THE EARNED INCOME TAX CREDIT AND SOME FUNDAMENTAL INSTITUTIONAL DILEMMAS OF TAX-TRANSFER INTEGRATION

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The earned income tax credit (EITC) has enjoyed remarkable political success in the 1990s. Legislation in 1990 and 1993 transformed the EITC from a relatively obscure program into one of the federal government's largest cash transfer programs.[1] The expansion of the EITC, which provides an earnings subsidy to low-income workers, marks an important liberalization of United States social welfare policy and a new recognition of the needs of the working poor.

The EITC is also a notable conceptual achievement. For several decades, economists and others have recommended using the institutions of the federal income tax system to deliver income-tested transfer payments. Many view the EITC as the politically successful descendant of the negative income tax plans of 25 years ago.[2] The EITC's basic design differs in important ways from that of the negative income tax (most importantly, the EITC is an earnings subsidy rather than a guaranteed minimum income), but EITC advocates echo proponents of the negative income tax in arguing that tax-based administration is simpler, cheaper, and less stigmatizing than traditional welfare administration.[3]

In this paper, I argue that the EITC illustrates how the traditional case for tax-transfer integration has overlooked important institutional limitations. While tax-based administration may deliver the benefits that advocates claim, the EITC and other tax-based transfer programs also face structural constraints that limit accuracy, responsiveness, and compliance.[4] More data are needed to assess the magnitude of these limitations, both in absolute terms and relative to alternative institutions. Nevertheless, these features are qualitatively important and may

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raise questions of political acceptability regardless of their size. In addition, the structural nature of these restrictions may limit the potential success of popular incremental reforms of the EITC.

These institutional limitations do not compel firm conclusions about the ultimate desirability of the EITC, but they do establish that tax-based programs are not the easy choice their advocates have often assumed. Further, a recognition of these constraints suggests that policymakers should take steps to assess the importance of these institutional limitations in deciding whether (and how) to expand or reform the EITC, to create new tax-based transfers, or to turn instead to alternative institutions.[5] The last section of this paper suggests directions for further research along these lines.

THE CASE FOR TAX-TRANSFER INTEGRATION

Income taxes and income transfers can be viewed as different components of a unified tax-transfer system, which provides benefits ("negative" taxes) to poorer families and collects taxes from richer families. This important conceptual point has led prominent economists and other social scientists to advocate actual, administrative "integration" of the tax and transfer systems. They argue that there is, in principle, no reason to have separate welfare and income tax systems: why should families with low incomes face one set of rules and procedures (the welfare system), while higher-income families face another (the tax system)? In both cases, they argue, the goal is to measure income for purposes of determining benefits or taxes, and it seems fairer and simpler to apply one set of rules to all families at all income levels.

Further, these advocates say, tax-based administration would be a considerable practical improvement over traditional welfare administration. Welfare administration is labor intensive (and therefore expensive) and tends to stigmatize recipients. Further, welfare programs like AFDC and state-level "general assistance" use benefit schedules and eligibility rules that vary significantly from state to state. In contrast, advocates say, administering income transfers through the federal income tax system could accomplish several reforms at once, by lowering administrative costs, reducing stigma, and using federally standardized, objective rules and procedures. The EITC, which is administered through the federal income tax system, illustrates these claimed advantages. The EITC maintains recipients' privacy, because recipients can claim benefits through the mail by filing a tax return. Privacy, in turn, minimizes the stigma of receiving government benefits. In addition, the EITC is awarded based on objective rules that use the relatively streamlined and inexpensive administrative procedures of the federal income tax system.

This is an appealing picture of the benefits of tax-transfer integration, which seems to promise improvements for both the government and transfer recipients. The problem is that this picture is incomplete. While tax-transfer integration may confer these benefits, it also creates a set of unavoidable institutional tradeoffs between the goal of tax-transfer integration and important goals of transfer policy: accurate measurement of need, responsiveness to changing needs, and compliance with the terms of assistance.

THE INHERENT LIMITATIONS OF TAX-TRANSFER INTEGRATION

In a larger paper, I describe in detail how the EITC illustrates four tradeoffs between the goals of tax-transfer integration and other important goals of

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transfer policy.[6] Very briefly, the four dilemmas are the following.

