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Federal Tax Policies and Low-Income Rural Households

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Ron Durst

Tracey Farrigan

Abstract

The authors analyze the increasing use of refundable tax credits targeted to low- and moderate-income households in the Federal individual income tax and determine their implications for rural America. To identify rural and urban households, the analysis matches a zip code approximation of the 2006 Rural-Urban Commuting Area Codes with Internal Revenue Service Individual Income Tax zip code and related data. These data are then used to examine the impact of the recent expansions to income tax credit programs on affected households. The analysis finds that expansions to both the refundable and nonrefundable portions of the Earned Income and Child Tax credits have provided a major source of income support for low-income workers and their families. This is especially true in the South, where the rural poor are concentrated.

Keywords: earned income credit, child credit, rural households, poverty, tax policy, refundable tax credits.

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Summary

What Is the Issue?

Tax credits provided to low- and moderate-income households have grown over the last several decades and now provide a significant boost to the after-tax incomes of taxpayers receiving these credits. This growth has primarily involved enactment of new income tax credits and the expansion of existing ones, especially refundable tax credits (which allow a rebate to the taxpayer of any balance after the credit is applied against the tax owed to the IRS). Two refundable tax credits in particular—the Earned Income Tax Credit (EITC) and the Child Tax Credit (CTC)—have reduced rural poverty and boosted income for low- and middle-income rural households. These and other tax policies, however, could be affected by tax reform or be allowed to expire, since some provisions are only temporary. This report examines the effects of current tax provisions targeting low- and moderate-income households in rural America—focusing on the EITC and the CTC—and compares them with traditional income support programs.

What Did the Study Find?

- Over the last two decades, income tax credits targeted to low-income households have markedly increased. In 1990, the EITC provided \$4.4 billion in payments to low-income households; in 2008, the total amount provided by the EITC and the CTC exceeded \$64.7 billion.
- In 2008, rural taxpayers reported an average adjusted gross income (AGI) of \$43,616 compared with \$60,841 for urban taxpayers. The poverty rate was also significantly higher in rural areas (15.1 percent) than in urban areas (12.9 percent).
- Overall, in 2008, one of every three rural taxpayers received benefits from either the EITC or the CTC. These two refundable tax credit programs provided a total of \$20.6 billion to rural taxpayers. Of this, \$13.7 billion (about two-thirds of the total benefit) exceeded individual taxpayer liabilities and was refunded. These two tax credits provided a 13-percent increase in income, on average, to those receiving one or both of the credits.
- A larger share of eligible households receive the EITC compared with other Federal low-income support program payments, and EITC and other tax-based benefits represent an increasing share of low-income support funding. However, compared with traditional income-support programs, a greater share of the EITC benefits go to low-income households that are above the poverty level.

How Was the Study Conducted?

This report uses both published and special tabulation data obtained from the Internal Revenue Service (IRS) to evaluate the growth of the EITC, CTC, and other tax credits supporting a variety of social policy objectives. The effect of these policies on rural taxpayers' income and on rural poverty was determined by using a zip code approximation of the 2006 Rural-Urban Commuting Area Codes (to identify rural taxpayers) and matching the zip code data with IRS tax data.

Introduction

The Federal income tax structure has changed substantially over the last two decades. Tax rates have been reduced and deductions and credits, especially refundable tax credits, have expanded, reducing Federal income tax burdens and significantly increasing after-tax income. While these tax reforms have provided the greatest benefit to those with the highest tax liabilities, low- and middle-income rural residents, especially those with children, have been major beneficiaries of some of the changes.

In recent years, the Federal tax code has become an important vehicle for promoting social policy objectives such as encouraging employment and savings and providing support to families with children. The primary method of providing support has been to allow tax credits, especially refundable tax credits. These include the Earned Income Tax Credit (EITC), the Child Tax Credit (CTC), and the new Making Work Pay Credit. Participation in these tax-based programs is higher than for traditional income support programs, and the tax programs represent an increasing share of total support to low-income households. Thus, the Federal income tax system has played an increasingly important role in Federal support to low- and middle-income taxpayers, especially families with children. Compared with traditional programs such as Temporary Assistance to Needy Families (TANF) or Supplemental Nutrition Assistance Program (SNAP), a larger share of the benefit of the tax credit programs goes to those with incomes above the poverty level. Nevertheless, these tax credits represent a large share of disposable income for many low-income rural families and have reduced the rural poverty rate.

A number of tax provisions enacted or expanded as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 and the American Recovery and Reinvestment Act of 2009 were temporary. Furthermore, interest in tax reform and simplification continues to grow, and the expanding Federal budget deficit is placing increased pressure on policymakers to rein in both direct spending programs and tax expenditures.

This report examines the effect on rural Americans of tax credits targeting low- and moderate-income households by estimating the number of beneficiaries, the level of benefits, and the impact of the benefits on income and rural poverty. (See box, “About the Data.”) The relative importance of these tax credits compared with traditional income support programs is also discussed.

About the Data

Two definitions of rural residence are used in this report: The 2006 Rural-Urban Commuting Area Codes (RUCAs, of the WWAMI Rural Health Research Center) and nonmetropolitan (nonmetro). Nonmetro refers to counties that are outside core-based statistical areas, as identified by the Office of Management and Budget (OMB 2003). RUCAs are a sub-county classification system that utilizes standard Census Bureau Urbanized Area and Urban Cluster definitions, in combination with work-commuting information, to determine rural and urban status and relationships. RUCAs are used as the basis for eligibility for several Federal programs.

Unless otherwise noted, in this report rural residence of taxpayers is based on zip code approximations of the 2006 RUCAs. Corresponding data are from special tabulations of the 2008 Internal Revenue Service Individual Tax Model File and the Brookings Institution Earned Income Tax Credit Series (1997-2007). The term “taxpayer” is comparable to the Census Bureau definition of a household. It may include a single person as well as a single person or married couple with children.

Increased Use of Tax Code for Social Policy Goals

The Federal tax system has always served purposes beyond the collection of revenue to fund Government programs. However, the system has increasingly been used as a means of promoting or achieving various Government social policy objectives (Berube, 2005). Through various deductions, exclusions, and credits, the tax system is used to encourage home ownership, employment, education, and savings, as well as to provide support for families with children.

Income tax provisions that reduce tax liabilities for targeted activities are often referred to as tax expenditures. Tax expenditures are tax revenue losses attributable to provisions of Federal tax law that allow an exclusion, exemption, or deduction from gross income or which provide a credit, preferential tax rate, or a deferral of tax liability. These expenditures can be considered comparable to direct spending programs, as the two are often used as alternative means of accomplishing social or other policy objectives.

