Earned Income Tax Credit

The Earned Income Tax Credit (EITC) is a federal tax credit for working individuals and families with low to moderate incomes. The credit was first created in 1975 and has changed numerous times to conform to rising wage inequalities and to maximize its benefits to workers. In 1999, Indiana created its own EITC that is a percentage, roughly, of the federal credit. The credits are fully refundable, meaning taxpayers always realize the full value.

Both the federal and state credits function as a wage subsidy by boosting earnings as workers increase their hours, which encourages work. The EITC is one of the federal government’s most successful anti-poverty programs and is extremely effective. In 2018, the federal EITC lifted approximately 5.6 million people out of poverty, including about three million children. Research suggests that expansions to the federal EITC improve infant and maternal health, boost children’s school achievement, and lead to higher college attendance among children. The most recent analysis of the Indiana credit found that the state credit reduced the number of Hoosier households living in poverty by 2.2 percent.

Federal EITC

The federal credit is available to most low- to moderate-income households. Eligibility and the amount of the credit are a function of taxpayers’ (1) earned income and adjusted gross income (AGI), (2) filing status, and (3) the number of qualifying children. Earned income comes directly from work, such as wages, tips, or business income. AGI is earned income plus passive income sources, such as dividends, less above-the-line adjustments to income, such as student loan interest payments or contributions to a Traditional Individual Retirement Account (IRA).

General Eligibility & Maximum Credit

All taxpayers must have a Social Security number (SSN) that is valid for work in the United States to claim the federal EITC, meaning those with Individual Tax Identification Numbers are ineligible for the credit. Taxpayers must also have earned income and an AGI below a certain threshold; depending on their filing status and number of qualifying children (see Table 1). For 2021, taxpayers with investment income (interest, tax-exempt interest, dividends, capital gains distributions, and capital gains) more than $10,000 are ineligible for the credit.

<table>
<thead>
<tr>
<th># of Qualifying Children</th>
<th>Maximum AGI &amp; Earned Income for Any Credit</th>
<th>Maximum Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Single / Head of Household</td>
<td>Married Filing Jointly</td>
</tr>
<tr>
<td>0</td>
<td>$21,427</td>
<td>$27,380</td>
</tr>
<tr>
<td>1</td>
<td>$42,158</td>
<td>$48,108</td>
</tr>
<tr>
<td>2</td>
<td>$47,915</td>
<td>$53,865</td>
</tr>
<tr>
<td>3*</td>
<td>$51,464</td>
<td>$57,414</td>
</tr>
</tbody>
</table>

Source: Internal Revenue Service; Urban-Brookings Tax Policy Center, May 2021
The credit increases as workers earn more income (phases in) before reaching its maximum amount.\textsuperscript{11} As a taxpayer’s income increases beyond a range, it decreases (phases out) as a percentage of income until it reaches zero (see Figure 1). The mechanics of the credit avoid any financial cliffs and preserve the credit’s main objective—to encourage work.\textsuperscript{12}

\textbf{Figure 1: Federal EITC, 2021}

Source: Internal Revenue Service; Urban-Brookings Tax Policy Center, May 2021
Note: Earnings in Figure 1 are taxpayers filing single or head of household status. For couples filing married jointly, the credit phases out at $5,940 higher without children and $5,950 higher with qualifying children.

\textbf{Qualifying Children}

As illustrated above, eligible taxpayers can receive a larger credit over higher incomes based on the number of qualifying children in the household. To claim a child for EITC purposes, the child must meet three requirements: (1) relationship, (2) residency, and (3) age tests.\textsuperscript{13}

A qualifying child must be an EITC recipient’s child, sibling (biological or by marriage), foster child, or the descendant of any of them. Additionally, the child must live with the taxpayer for at least half of the year and have a SSN that is valid for work. Qualifying children must be younger than the taxpayer and under age 19 or under age 24 if a full-time student. There is not an age requirement for eligible children who are permanently and totally disabled.

Unlike some tax credits, the EITC does not have a support test, meaning the claimant does not have to provide over half of the qualifying child’s financial support throughout the year. There are instances where a child qualifies for more than one taxpayer who is eligible for the EITC, but only one person can claim the child. If eligible taxpayers cannot decide who will claim the child, a set of tiebreaker rules apply that, generally, provide preference to parents first and then to those with higher earnings.