Accurate measurement of income versus tax-transfer integration. The federal income tax system has adopted a relatively narrow definition of income. Numerous exclusions and other tax preferences create an income base that understates economic income, with the consequence that taxpayers may appear poorer than they really are. Thus, some people may (quite legally) receive EITC benefits to which they would not be entitled if income were measured more accurately.[7] In contrast, welfare programs tend to adopt relatively comprehensive definitions that attempt to capture most sources of income available for support. Welfare programs also typically attempt to measure (at least some kinds of) wealth as well as income in order to refine the assessment of a family's financial status.[8] While the tax system might adopt a more comprehensive definition of income, the Tax Reform Act of 1986 suggests that there are limits on the politically feasible expansion of the federal income tax base. Administering a comprehensive and accurate wealth test through the federal income tax system would be extremely costly and therefore probably impossible in practical terms.[9]

Accurate measurement of the family unit versus tax-transfer integration. The most accurate unit for measuring income is the "family," defined as the unit of persons (related or unrelated) who share expenses and pool their income. We would not, for example, generally be willing to evaluate whether a person is "poor" or "rich" on the basis of her income alone. We need to know something about the income and resources of her partner or other household members, and we need to know what her responsibilities are for the support of others in (or outside) the household. This approach underlies the relatively detailed and rather situation-specific household rules in welfare programs. The federal income tax system uses a rather narrow definition of family, which encompasses only the married couple and their "dependents," a relatively formal and restrictive grouping. The rules do not capture the growing variety of living and family arrangements in our society in which people share income and expenses outside a marital or a "dependency" relationship.[10] Thus, the EITC may fail to measure income accurately because it uses the wrong family unit. Improvements in the EITC's family definition enacted in 1990 may have improved accuracy, although at the cost of compromising tax-transfer integration, as described below.[11]

Responsiveness to recipients' changing circumstances versus tax-transfer integration. Ideally, a transfer program would adjust benefits as the need for them changes, but the tax system's annual accounting interval is not particularly responsive to fluctuating incomes. As a consequence, relative to transfer programs with shorter accounting intervals, the EITC may offer too little help to newly needy families and may continue to provide benefits to families whose fortunes have improved. Critics of the EITC have argued that the relative unresponsiveness of the EITC not only delays income support but also may reduce the effectiveness of the EITC's earnings subsidy.[12] Although the EITC's advance payment mechanism nominally allows recipients to receive EITC benefits with each paycheck, a (widely cited but now somewhat dated) GAO study suggests that virtually no EITC recipients have chosen to receive advance payments, in part because they fear they will owe the IRS money at year-end.[13] This fear is, in fact, quite realistic. The problem of overpayments is inherent in the structure of the EITC; it arises because the combination

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of the EITC, an income-tested program, with our payroll withholding system makes it likely that an EITC recipient whose income fluctuates will be overpaid.[14] In such cases, the annual accounting period of the tax system requires "recapture" of excess payments at year-end, a procedure that is costly to the government (given the relatively small sums involved by IRS standards) and traumatic for recipients (given the potentially large sums involved relative to their incomes).[15] While the tax system could in theory account for EITC benefits using, say, the monthly intervals common in traditional transfer programs (without annual recapture), or could adopt a cumulative system of payroll accounting that would automatically prevent overpayments, either choice would require a major (and expensive) shift in tax procedures.

Compliance versus tax-transfer integration. Recent studies of the EITC have suggested that the program has relatively high rates of participation and relatively low rates of compliance. A study by John Karl Scholz found that the EITC's participation rate was about 80 percent in 1990, which is higher than participation rates for traditional transfer programs.[16] IRS data from the mid-1980s suggest that overpayment rates were about 30 percent, although there is reason to believe that legislative changes since then have reduced error rates.[17] While these data do not reveal the underlying causes of these results, the concept of tax-transfer integration may prove useful here as well. The EITC, as a tax-based transfer program, may be inherently likely to encourage participation but permit noncompliance. The relative ease of participation in a tax-based program has traditionally been promoted as one of its good features; once eligible claimants become aware of the program, they can claim benefits using a private, nonstigmatizing procedure that requires (relatively) little effort.[18] These institutional characteristics may also, however, facilitate "participation" by ineligible recipients. For example, as Eugene Steuerle has pointed out, the EITC poses a particularly severe problem because it is vulnerable to taxpayers' *overstatement* of earnings. The IRS, in its traditional role as tax enforcer, is geared to look only for under-reporting, and so is (for the moment) left particularly vulnerable to EITC fraud.[19]

