule E ^a	4.7 ^b	0.2 ^b	1.9 ^b	-0.9 ^b
Schedule E profits	2.9 ^b	0.8 ^b	1.1 ^b	0.5 ^b
Schedule E losses	1.8 ^b	-0.6 ^b	0.8 ^b	-1.4 ^b
Taxable pension	4.3 ^b	1.0 ^b	2.4 ^b	0.8 ^b
Taxable dividends	4.2 ^b	0.1 ^b	1.6 ^b	0.2 ^b

Note: Percentages do not add to 100. Recipients report more than one type of income, and not all income types are shown on the table.

^aSchedule C is used to report business income/losses from self-employment. Schedule E is used to report income/losses from rental real estate, royalties, partnerships, S corporations, estates, and trusts.

^bConfidence intervals are +/- 11 to +/- 67 percent of reported values except for phase-out range Schedule E percentage of income which is +/- 100 percent.

Source: GAO analysis of IRS' SOI data.

**Income Patterns Vary
Slightly by Credit Range**

The table shows the types of income reported by EIC recipients in descending order based on the number of phase-out recipients reporting each type. There are some differences in the distribution of income between the phase-out and phase-in/plateau range groups. Although salaries and wages and Schedule C income account for most of the total income before adjustments for both groups, Schedule C income accounts for a larger portion of income for recipients in the phase-in/plateau ranges. A greater proportion of phase-out range recipients reported other types of income, particularly taxable interest, Schedule E, pensions, and dividends, than did those with incomes in the phase-in and plateau ranges.

GAO Investment Income Threshold, EIC Families With Children, Tax Year 1994

	Recipients ^a with investment income over \$2,210	Total EIC (in millions)
Phase-in and plateau ranges	37,000	\$40
Phase-out range	145,000	159
Total	182,000	\$199

Note: Confidence intervals are +/- 17 to +/- 40 percent of reported values.

^aRounded to the nearest thousand.

Source: GAO analysis of IRS' SOI data.

**Half of Recipients Meeting
the Investment Income
Threshold Would Have
Been Families in the
Phase-Out Range**

As discussed on page 33, about 284,000 taxpayers (families with children and childless adults) who claimed \$212 million of EIC in tax year 1994 would not have been able to do so had the 1996 investment income threshold of \$2,350 been in place that year. (Deflated to 1994 dollars, the investment income threshold would have been \$2,210.) Phase-out range families with children would have accounted for 51 percent¹⁰ of the 284,000 recipients and 75 percent of the \$212 million of EIC.

¹⁰Confidence interval is +/- 15 percent of the reported value.

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