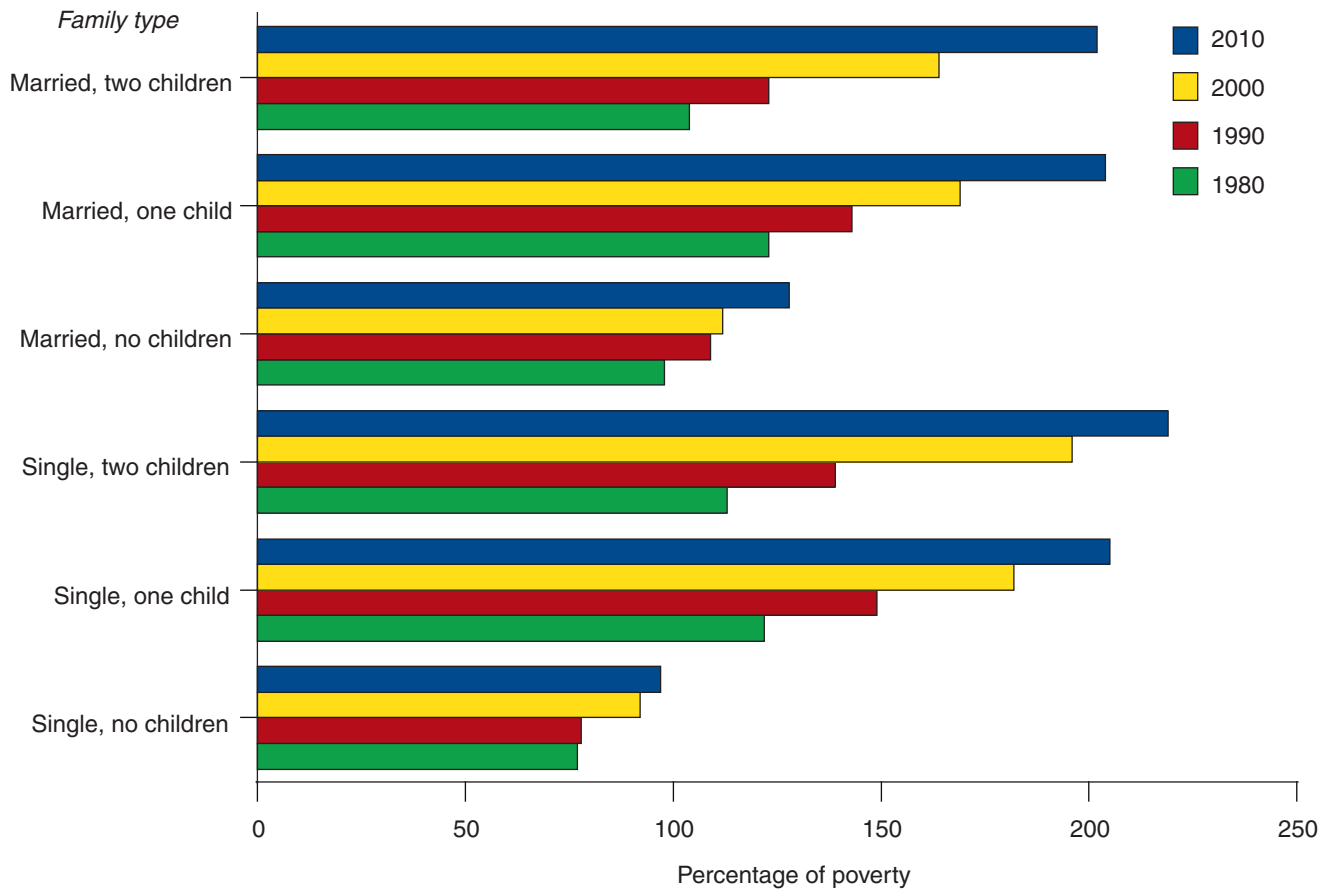
Since 1980, the total cost of tax expenditures has increased by over 250 percent and currently exceeds \$1.1 trillion (The White House, 2010). A primary reason for this growth is that there is greater bipartisan support to enact tax expenditures than to fund or increase direct spending programs, especially since tax expenditures are often viewed as tax cuts. These expenditures have significantly reduced the share of taxpayers who owe Federal income tax.

For taxpayers with children, the income tax threshold (with the EITC and CTC) increased from at or below the poverty level in 1985 to more than twice the poverty level by 2005 (fig. 1). (The threshold increase for single taxpayers and married taxpayers without children has not been as dramatic.) As a result, in 2009, only about half of rural taxpayers owed any Federal income tax. This is slightly below the overall rate of 53 percent of all taxpayers and reflects the lower income levels of rural taxpayers.

Taxpayers with no Federal income tax liability cannot benefit from a deduction or nonrefundable credit. This has led to the increased use of refundable tax credits, primarily the EITC and CTC, which often lead to cash payments to taxpayers that owe no Federal income tax. In many instances the amount of the credit also exceeds the amount of the payroll tax. In 2008, 22 percent of rural taxpayers received a cash payment from one or more of the refundable tax credits. The average amount was \$2,428. Thus, an effect of the increased use of the tax code for social policy goals has been an increase in the number of rural taxpayers who owe no Federal income tax and who receive a cash payment as a result of the refundable tax credits.

Figure 1

Income tax entry threshold with Earned Income Tax Credit and Child Tax Credit¹ as a percentage of poverty level



¹The Child Tax Credit was first effective in 1998, so it is only included in 2000 and 2010.

Source: Economic Research Service using information from the Internal Revenue Service and The Hatcher Group.

Significant Federal Tax Policy Developments

While the tax code has historically been used for more than the collection of revenue, the most significant developments in use of the code for social policy objectives have occurred over the last two decades. These developments include both the enactment of several new tax credits and the expansion of existing tax credits, especially the EITC and CTC. These credits, combined with reductions in marginal tax rates, reduced tax rates on dividends and capital gains, marriage penalty relief, and other tax reduction provisions, have provided a significant increase in after-tax income to both rural and urban households. An overview follows of the most important tax expenditures for low- and moderate-income households.