These institutional tradeoffs have several implications. First, we need more data to evaluate the practical importance of these constraints. For example, it may be that the tax system's inaccurate definitions of income and family have little effect on the distribution of EITC benefits. Alternatively, even if the tax rules affect the distribution of EITC benefits in some significant way, we may be unconcerned if technically "excessive" benefits go primarily to people with (accurately measured) incomes within or just above the EITC income range. A distributional table prepared by the Joint Committee on Taxation in 1993 suggests that the income measurement problem, although currently small, is not trivial.[20] Current studies, like the Scholz study of compliance and participation mentioned above, are important and useful, but given the rapid changes in the EITC since 1990, additional work is needed.[21] Unfortunately, some of these institutional problems may worsen as the EITC program expands. For example, it is possible that income measurement may become increasingly inaccurate as the EITC income eligibility cutoff rises to $27,000 by 1996. Families with reported incomes at this level may be more likely than current EITC recipients to have excludable fringe benefits and other types of excludable income (although less likely to have excludable income-tested transfer

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payments). Similarly, the incentive for noncompliance may grow with the size of the EITC benefit.[22]

While empirical work could greatly improve our understanding of the administrative limitations of the EITC and other tax-based transfers, these institutional features may also create strong political reactions that are unresponsive to statistical evidence. For example, it is not too hard to imagine a politician hostile to redistribution attacking the EITC as "welfare for the rich" on the basis of a few "horror stories" involving taxpayers with low earned income and substantial wealth invested in municipal bonds, even if studies show that such cases are rare.

Second, these tradeoffs suggest that incremental reforms of the EITC may have only limited success. For example, a separate definition of income for EITC purposes might improve accurate targeting of benefits,[23] but at the cost of compromising tax-transfer integration.[24] The ongoing controversy over the EITC's separate definition of "qualifying child" provides another example of this tradeoff. To claim higher benefits, an EITC recipient must have a qualifying child, a term that is not equivalent to the usual tax concept of a dependent. While this change in the EITC was made in 1990 in order to create a more realistic family definition and to increase compliance, this rule, together with other features of the EITC, requires claimants to complete a separate schedule to the tax return. Some have criticized the separate EITC rules and schedule as likely to reduce the participation and other benefits of an integrated tax-transfer system.[25] A third illustration is the change in advance payment procedures adopted in the 1993 expansion of the EITC. To reduce the potential for overpayments, the drafters of the 1993 amendments to the EITC decided to limit advance payments to 60 percent of the EITC payable to a family with one child.[26] While probably desirable on balance, this rule illustrates the restricted opportunities for incremental reform: in this case, the avoidance or reduction in recapture for some families comes at the cost of lowered responsiveness for others, who must forgo current payment of a significant portion of their EITC benefit.[27]

More fundamental structural reforms are possible, of course, but they raise again the basic tradeoff between traditional goals of welfare administration and the benefits of tax-transfer integration. Separate rules for the EITC within the tax system tend to compromise integration. Changing the underlying institutions of the tax system for all taxpayers has the potential to remove the conflict between these goals and tax-transfer integration, but at a potentially large cost. Some kinds of restructuring are relatively plausible and inexpensive. There is, for example, a persuasive case for conforming the tax code's dependency definition to the EITC's definition of qualifying child, thus creating greater integration automatically.[28] In other cases, however, the required changes could be more disruptive (*e.g.*, the adoption of a cumulative wage withholding regime for all taxpayers) and are more likely to be constrained by considerations of cost and by politics. Although the EITC is a large transfer program, it is only a tiny part of the federal income tax system, and it is unrealistic to expect that the EITC can (or perhaps should) drive such large-scale reforms. This is not to say that structural reform is impossible or undesirable—only that it, too, is not easy.

Third, these tradeoffs correspond, not coincidentally, to the classic problems of measuring income in any setting. Economists attempting to measure the distributional effects of tax law changes, for example, must balance the availability of

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tax return income data against the theoretically correct income measure and must confront issues of family definition and periodicity.[29] Income transfer programs face analogous tradeoffs, *e.g.*, between accuracy and administrative cost, or between compliance and participation.[30] A *tax-based* transfer program is, however, sharply constrained in its balancing of these tradeoffs. The goals of tax-transfer integration in effect require (or create a strong gravitational pull toward) the institutional compromises already implicit in the tax system, even where alternative choices are more typical for transfer programs.