For example, assume a six-year-old girl lives with her father and her grandmother all year. The father earned $15,000 and the grandmother earned $20,000. They both otherwise qualify for the federal EITC. The girl meets the relationship (daughter and granddaughter), residency (lived with both all year), and age (under age 19) tests to be the qualifying child of both her father and her grandmother. The father and the grandmother disagree on who will claim the child. Given the tiebreaker rules, the father claims the girl as a qualifying child for EITC purposes. The grandmother could then claim the EITC as a childless worker, assuming she otherwise qualifies for the credit as a childless worker.
Tax Credit Fully Refundable

Unlike tax deductions, which reduce a taxpayer’s taxable income, the EITC is a tax credit and reduces tax liability dollar-for-dollar. One of the more important features of the credit is that it is fully refundable, meaning when taxpayers file their tax return, they recoup any remaining credit value after all tax is offset. A fully refundable tax credit ensures working families and individuals have resources to meet their basic needs and puts money back into local economies.

For example, assume a taxpayer owes $2,000 in taxes and has a $2,400 credit. If the credit is refundable, the taxpayer’s tax liability reduces to zero and they receive the remaining $400 of the credit as a refund on their return. If the credit is non-refundable, the remaining $400 is left on the table and unclaimed. A fully refundable tax credit ensures low-income taxpayers who may reduce their tax liability to zero through other credits and deductions realize the credit’s full value.

Participation Rate

Data from the Internal Revenue Service (IRS) for tax year 2020 demonstrates the credit’s popularity. About 25 million individuals and families nationwide received an average federal EITC of $2,461, including 515,000 Hoosiers with an average credit of $2,424. Unfortunately, only 78.1% of eligible taxpayers (80.3% in Indiana) claimed the federal tax credit in 2018. To put this in perspective, over 125,000 additional Hoosiers were eligible but did not claim the credit—equating to over $305 million gone unclaimed. This sizable amount going unclaimed could help vulnerable families pay for large, one-off expenses such as repairing a car or obtaining additional education or training to increase their wages.

Recent Changes to Federal EITC & Outlook

In March 2021, Congress temporarily expanded the EITC for childless workers through the American Rescue Plan Act (ARPA). For 2021 only, this change (1) allows younger and older working adults without children to claim the credit, (2) increases the maximum credit, and (3) raises the income threshold at which the credit phases out.

Prior to ARPA, childless workers were eligible for the EITC only between ages 25 and 64. ARPA reduced the eligible age to 19 for most workers. Students attending school at least part-time are now eligible at age 24, and foster children and homeless youth are eligible at age 18. The new law also temporarily eliminated the maximum age for childless workers, allowing workers 65 and older to claim the credit in 2021.

ARPA increased the maximum credit for childless workers in addition to phasing the credit in more aggressively and phasing the credit out over a higher income (see Table 2).

<table>
<thead>
<tr>
<th>Age Band</th>
<th>Prior to ARPA: Phase Out Begins</th>
<th>Current Law –ARPA: Phase Out Begins</th>
<th>Prior to ARPA: Maximum Credit</th>
<th>Current Law –ARPA: Maximum Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>19-24</td>
<td>n/a</td>
<td>$11,610 // $17,550</td>
<td>$0</td>
<td>$1,502</td>
</tr>
<tr>
<td>25-64</td>
<td>$8,880 // $11,610</td>
<td></td>
<td>$543</td>
<td></td>
</tr>
<tr>
<td>65+</td>
<td>n/a</td>
<td></td>
<td>$0</td>
<td></td>
</tr>
</tbody>
</table>

Source: Congressional Research Service, May 2021

Over 367,000 Hoosier workers without children benefit from this expansion, of whom over a quarter are non-White. Approximately 11.4% of Hoosiers would receive a federal tax cut of $690 on average in 2022, providing meaningful relief to individuals who need it the most to meet their basic needs.
Again, this expansion is temporary and effective for tax year 2021 only. Currently, Congress is considering legislation, the Build Back Better Act, which includes a provision to extend the childless worker expansion through 2022.  