Earned Income Tax Credit

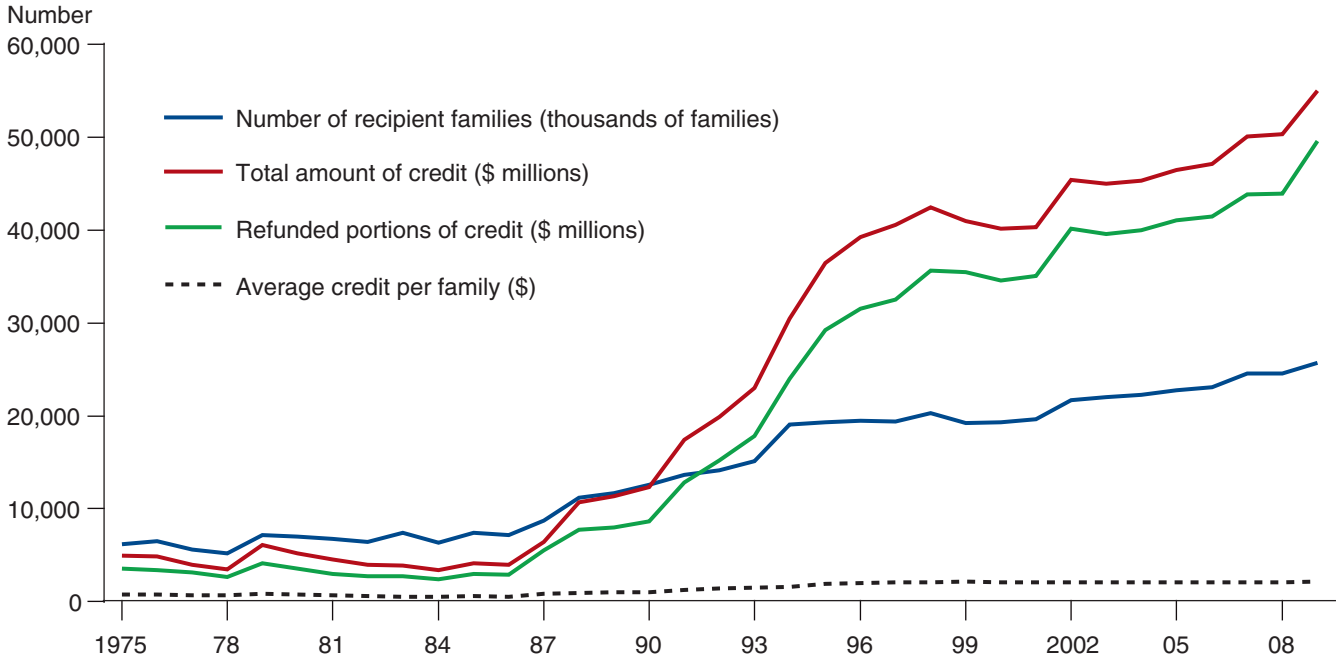
The earned income tax credit (EITC) was enacted in 1975 to reduce the burden of Social Security taxes on low-income workers and to encourage them to seek employment rather than welfare benefits. The original credit was equal to 10 percent of the first \$4,000 of earnings and thus could not exceed \$400 per year. The Omnibus Budget Reconciliation Act of 1990 expanded the basic credit and provided a larger credit for families with two or more children. The Omnibus Budget Reconciliation Act of 1993 expanded the credit again and added a small credit for childless workers. As a result of the 1990 and 1993 program expansions, the EITC is now one of the largest Federal income-support programs targeted to low-income individuals (Scholz et al., 2009). For 2008, a maximum credit of \$4,826 was available to married couples with two or more children. A married couple with one child was eligible for a maximum credit of \$2,917, and a childless couple was eligible for a maximum of \$438. In 2008, the credit provided an estimated \$51.5 billion to nearly 25 million low-income workers and their families, for an average of \$2,063 per recipient (fig. 2). Rural residents are major beneficiaries of the expanded credit. While they represent about 18 percent of all taxpayers, they receive about 22 percent of all benefits (fig. 3).

Child Tax Credit

The child tax credit (CTC) is a refundable tax credit for families with children under the age of 17. It was originally enacted as part of the Taxpayer Relief Act of 1997, in response to concerns that the tax code did not fully reflect the ability to pay taxes as family size increased. The credit was originally \$500 and refundable only for families with three or more children. The credit was phased out for single taxpayers with incomes in excess of \$75,000 and for married couples with incomes in excess of \$110,000. The Economic Growth and Tax Relief Act of 2001 increased the credit to \$600. The Jobs Growth and Tax Relief Reconciliation Act of 2003 increased the credit to \$1,000 and expanded refundability to families with fewer than three children. In 2008, the CTC provided a total benefit of \$51 billion, with \$20.4 billion of that amount refunded to taxpayers.

Figure 2

Number of Earned Income Tax Credit recipient families, total amount of credit, and refunded portions of total, 1975-2009¹

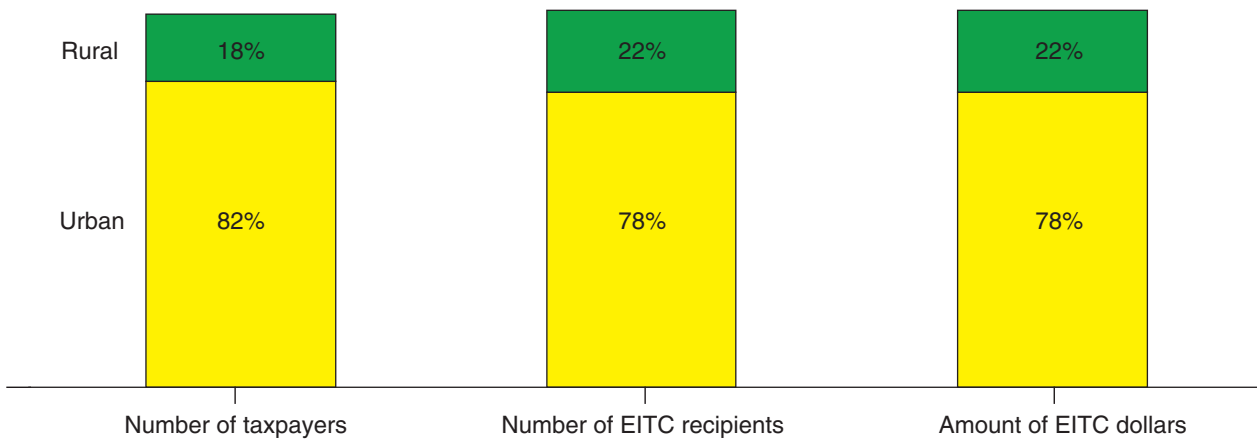


¹Dollar amounts are in constant 2009 dollars.

Source: Economic Research Service using data from the internal Revenue Service.

Figure 3

Distribution of Earned Income Tax Credit (EITC) for rural and urban households, 2008



Source: Economic Research Service using data from the Internal Revenue Service.

Child and Dependent Care Credit

This tax credit, a version of the child care credit, has existed since 1976. The amount of the credit depends upon the income of the taxpayer and the amount of child care expenses. The 2001 Act increased the percentage of eligible expenses allowed and expanded the expenses covered by the credit for 2003 and later tax years. In general, the current credit ranges from 20 to 35 percent, for up to \$3,000 of expenses per child or \$6,000 total for two or more children. Since the credit is not refundable, moderate-income taxpayers receive more benefits than lower income taxpayers. In 2008, the child and dependent care credit totaled \$3.5 billion.

Education Credits

For 2008, the Federal tax code provided two related credits for post-secondary education costs: the Hope Credit and the Lifetime Learning Credit were introduced in 1997 to assist taxpayers with education costs for themselves and their children. The Hope Credit provides up to \$1,500 for tuition and fees for the first 2 years of post-secondary education expenses for students who are pursuing a degree at least half-time. The Lifetime Learning Credit is more flexible and provides a 20-percent tax credit for up to \$10,000 of costs for students enrolled less than half-time and extends beyond the first 2 years of post-secondary education. Neither of the credits is refundable. The two education credits provided \$7.6 billion to 7.7 million taxpayers in 2008.

Saver's Credit

The Saver's Credit was enacted as part of the Economic Growth and Tax Relief Reconciliation Act of 2001. The credit provides a Government match for low- and moderate-income taxpayer contributions to individual retirement or employer-sponsored 401(k) plans. The credit is equal to 10, 20, or 50 percent of the contribution, depending on the level of income. The credit is not refundable and is phased out for single taxpayers with an income above \$27,750 and married taxpayers filing a joint return with an income above \$55,550. (The effectiveness of the credit in increasing retirement savings is reduced due to its nonrefundability and to the relatively low matching percentage for moderate-income households.) In 2008, only single taxpayers with incomes below \$16,500 or married couples with incomes below \$33,000 were eligible for the 50-percent match. For the remaining taxpayers, the match was 10 or 20 percent. Thus, both the number of taxpayers claiming the credit and the benefit amounts have been relatively small. For 2008, just under 6 million taxpayers received the credit, receiving a total of \$977 million.