One might question whether these tradeoffs are important for evaluating the EITC if we view the EITC as an earnings subsidy rather than as a transfer program. For example, perhaps accuracy in awarding benefits is less important if the goal of the EITC is to encourage work rather than to provide benefits to a sharply defined group of very poor recipients, as in the case of welfare. This is a serious question, raising normative issues about the proper gauge of performance of the EITC, but it implies a somewhat oversimplified view of the multiple purposes of the EITC. The EITC is an earnings subsidy, intended to encourage work among the poor, but it is, simultaneously, a redistributive program that provides income support for the already-working poor. The income support function of the EITC became particularly significant in the early 1990s, as legislation expanded the program dramatically.[31] Thus, although the EITC's earnings subsidy is unique, the EITC's redistributive purposes suggest that traditional concerns about accuracy, responsiveness, and compliance may have a place in assessing the benefits and costs of tax-based administration. Further, even if we could agree to evaluate the EITC only as an earnings subsidy, it is not clear that these criteria are much less important. Ideally, the EITC earnings subsidy should be targeted accurately to reach the low-income workers (and potential workers) it is intended to motivate. An earnings subsidy also should be responsive in order to transmit its incentives effectively. Compliance is also crucial, because the earnings subsidy will not produce the intended behavioral effects if it is available, *e.g.*, to nonworkers who falsely claim earnings.

This question does, however, underscore the importance of evaluating the EITC not in isolation but in relation to other institutions. As long as the EITC is part of a larger social welfare system that provides other means of ensuring responsive assistance targeted closely to poor families, then the accuracy and responsiveness of the EITC may well be of less concern than otherwise, at least on distributional grounds (the transmission of incentives may still be problematic). The corollary, however, is that as the EITC expands to assume a larger redistributive role—as it may, depending on the outcome of the current welfare reform debates—these concerns may be more important than they are now.[32]

DIRECTIONS FOR FURTHER RESEARCH

An understanding of these tradeoffs does not require that we reject the EITC or tax-based administration. The institutional limitations of the EITC should be evaluated in the short run in comparison with existing alternative institutions and in the longer run with reformed or newly created institutions.[33] This section sketches briefly several possible directions for future research aimed at evaluating the role of the EITC and alternative institutions in United States social welfare policy.

Can we develop data that allow us to assess the importance of institutional di-

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lemmas in tax-based programs and to compare them to alternative institutions? As the preceding section discusses, it would be extremely useful to have empirical evidence about the practical importance of these institutional constraints. Ideally, these data would describe the magnitude of these limitations both in absolute terms and relative to existing welfare programs or other alternative policies. They might, in addition, provide some aggregate measures for comparing programs: for example, how inaccurate is the EITC compared to nontax programs if errors due to income definition, family definition, and compliance are all taken into account? In a perfect world, these data also would tell us how sensitive these institutional features are to changes in the size and design of the program. This is, of course, a lawyer's wish list and not a practical plan of action; I (must) leave it to the economists to decide whether it is feasible to conduct studies of this kind.

Should we rethink traditional norms of welfare administration in order to accommodate tax-based transfers? In theory, transfer programs should maximize accuracy, responsiveness, and compliance, and traditional transfers are designed in ways that reflect those expectations. Existing norms are not and should not be set in stone, however. The EITC and other tax-based transfers offer important potential benefits in reducing stigma, enhancing privacy, and limiting administrative discretion, and we might conclude that those benefits make it worthwhile to moderate our expectations about accuracy, responsiveness, and compliance. We should recognize the normative shift involved, however. Thus far, the compromises inherent in tax-based administration have often been accepted without explicit recognition. As the EITC comes under increasing attack from the right as "fraud-prone" and a "handout," it becomes particularly important for policymakers to be able to articulate why a tax-based program may be worth retaining despite its limitations.[34]

Other aspects of EITC administration may also require some combination of administrative reform and changes in traditional norms. For example, evidence suggests that a significant portion of EITC recipients pay commercial tax preparers to prepare their returns and rely on their preparers in determining eligibility and amount of benefits.[35] Although more study is needed, this fact may call into question the extent to which tax-based administration is as nondiscretionary and automatic as it appears. Are we in fact turning commercial tax preparers into privately paid EITC "intake workers"? How good a job do these preparers do? Should we be troubled by the high fees paid to the preparers,[36] or should we view them as a productive way to use private markets to improve social-service delivery? If the reliance on commercial preparers is troubling, can it be ameliorated over time by expanding free return-preparation services for the poor and by educating EITC recipients to do their own returns?