**State EITC**

Indiana is one of 30 states with a state EITC. Like its federal counterpart, the state EITC is fully refundable, requires a SSN to claim, and is a function of the taxpayer or household’s income and number of qualifying children. However, the state credit is decoupled from the federal credit, and is a percentage of the federal credit as it was calculated before 2009 (adjusted for inflation). While Indiana has a flat income tax rate (3.23%), the state’s general sales tax (7%), local property taxes, and other levies account for a higher share of income for low- and moderate-income families. Indiana’s regressive state and local taxes exacerbate longstanding and widening racial wealth gaps as communities of color, on average, earn less income and are likely to pay more of their income in taxes as compared to white communities. The state credit is currently nine percent but will rise to ten percent of the federal credit beginning in 2022. The credit is an important tool for low- and moderate-income workers and families to offset regressive state and local taxes.

| Table 3: Indiana EITC Compared to Neighboring States, 2021 |
|-----------------|---|---|---|---|---|
| **State** | IN | OH | IL | MI | KY |
| **Rate** | 9% | 30% | 18% | 6% | No State EITC |
| **Refundable?** | Yes | No | Yes | Yes | Yes |
| **Coupled to Federal Credit?** | No | Yes | Yes | Yes | Yes |
| **Federal Credit Participation** | 80.3% | 79.9% | 78.4% | 80.5% | 79.9% |

Source: See endnotes

**Recent Changes to State EITC**

The state EITC had been largely unchanged since state lawmakers decoupled from the federal credit in 2011. During the 2021 session of the Indiana General Assembly, state lawmakers increased the Indiana EITC from nine percent to ten percent of the federal credit, but kept the credit decoupled from the federal EITC. These changes, beginning in 2022, will provide a tax cut to 13 percent of Hoosier workers and their families (see Table 4).

| Table 4: Changes to State EITC – Indiana Taxpayers Receiving Tax Cut Starting 2022 |
|-----------------|---|---|---|---|---|
| **Income Range** | Less than $22,000 | $22,001 - $42,000 | $42,001 - $64,000 | $64,001 - $101,000 | $101,001+ | Overall |
| **% Receiving Tax Cut** | 33% | 22% | 8% | 4% | 0% | 13% |

Source: Institute on Taxation and Economic Policy, May 2021

**Difference between State & Federal EITC**

In response to the 2007-2008 global financial crisis, Congress enacted the American Recovery and Reinvestment Act (ARRA) that included a two-year expansion of the federal EITC. The expansion included two notable changes designed to provide temporary economic stimulus to the struggling national economy. First, ARRA reduced the “marriage penalty” that occurs when a couple filing a joint return receives a smaller refund (or owes more in taxes) than they would if they were unmarried and filed separate returns. ARRA increased the income threshold for married households where the credit phased out, helping to account for two incomes. Second, ARRA created a larger credit and income threshold for families with three or more children. These two provisions were originally set to expire at the end of 2010, but were extended several times until being made permanent in 2015.
In 2011, the Indiana legislature decoupled the state credit from the federal EITC through the biennial budget, opting to calculate the state credit as a percentage of the federal credit as it was calculated before 2009. While the state credit adjusts for inflation, it is not larger for families with three or more children (capped at two or more children) and maintains a marriage penalty. The state credit also requires a higher residency standard for foster children, requiring that the child live with the taxpayer for the entire year versus at least half of the year for the federal credit.

Similar to the federal credit, there are instances where a child satisfies the tests of a qualifying child for more than one person. However, the state EITC does not follow the same tiebreaker rules as its federal counterpart. Taking the previous example, a six-year-old girl lives with her father and her grandmother all year. The father earned $15,000 and the grandmother earned $20,000. They both otherwise qualify for the state EITC. The girl meets the relationship (daughter and granddaughter), residency (lived with both all year), and age (under age 19) tests to be the qualifying child of both her father and her grandmother. Unlike the federal credit where tiebreaker rules apply if the taxpayers cannot agree, the grandmother is the only person who can claim the girl because she has a higher income. The father could then claim the state EITC for childless workers, but cannot claim his daughter even if the grandmother does not want to claim the girl.