Rural America Receives a Relatively Larger Share of Benefits

Rural households have historically had lower incomes and a higher poverty rate than urban households. In 2008, rural taxpayers reported an average adjusted gross income (AGI) of \$43,616, compared with \$60,841 for urban taxpayers. A larger share of rural taxpayers had an AGI below \$50,000. While there is little difference between the share of urban and rural taxpayers with incomes between \$50,000 and \$100,000, the share of urban taxpayers with incomes in excess of \$100,000 is more than double that for rural taxpayers. This distribution of income is a primary reason that a larger share of rural taxpayers benefit from the EITC and the CTC. The poverty rate has also been significantly higher in rural areas.¹ In 2008, 15.1 percent of the rural population lived in poverty compared with 12.9 percent of the urban population. One reason for the higher rural poverty rate is the preponderance of low-wage jobs in rural areas. Given the income differential and the prevalence of low-wage jobs, it is not surprising that rural taxpayers receive relatively greater benefits from programs targeted at low-income workers, especially from the EITC.

In 2008, 21.6 percent of rural taxpayers received EITC benefits compared with 16.9 percent of urban taxpayers. However, urban taxpayers receive slightly higher benefits—\$2,065 on average compared with \$2,061 for rural taxpayers. This reflects the fact that the EITC payment increases as the amount of earned income increases before being phased out at higher income levels. Thus, a married couple with two or more children and \$25,000 in income would receive a larger benefit than a similar couple with an income of \$10,000. With lower average incomes, rural taxpayers receive slightly lower average EITC payments than urban taxpayers. The share of rural taxpayers who receive the refundable portion of the CTC is also slightly higher, at 13.9 percent compared with 12.6 percent for urban taxpayers.

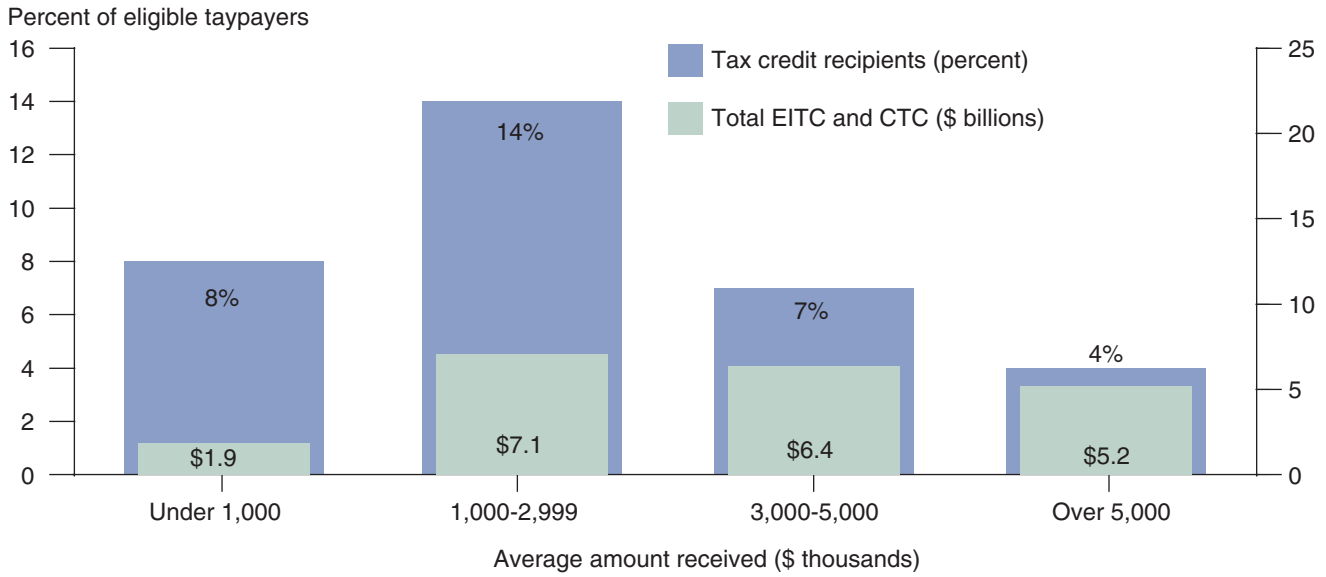
The earned income and child tax credits provided a total benefit of \$20.6 billion to rural taxpayers in 2008. Overall, one of every three rural taxpayers received benefits from either the EITC or the CTC. While most rural taxpayers received less than \$3,000, 7 percent received between \$3,000 and \$5,000, and 4 percent—or about 1 million rural taxpayers—received more than \$5,000 (fig. 4). Households receiving more than \$5,000 received an estimated total of \$5.2 billion in either reduced taxes or cash payments.

Of the \$20.6 billion in EITC and CTC benefits going to rural taxpayers, \$13.7 billion, or about two-thirds of this amount, was refundable. The refundable portion significantly increases the incomes of lower income rural taxpayers. For rural taxpayers with an AGI under \$10,000, refundable credits were nearly a third of the AGI (table 1). The average credit was \$1,276. For those with incomes between \$10,000 and \$20,000, EITC/CTC refundable credits were nearly a fourth of the AGI, or \$3,474 on average. Overall, these credits provided a 13-percent increase in income to taxpayers receiving one or both of the credits. Also, since tax refunds generally do not constitute income in determining eligibility or benefits under other federally funded income support programs, benefits under traditional support programs are not reduced by refundable credits.

¹The official poverty measure from the U.S. Census Bureau assumes that the cost of living is the same throughout the United States. The Federal Government is examining experimental poverty measures, however, that adjust poverty rates according to geographic cost-of-living differences (Jolliffe, 2006).

Figure 4

Share of rural taxpayers and total amount of EITC and CTC received, by average amount, 2008



EITC = Earned Income Tax Credit; CTC = Child Tax Credit.

Source: Economic Research Service using data from the Internal Revenue Service.

Table 1

Refundable credits and adjusted gross income for rural taxpayers by level of adjusted gross income, 2008

Adjusted gross income	Refundable earned income and child tax credits \$ Millions	Adjusted gross income \$ Millions	Credits as share of adjusted gross income Percent
Under \$10,000	2,026	6,442	31
\$10,001 to \$20,000	6,025	25,620	24
\$20,001 to \$25,000	2,383	16,148	15
\$25,001 to \$50,000	2,968	45,730	6
\$50,001 to \$100,000	273	12,472	2
Over \$100,000	2	220	1
All	13,680	106,633	13

Source: Economic Research Service, based on special tabulations from 2008 Internal Revenue Service (IRS) tax data.