Can we develop alternative administrative structures that capitalize on the strengths of tax-based transfers? We might also consider whether alternative institutions could preserve the benefits of tax-based transfers while minimizing their shortcomings. How might we use the best features of tax and welfare administration to create a combined system that is stronger than either standing alone? The EITC (like the negative income tax) embodies a set of desirable reforms that can (in theory at least) be implemented through traditional administrative structures as well as through the tax system. Although politics and administrative inertia may create formidable

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barriers, it may be worth continuing to explore ways to incorporate uniform federal rules, relatively simple and objective rules, and reduced discretion in administration into traditional programs. Other possible avenues for progress include information sharing between the tax system and transfer programs and sharing of facilities and personnel. For example, John Karl Scholz reports that Michigan has applied for a waiver for a welfare demonstration that would administer EITC advance payments though the AFDC and Food Stamp delivery system.[37]

My long-term project is to continue to examine the role of tax-based transfers and tax policy in implementing social policy. One aspect of that project will consider the institutional features of a wider variety of tax-based transfers (including non-income-tested transfers). My immediate goal is to focus on current proposals relating to "family policy." Analyses of the treatment of the family in the tax system have traditionally focused either on the distributional and incentive effects of the taxation of married couples or on adjusting for family size (*e.g.*, dependency exemption or credit). My focus will be, instead, on current proposals for the United States to adopt something approximating a European-style family policy through family allowances or child support assurance,[38] and particularly on proposals that envision implementation through the tax system.

ENDNOTES

1 By 1998, estimates suggest that the EITC will cost the federal government roughly 150 percent as much as Aid to Families with Dependent Children (AFDC), the best-known national welfare program. See Yin *et al.* (1994).

2 See, *e.g.*, Munnell (1994). Part of the appeal of some proposals for tax-transfer integration (like the negative income tax) is that they would also consolidate numerous overlapping and separate transfer programs into a single program. My argument addresses only tax-based administration and does not address consolidation.

3 See, *e.g.*, Ellwood (1988, p. 115).

4 The analysis in this paper uses the EITC to illustrate issues arising in income-tested programs administered through the tax system. Non-income-tested, or "universal," programs might also be administered through the tax system, but they raise separate issues, which are not addressed here.

5 This paper examines only the costs of the EITC's tax-based administration and does not address its behavioral incentives. In another paper, I argue that the debates about the EITC's behavioral incentives are oversimplified (Alstott, 1994). I also do not address here the extent to which the EITC's tax-based administration enhances privacy, reduces stigma, or lowers administrative costs relative to welfare: my focus is on identifying the *costs* of tax-transfer integration rather than attempting to verify its benefits.

6 Interested readers should consult Alstott (1994) for a more complete exposition and defense. Several of these administrative issues were discussed by analysts of the negative income tax. See, *e.g.*, Asimow and Klein (1970), Klein (1971), Klein (1974), and Tobin *et al.* (1967). These excellent papers concentrate on devising concrete rules and procedures to eliminate these limitations within the context of the negative income tax, while my principal point is that the acceptability of such solutions is strongly constrained by the goals of tax-transfer integration.

7 The issue is *not* that poor people are understating their incomes by claiming accelerated depreciation and shifting assets into municipal bonds. Truly poor people obviously do not have assets of that kind (although at the margin the exclusion of some items, like imputed rent and transfer payments, may weaken the federal income tax base's ability to draw distinctions among the poor). The issue is that nonpoor people may look poorer than they are on the basis of their income reported for tax purposes.

8 Traditional welfare programs may, of course, be inaccurate as well, for a variety of reasons, including the complexity of their eligibility rules and the subjective decision making of "street-level" bureaucrats. My intent is not to exaggerate the accuracy or other virtues of traditional welfare programs, but to point out that, in a tax-based program, there are potentially significant inaccuracies *even if* the rules are followed to the letter. Thus, issues of noncompliance—in the EITC and welfare—are analytically distinct.