The issue illustrated above may make sense because the family, collectively, is likely better off with the higher-income worker claiming the girl and then receiving a larger tax credit. This issue becomes problematic when more than one person can claim the child, but one taxpayer has earned too much and is ineligible for the credit altogether. Revising the previous example, assume the grandmother earns $45,000. Under the income limits for both the federal and state credit, the grandmother cannot claim either credit. However, the father could still claim the federal credit, but could not claim the state EITC because the credit is attached to the taxpayer with the higher income—regardless if they cannot claim it.

**Policy Recommendations**

**Federal:** Make permanent ARPA’s expansion of federal EITC for childless workers and lower the minimum age to include all working adults. As previously noted, ARPA nearly tripled the maximum credit for childless adults while also phasing the credit out over a higher income for these workers. ARPA also lowered the minimum age for some childless workers and eliminated the maximum age. These changes need to be made permanent and are currently effective for 2021 only.

However, federal lawmakers should take an additional step and reduce the minimum age for childless workers to 18, regardless of school status. While ARPA took an important step by temporarily reducing the minimum age to claim the credit for childless adults, the law did not go far enough. Specifically, the youngest working adults without children remain excluded as are young students attending school at least part time. All working adults without children age 18 and over should be eligible for the credit, assuming these workers otherwise qualify.

**Federal:** Reduce or eliminate marriage penalties for low- and moderate-income couples who marry. The changes made to the federal EITC through ARPA are significant, but the law created significant marriage penalties (or conversely “divorce bonuses”) for childless workers marrying workers with a qualifying child. Congress could reduce or eliminate this problem by phasing out benefits over higher income thresholds or tying the credit to each worker’s earnings.

**State:** Couple the Indiana EITC to the federal credit. This change would increase the credit for working families with three or more children and help offset a marriage penalty where taxpayers would receive a higher state credit separately than filing jointly. Coupling to the federal EITC provides parity in the treatment of foster children and ensures
that the credit’s structure optimizes benefits for families and households who may have children that qualify for more than one person.

**State: Notify taxpayers to drive higher EITC participation.** With approximately one in five eligible Hoosiers claiming the federal EITC, there is work to be done to drive participation, which is especially important for low- and moderate-income Hoosiers. The state should leverage existing communication channels to drive participation in the federal and state credits, such as by providing a supplemental notification to recipients of Temporary Assistance for Needy Families (TANF), Supplemental Nutrition Assistance Program (SNAP), and Medicaid. Research supports that such notification could lead to higher EITC participation. In the 2021 Legislative Session of the Indiana General Assembly, legislation was introduced to achieve this goal and to close the participation gap.

**Federal, State, and Local: Provide additional resources for programs that help individuals and families file their tax returns.** Despite challenges in our regressive federal and state tax code, filing a tax return is a civic duty and paying taxes is a legal requirement. However, complexities in the tax code make it difficult for individuals to file their own tax return. For no-, low-, and moderate-income individuals and families, hiring a tax preparer may utilize their entire refund, driving a disincentive to file a return at all. Resources such as the Volunteer Income Tax Assistance (VITA) program in partnership with local social service agencies, faith institutions, and other organizations provide free, professional tax preparation services to those with moderate incomes and lower. All levels of government and funders should increase resources for these programs to ensure those who need it the most can maximize benefits and file a return.

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7 The terms “qualifying child” or “qualifying children” and associated phrasing such as “a child who qualifies for EITC purposes” includes qualifying relatives who may not be children but who qualify for EITC purposes (such as individuals who are permanently and totally disabled). This brief omits “relative” for efficiency.

8 Earned income examples are not exhaustive of all possible sources.

9 Passive income and adjustment examples are not exhaustive of all possible sources.


16 Author’s calculations using tax year 2018 participation rates (80.3%), number of EITC claims (511,000), and average EITC amounts ($2,439).

17 Center on Budget and Policy Priorities, “Policy Basics: The Earned Income Tax Credit.”


25 Ind. Code § 6-3.1-21-6


32 Calculations by the Institute on Taxation and Economic Policy at the request of the Indiana Community Action Poverty Institute.


34 Crandall-Hollick, A Brief Legislative History.
35 Ind. Code § 6-3.1-21-6

36 Davis, “Nearly 20 Million Weill Benefit.”


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