Compared with the EITC and the CTC, the child care, education, and saver’s credits benefit a relatively small share of rural taxpayers with relatively small amounts. These credits combined provided less than \$1.8 billion to rural taxpayers in 2008. A larger share of urban taxpayers received the education and child care credits, while a larger share of rural taxpayers received the saver’s credit. Only about 4.4 percent of rural taxpayers received the education credit in 2008, for an average benefit of \$981. An even smaller share of rural taxpayers claimed the child care credit, with 3.6 percent of rural taxpayers receiving an average credit of \$487. A slightly higher share of rural taxpayers claimed the saver’s credit—5.6 percent compared with 3.9 percent for urban taxpayers. However, the average credit amount for rural taxpayers was only \$171.

Tax Credit Programs Have Grown in Importance Relative to Traditional Income Support Programs

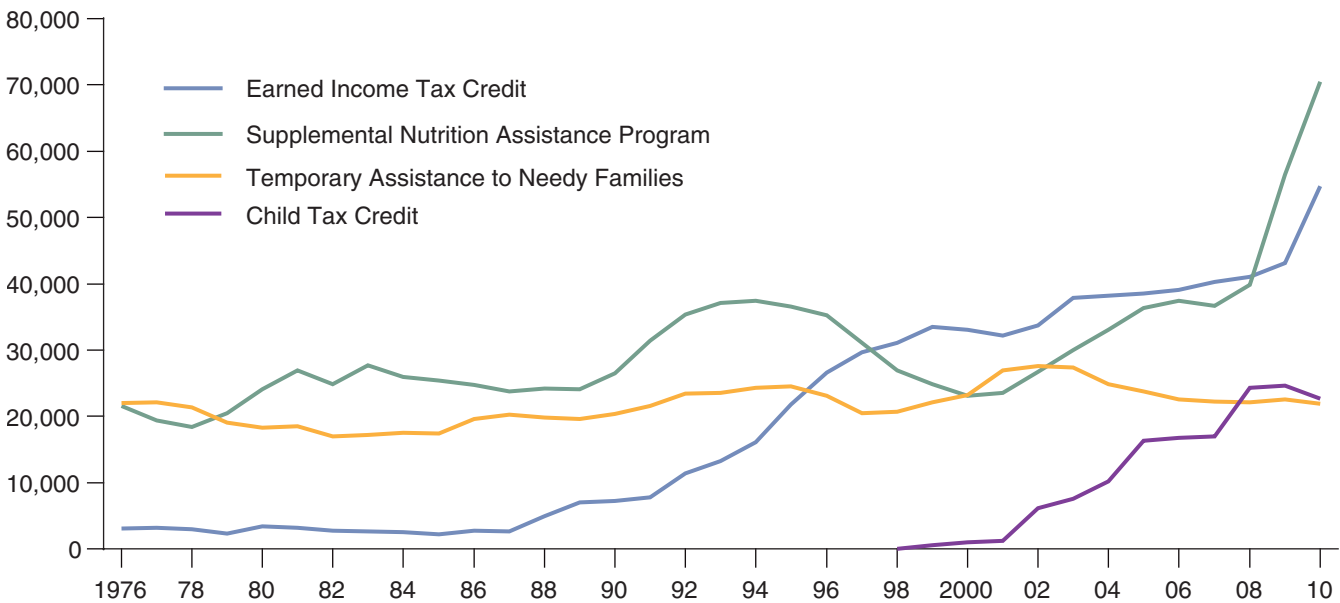
The three largest Federal income support programs for low-income households are the EITC, Supplemental Nutrition Assistance Program (SNAP—formerly food stamps), and Temporary Assistance to Needy Families (TANF—formerly Aid to Families with Dependent Children). Prior to 1990, the Federal outlay for the EITC was substantially below that for SNAP and TANF (fig. 5). Expansions to the EITC that occurred in 1990 and that have since continued have resulted in tax code program expenditures now rivaling those of the more traditional welfare expenditure programs. For example, based on the 2012 Federal Budget, the actual EITC outlay for 2008 was slightly larger (by 3.3 percent) than SNAP and significantly larger (by 86.1 percent) than TANF.

However, the Federal budget estimates for 2009 and 2010 show a significant increase in SNAP for low-income households not matched by outlays for the EITC. Outlays for programs such as SNAP and unemployment insurance automatically increase during economic downturns to meet rising needs. Spending levels for those programs have also increased more than in the past due to the policies enacted to combat recessionary impacts. For instance, SNAP, unemployment insurance, and expanded health insurance benefits are the primary income support programs that have impacted the budget through the American Recovery and Reinvestment Act of 2009 (ARRA). While estimated costs of the ARRA expansions of those income support programs are less than the tax-based program expansions, they provide a larger share of total benefits to lower income households (Mattingly, 2009a and b).

Figure 5

Annual Federal outlays for Earned Income Tax Credit, Child Tax Credit, Supplemental Nutrition Assistance Program, and Temporary Assistance to Needy Families

Constant 2010 dollars (millions)



Source: Economic Research Service using data from FY 2012 U.S. Government Budget (U.S.G.P.O.).

Aside from annual outlays, there are several features that distinguish the EITC and other tax credits like the CTC from SNAP and TANF. One is the fact that only taxpayers who work are eligible for EITC and the refundable portion of the CTC. Another is that—unlike in-kind (SNAP) and other cash (TANF) benefits—refundable tax credits are entirely administered through the tax system. This has important implications for participation and compliance rates, administrative costs, and the ways in which recipients perceive tax credit incentives.

Tax Credit “Participation” Exceeds That of Traditional Income Support Programs

Compared with seeking benefits from other programs designed to provide income support to low-income households, claiming the EITC is relatively easy. Since most eligible households are already required to file an income tax return, all that is necessary is to complete a couple of extra forms and file them with the return. It is not necessary to fill out a separate application or visit an office to establish eligibility for benefits.

As a result, the EITC provision has been especially successful in reaching low-income families with children. Throughout the 1990s, participation by this group ranged from 80 to 86 percent and was 85 percent for families with two or more children in 2005 (Burman and Kobes, 2005). In that year, the overall participation rate was 75 percent. The participation rate was significantly lower for individuals and families without children, reaching only about 55 percent in 2005. One reason for this lower participation rate is the relatively small size of the credit compared with the amount available to families with children.

While a larger share of rural taxpayers claim the EITC than urban taxpayers, there is some evidence that a significant number of eligible taxpayers in rural American are not filing for the credit due to limited availability of information and resources such as free tax preparation sites, which are more prevalent in urban areas. Outreach efforts in several urban areas have increased awareness of the credit and led to increased participation. The Internal Revenue Service has targeted workers in rural areas for outreach efforts to educate eligible taxpayers about the EITC and to encourage them to file for the credit. Those efforts include increasing the availability of volunteer tax preparation services so that taxpayers who need help filing their returns can take advantage of the expansion in EITC and other tax credits. As a result, users of volunteer tax preparation services went from about 1 out of every 75 rural filers receiving the EITC in 2000 to 1 out of every 8 rural filers receiving the EITC in 2007. Studies indicate that users of volunteer services tend to include public assistance recipients, young adults, the elderly, those with low levels of educational attainment, those who lack homeownership, racial/ethnic minorities, and single females with children (Liebman, 1998).