9 O'Neil and Nelsestuen (1994) analyzed IRS

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Statistics of Income data and found that, in 1988, 10 percent of EITC benefits were paid to households with significant investment assets. They recommend denying EITC benefits based on wealth, using (taxable and nontaxable) investment income as a (partial but relatively easily administered) proxy for wealth.

[10] A broader family definition for purposes of determining income might deny EITC benefits in some cases, *e.g.*, in the case of two cohabitants with a combined income above the EITC income cutoff. On the other hand, taking into account a wider range of family responsibilities might expand EITC eligibility, *e.g.*, in the case of a low-income worker who is responsible for supporting or helping to support "family" members other than qualifying children.

[11] Before the 1990 amendments to the EITC, many poor workers with children technically did not qualify for the EITC because their public assistance receipts prevented them from meeting the "support" and "household maintenance" tests implicit in the tax code's definitions of dependent and head of household. The issue in this case was not so much that the family definition hindered accurate measurement of income but that it denied eligibility to families who were well within the intended scope of the EITC program. As described in the text below, the EITC now substitutes the concept of "qualifying child" for "dependent" (Holtzblatt, 1991).

[12] See, *e.g.*, Olson and Davis (1994) and Yin *et al.* (1994). On the other hand, Scholz argues that the infrequent use of the advance payment option "suggests that it is not a critical public policy issue except, perhaps, for households making the transition from welfare to work." Scholz (1993–4), p. 7.

[13] General Accounting Office (1992); Olson and Davis (1994).

[14] In contrast, a "positive" taxpayer whose income fluctuates is likely to have too much income tax withheld. The difference is due to the structure of marginal tax rates facing EITC recipients. An EITC recipient in the EITC phaseout range faces a marginal "tax" rate (the rate at which benefits are recaptured as income rises plus, in some cases, the 15 percent federal income tax rate) that is higher than the 15 percent marginal tax rate that faces those with incomes just above the EITC's income cutoff point. This "regressive" *marginal* (not average) rate structure means that families with incomes that fluctuate between the phaseout range and the range above the income cutoff point will receive EITC advance payments that, viewed on an annual basis, are too high (Alstott, 1994; Asimow and Klein, 1970; Kesselman, 1982). Overpayments may also arise because of other features of the EITC (see Holt, 1992).

[15] For an examination of the recapture dilemma in the context of health care subsidies, *see* Steuerle (1994).

[16] Scholz (1994). Scholz discusses studies of participation rates in Food Stamps and AFDC, which find lower rates of participation (roughly 55 to 70 percent in the mid-1980s).

[17] Scholz (1993–4) presents the error rates found by IRS TCMP studies in 1982, 1985, and 1988. Scholz compares the EITC error rate to that of traditional transfers by citing Holtzblatt's report of overpayment error rates in AFDC and Food Stamps of less than 10 percent. A note of caution is probably appropriate here, however: both the TCMP statistics and the "quality control" statistics used to determine overpayments in AFDC have been criticized as inaccurate, though in different ways. See, *e.g.*, Holtzblatt (1991) and Brodkin (1986). For a discussion of the possible effects of subsequent legislation on EITC error rates, see Holtzblatt (1991).

[18] See, *e.g.*, Yin *et al.* (1994) (describing reasons why "expectations for participation in the EITC should be ambitious" and suggesting methods for improving participation still further).

[19] Steuerle (1993). See also Yin *et al.* (1994).

[20] U.S. Congress (1993b, p. 1060). This distribution table shows that, at a minimum, 3.89 percent of EITC benefits are paid to families with "expanded incomes" of $30,000 or more (1 percent of benefits are paid to families with expanded incomes of $40,000 or more). Because the table is divided into increments of $10,000, it is impossible to tell how many families have expanded incomes greater than $23,000 (the EITC income cutoff in 1993). A rough, but hopefully conservative, guess is that 15 percent of the payments shown for families in the $20,000 to $30,000 income range are made to families with incomes of more than $23,000. Using that figure, a total of 6.86 percent of EITC payments go to families with expanded incomes above the income cutoff. This table suggests that a tiny fraction (0.04 percent) of EITC benefits may be paid to families with expanded incomes as high as $75,000 to $100,000 per year. My understanding, based on conversations with Joint Committee on Taxation (JCT) staff, is that the distribution of EITC benefits reflected in the distributional table is a result

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of the income definition (*e.g.*, the exclusion of municipal bond interest) and is not due to noncompliance with EITC rules. (It also is not due to differences in family definitions, because the JCT calculations are based on tax filing units.) The table does not, of course, allow determination of overpayment of benefits *within* the EITC population, although in theory that calculation could be made as well. Note that underpayment of benefits due to the income definition is unlikely, because "earned income" (the figure on which earnings subsidy payments are based) is defined for EITC purposes to include many sources of untaxed income. For an analysis of the inaccuracy in the EITC due to the failure to measure wealth, *see* O'Neil and Nelsestuen (1994).