Tax Credits Face Targeting and Delivery Challenges

While participation rates for tax credit programs may be higher than for traditional income support programs, implementing social policy through the tax code is not without its disadvantages. The EITC has experienced a relatively high error rate in that a large number of EITC recipients received more than they should have or were not eligible for the credit because they did not meet all of the eligibility criteria. The erroneous payment rate is estimated at between 23 and 28 percent (IRS, 2008). Overpayments can be attributed both to unintentional error and to fraud. The Internal Revenue Service has initiated efforts to address this problem through increased customer service, education and outreach, and enhanced enforcement activities. The effort has increased the administrative costs of the program, although they still remain relatively low compared with traditional income support programs.

Another difficulty with tax credits is the timing of payments. Many income support programs provide a benefit at regular intervals on a weekly or monthly basis. Most individuals receive EITC and refundable child tax credit payments as a lump sum when they file their tax return. Research has shown that these lump sum payments are primarily used to repay loans or bills and to improve access to transportation. The once-a-year funds are not available to pay daily living expenses.

A further disadvantage arises because the EITC and refundable portion of the CTC increase as earnings increase before being phased out at higher income levels. With regard to the EITC, this partly reflects the original purpose of the credit—to offset the payroll tax and to encourage work. While this provides increased benefits to those in poverty, it means that households with incomes of less than half the poverty level receive lower benefits than those at or slightly above the poverty level. In 2008, those with incomes below \$10,000 received refundable credits of \$1,276 on average, while those with incomes between \$10,000 and \$20,000 received \$3,475. Thus, for those earning at or below the income level at which benefits are phased out, a decline in earnings as a result of a job loss or reduced hours could result in a drop in an eligible household's credit payment just as the household's need increases. This is exactly the opposite path of traditional income support programs, which tend to increase support with increased need.

Finally, each of these credits has numerous eligibility criteria to target benefits to intended recipients. These criteria add considerable complexity to an already complex tax code, increasing the administrative burden on both the taxpayer and the Internal Revenue Service.

Refundable Tax Credits Have Contributed to Reduced Poverty Rates

Refundable tax credits, especially the EITC, have lifted a significant number of households above the poverty line. As noted, for taxpayers with children, the income tax threshold with the EITC and CTC has increased from at or below the poverty level in 1985 to more than twice the poverty level by 2005. In 2005, the EITC lifted an estimated 5.1 million individuals above the poverty level, including 2.6 million children (Sherman, 2009b). This was more than any other single program, including SNAP and the TANF program.

While the official measure of poverty does not include the EITC as a form of income, the Census Bureau publishes information on poverty under various alternative definitions. Comparing the poverty rate under the definition of income for various support programs and the EITC with the official poverty estimates for 2006 suggests a reduction in the rural poverty rate from 15.1 percent to 11.1 percent (U.S. Census Bureau). The EITC alone was responsible for a reduction of 1.7 percentage points in the rural poverty rate. This suggests that in 2006, the EITC lifted an estimated 800,000 rural residents above the poverty line. Given the expansions in the EITC and refundability of the CTC that have occurred since 2006, as well as increases in the number of States that offer EITC benefits supplemental to the Federal benefit, the current impact on rural poverty is likely to be even greater. (See box, “Federal Policies Have Been Supplemented by State Policies.”)

The impact of the expanded EITC on the rural poor is indicated in part by the geographic distribution and share of tax return filers receiving the credit. The percentage of rural taxpayers who received the EITC in 2007 was greatest in the South (fig. 6), where a large percentage of the Nation’s rural poor has historically resided. The median rate of the EITC receipt for Southern States is 21.2 percent of rural households that filed a tax return. This compares with 13 percent of rural households in Northeastern States and 15 percent in the Midwest and the West. These differences reflect higher average income levels in rural areas outside of the South, particularly in the Northeast.²

Accounting for the effects of EITC and other sources of income-related assistance using an alternative measure of poverty increases mean and median incomes for vulnerable populations, such as single females with children and racial and ethnic minorities, but it still leaves many low-income families below the poverty line. This is a result of the program’s focus on the working population and the fact that an increasing share of the benefit goes to the near-poor, those with an income level just above their poverty income threshold. Those most likely to have been raised out of poverty by tax credits and other income support programs are the poor whose income level is not far below their poverty income threshold. Families in that category who qualify for EITC typically include married couples with children, where the likelihood that the household will contain a full-time worker is greatest. Therefore, reduction of the marriage penalty and increases in credits available to larger families has benefited that group in particular.

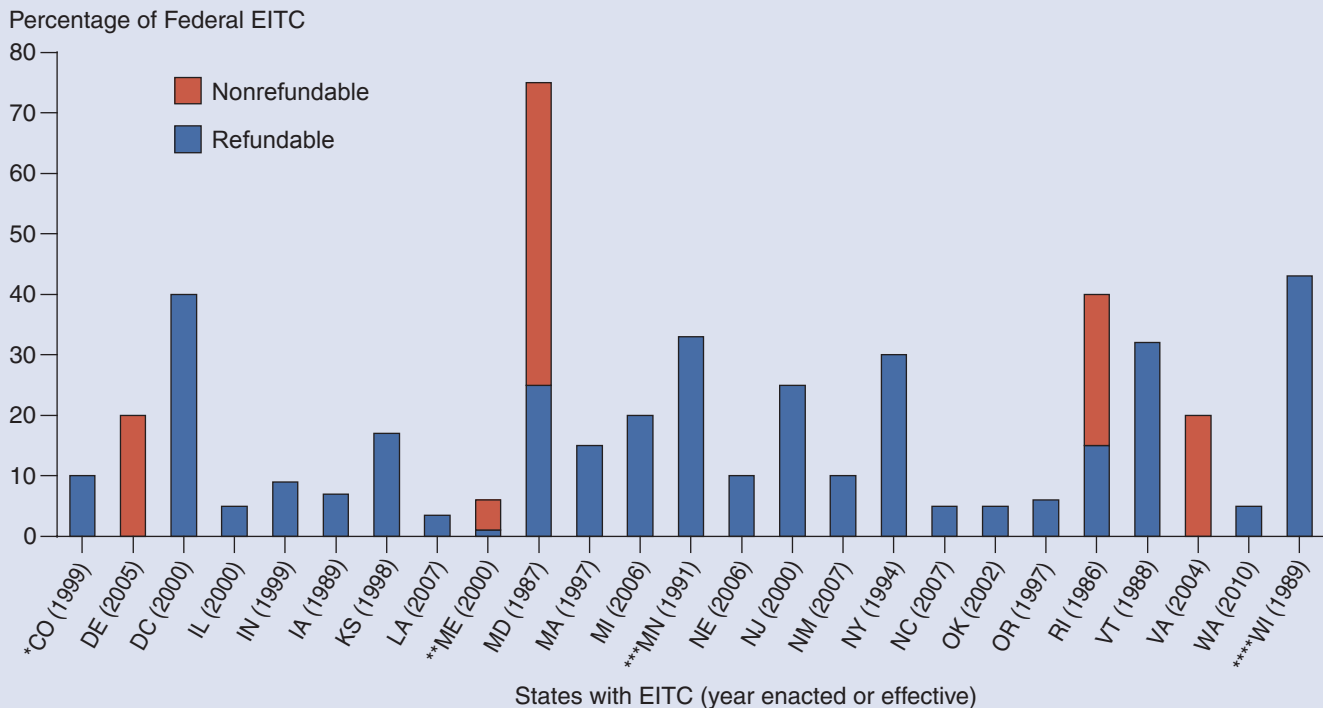
²A smaller share of taxpayers in urban areas received the credit in 2007, which is the normal pattern. The median urban rate of taxpayers who receive the credit is 18.6 percent in Southern States, 11.5 percent in the Northeast, 12.9 percent in the Midwest, and 13.1 percent in the West.