21 Data collected before 1991 reflect the characteristics of a much smaller program and thus may understate problems of inaccuracy and noncompliance. Data collected between 1991 and 1993 will reflect a somewhat larger program but may be distorted by the transition to new eligibility rules enacted in 1990 and the "supplemental" credits enacted in 1990 and repealed in 1993. Post-1993 data will be more reliable, but the expanded program will not be fully phased in until calendar year 1996. For these reasons, analysts may not be able to undertake completely reliable studies of the EITC until the late 1990s.

22 In 1990, the EITC income cutoff (in nominal dollars) was $20,264; by 1996, it will be $27,000 (in 1994 dollars). In 1990, the maximum EITC benefit (in nominal dollars) was $953; by 1996, it will be $3,370 (in 1994 dollars).

23 See Forman (1988), suggesting adoption of a broader income base for phasing out the EITC.

24 *Cf.* Yin *et al.* (1994), suggesting that it may be desirable to *narrow* the definition of earned income for EITC purposes, which currently includes some nontaxable income, to include only taxable items in order to permit easier administration of the EITC.

25 These critics have suggested moving toward rules that will award the EITC based on information found on the face of the basic tax form (the Form 1040). For an excellent discussion of the 1990 changes, see Holtzblatt (1991). For suggested reforms (of the EITC and the tax code generally) designed to eliminate the need for Schedule EIC, see Scholz (1993–4) and Yin *et al.* (1994).

26 U.S. Congress (1993a).

27 A recognition of these fundamental tensions does not mean that work on incremental reform is fruitless. A number of analysts have produced innovative work on administrative reforms of the EITC, particularly in the areas of compliance, participation, and advance payment. See, *e.g.*, Yin *et al.* (1994), Holtzblatt (1991), Steuerle (1993), Holt (1994), and Williamson and Lipman (1992). Although my analysis suggests that we cannot expect reforms at the margin to remove these inherent, structural constraints, the resulting improvements may still be worth undertaking.

28 Scholz (1993–4); Yin *et al.* (1994).

29 See Staff of the Joint Committee on Taxation (1993).

30 See, *e.g.*, Beebout and Ohls (1993) (similar tradeoffs in the Food Stamp Program). And, of course, every basic income tax course considers the consequences of our system's deviations from Haig–Simons income.

31 The legislative history of the EITC since 1990 characterizes it as a work incentive but emphasizes strongly the income support aspects of the program. Among other changes, the 1990 legislation adjusted the EITC for family size, recognizing (in part) the different income support needs of families of different sizes. See, *e.g.*, U.S. Congress (1990, p. 279) (EITC increase is intended to "provide additional financial support" to low-income families and to enhance the progressivity of the tax system); U.S. Congress (1993c, p. 609) (expanding the EITC "recognizes the role the EITC can play in alleviating poverty").

32 On the other hand, it may be that accuracy and responsiveness will always be of somewhat less importance in the EITC than in traditional welfare programs because the EITC serves a different clientele. By definition, EITC recipients have some other source of income and so are not in as dire need as some welfare recipients, so that responsiveness is perhaps less critical. (I am indebted to Joel Handler for pointing this out to me.)

33 Some commentators have proposed family allowances, employer credits, or wage subsidies as alternatives to the EITC, in part based on administrative concerns. See, *e.g.*, Yin *et al.* (1994) (family allowances or employer subsidies) and Forman (1988) (wage subsidies).

34 See, *e.g.*, Bovard (1994) and Roberts (1993).

35 Olson and Davis (1994, p. 13) (citing a survey of New Jersey families indicating that two-thirds of those applying for the EITC paid someone to do their taxes).

36 See Olson and Davis (1994, pp. 13–16) (describing fees paid by EITC recipients to preparers).

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[37] Scholz (1993–4).

[38] See, *e.g.*, Garfinkel (1992).

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