Federal Policies Have Been Supplemented by State Policies

State earned income tax credits supplement the Federal credit and can contribute to efforts to reduce child poverty, increase effective wages, and cut taxes for low- and moderate-income working families. Since 1986, 24 States and the District of Columbia have enacted an EITC. Nearly one-third were enacted between 2005 and 2010, including the one in the State of Washington, the first among nine States without a broad-based income tax to enact a State EITC.

These credits are generally based on the Federal EITC. Most of the States use Federal eligibility rules and express the State credit as a specified percentage of the Federal credit, which in 2010 ranged from 3.5 percent in Louisiana to 75 percent in Maryland. As with the Federal EITC, refundability is an important feature of most State EITCs. All but two States with an EITC have made the credit at least partially refundable.

States with Earned Income Tax Credit (EITC), year enacted or effective, percentage of Federal credit, and refundability



* Suspended since 2001 and will not be reinstated until at least 2013.

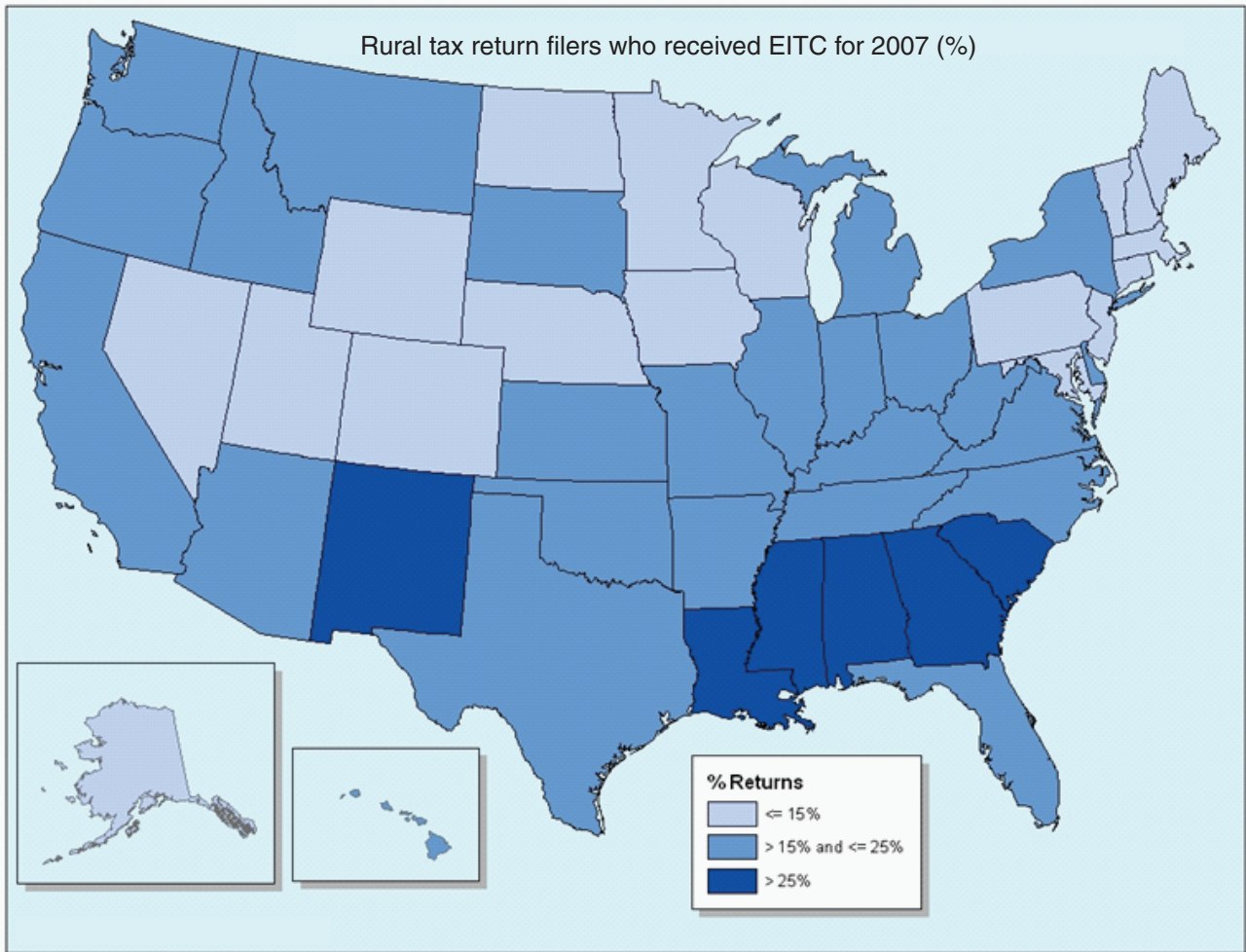
** Refundable portion is maximum \$150 for joint filers / maximum \$125 for single filers.

*** Average-percentage varies by income.

****Maximum-percentage varies by number of children.

Source: Economic Research Service using information from the Internal Revenue Service and The Hatcher Group.

Figure 6
Earned Income Tax Credit (EITC) receipts, percent of filers



Source: Economic Research Service using data from Brookings Institution EITC series.

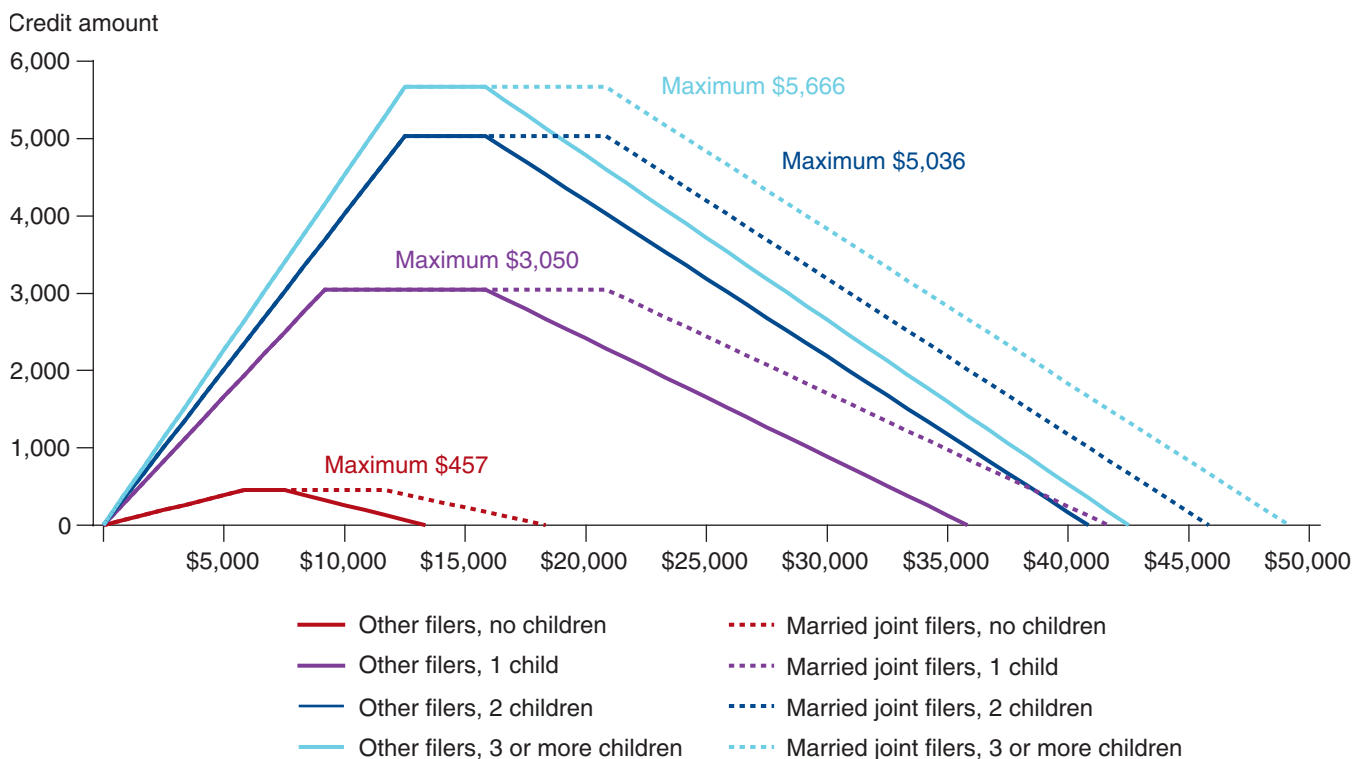
Recent Policy Changes Provide Expanded Benefits

The American Recovery and Reinvestment Act of 2009 (ARRA) made a number of changes to temporarily provide an income boost to low-income taxpayers. These changes included expanded benefits for both the EITC and CTC. The act also added a new refundable tax credit, the Making Work Pay Credit, aimed at low- and middle-income workers.

The ARRA made two important changes to the EITC for 2009 and 2010. First, it increased the amount of the credit for families with three or more children. For 2009 and 2010, they were eligible for an additional \$629, increasing the maximum credit for such families to \$5,666 (fig. 7). The act also reduced the marriage penalty by increasing the income range over which the EITC is phased out for married taxpayers by \$5,000. These changes are estimated to boost the EITC for rural taxpayers by more than 10 percent, with much of the additional benefit going to married taxpayers with three or more children.

The ARRA also increased the refundable portion of the CTC. Since the refundable portion of the credit is limited to 15 percent of income over a threshold amount, families with low incomes may not be eligible for the refundable CTC or may receive a reduced amount. The act lowered the income threshold from \$8,500 in 2008 to \$3,000 for 2009 and 2010. For a family with two children and an income of \$10,000, this could increase the refundable credit from \$225 to \$1,050. This change is estimated to increase the refundable portion of the CTC to rural taxpayers by about one-third.

Figure 7
Value of the Earned Income Tax Credit by income, 2010



Source: Economic Research Service using data from the Internal Revenue Service.

The ARRA also provided a new refundable credit for 2009 and 2010. The Making Work Pay Credit provided a refundable credit of 6.2 percent of earnings (the employee share of the old-age portion of the Social Security payroll tax), up to \$400 for an individual and \$800 for a married couple. The credit was phased out at a rate of 2 percent of income over \$75,000 for an individual and \$150,000 for married couples filing a joint return. About four out of five returns filed by rural taxpayers received the credit. The estimated benefit to rural taxpayers in 2010 was \$10.75 billion, with an average benefit of \$535.

When combined, these credits are expected to soften the impact of the recession by providing additional income support and keeping a significant number of taxpayers from falling below the poverty line. It has been estimated that the expansions of the EITC, CTC, and the new Making Work Pay Credit will prevent 1 million children from falling below the poverty line (Sherman, 2009a). For rural taxpayers, these credits are estimated at nearly \$36 billion, with about two-thirds of this amount received as cash payments through the refundable portion of the tax credits.

The Tax Relief, Unemployment Reauthorization and Job Creation Act of 2010 extended the EITC and CTC provisions through 2012. While the Making Work Pay Credit expired, a reduction in the Social Security tax rate on employees from 6.2 to 4.2 percent was provided for 2011. A comparable reduction of 2 percentage points was also provided for the self-employment tax rate. While this reduction will provide greater tax relief to rural taxpayers overall, low-income individuals with earned income below \$20,000 will receive less in tax relief and refund payments than with the Making Work Pay Credit.

Conclusion

The Federal Tax Code has become an increasingly important vehicle for promoting social policy objectives. Not only do these policies reduce Federal income tax burdens and the share of taxpayers who owe taxes, but they also provide income support to low- and middle-income families through refundable tax credits. This is especially true for rural taxpayers, whose income tends to be lower than that of urban taxpayers. As a result, rural taxpayers receive a disproportionately large share of the benefits, especially from the EITC and the CTC.

Many of these policies were enacted or expanded as part of the Economic Growth and Tax Relief Reconciliation Act of 2001, the Economic Growth and Tax Relief Reconciliation Act of 2003, and the American Recovery and Reinvestment Act of 2009 and were scheduled to expire at the end of 2010. The Tax Relief, Unemployment Reauthorization and Job Creation Act of 2010 extended the expansions to the EITC and CTC, as well as other expiring provisions, through the end of 2012. As the increasing Federal budget deficit puts additional pressure on policy officials to rein in direct spending and tax expenditures, and as the push for comprehensive tax reform grows, the effectiveness of these provisions in achieving their policy objectives is certain to be reevaluated. The resulting decisions to modify or extend these expenditures will be of considerable importance to rural America.

Glossary

Rural—Our classification of counties as “rural” for purposes of this analysis includes counties designated as nonmetropolitan (nonmetro) by the Office of Management and Budget in 2006. Nonmetro counties are defined as those counties lying outside urban cores of 50,000 people or more and their immediately adjacent commuting zones. For more detail on how nonmetro areas are defined, and how they differ from the U.S. Census Bureau’s definition of rural, see the ERS briefing room, “Measuring Rurality: What is Rural?” <http://www.ers.usda.gov/Briefing/Rurality/WhatIsRural/>.

Poverty rate—The percentage of households with a federally specified annual income less than the amount deemed sufficient to purchase basic needs of food, shelter, and clothing and other essential goods and services for its members is classified as “poor.” The poverty threshold is set by the Office of Management and Budget and varies by household size, constituency and, over time, with the cost-of-living index. In the 2000 Census of Population, information on income was collected for 1999. The threshold for a family of four, including two children, was \$16,985. For further information on the definition of poverty see: <http://www.census.gov/hhes/www/poverty/povdef.html>.

Refundable tax credit—A refundable tax credit is a credit that is payable in full even if it exceeds the taxpayer’s Federal income tax liability. Most tax credits are not refundable and can only be used to offset the taxpayer’s tax liability.

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