Earned Income Credit Participation—What We (Don't) Know

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Each filing season, Brookings and a number of other research organizations receive queries from people working in the field, wanting to know more about EITC participation in their communities. They seek that information for several reasons:

1. To help organizations target scarce outreach resources where they are most needed.

2. To describe the "missed opportunity" to potential partners, funders, and the public.

3. To measure the effectiveness of outreach campaigns in raising the proportion of eligible families and workers who benefit from the credit.

What Do People Want to Know?

People seek information on EITC participation in various forms: for different levels of geography, depending on the scope of their outreach (counties, cities, neighborhoods); in different metrics (number of additional families, dollars "left on the table"); and for different time periods (the most recent tax year, all tax years for which eligible nonparticipants could claim credits). One request we routinely receive is to provide ZIP code-level estimates of eligible nonparticipants, and unclaimed EITC dollars, as part of our online EITC database. These are the right questions to be asking, and they signal positive interest in using research evidence to inform policy and action.

What's the Problem?

Unfortunately, Brookings and other research organizations face constraints in their ability to provide accurate estimates on many of these participation-related questions. Briefly, the major obstacles are:

A. Some people who claim the EITC aren't technically eligible for it.
B. We can't know how many eligible families there are at a local level.
C. Eligible people who claim the credit differ from eligible people who don't.

This note offers a couple of ideas on how people **can** make use of data to measure and explain the opportunities for local EITC outreach programs. It then explains each of these obstacles in a little more detail.

How You Could Get Around the Problems

Because of the numerous methodological issues, Brookings has not been "in the business" of providing local-level estimates on EITC participation. This does not mean that people should stop trying to answer these questions, however. Communicating your continued interest in this subject to the IRS can prompt the Service to redouble its efforts to provide reliable, up-to-date participation estimates that assist local leaders in their efforts to connect eligible families to the credit. Forthcoming work from the IRS National Research Program could provide useful information on this subject.

Keeping in mind all of the caveats discussed below, there are two approaches that interested organizations might consider taking to communicate the opportunity before local outreach campaigns:

- Rather than estimate the full size of the "shortfall" owing to under-participation in the credit, local leaders might highlight the economic benefits of boosting the number of area workers and families claiming the EITC by 5 percent. This would represent a far more achievable goal for a local outreach campaign than reaching all eligible nonparticipants, while also leaving aside issues around the current level of overclaims. As well, there are likely few places in the United States where credit claims could not be expanded by at least 5 percent by reaching more eligible taxpayers. For further guidance on such an approach, see http://www.brookings.edu/es/urban/eitc/dataguide.htm.

- The latest authoritative study on EITC participation nationwide used tax year 1996 data [available online at http://taxpolicycenter.org/TaxFacts/papers/irs_eitc.pdf].[1] While the work of the IRS and national/local outreach campaigns has likely resulted in an increase in participation since that time, recent expansions in eligibility for the credit (most notably among married-couple families) and changes in the broader economy mean that participation rates may not be too dissimilar from those estimated for that year. As well, the relative ranking of states on participation is unlikely to have changed dramatically during this time.

  Additionally, IRS Wage and Investment and National Headquarters Research recently partnered with SPEC to derive estimates of EITC participation at the state level for tax years 2000, 2001, and 2002. The estimates rely on Current Population Survey data from those respective years, and compliance data from tax years 1997-1999. These figures are somewhat less reliable than those derived from the tax year 1996 study, and rely on outdated compliance studies that overstate EITC error. The estimates may, however, be better than underclaim figures previously distributed by SPEC (which assumed that national EITC participation and compliance rates applied uniformly to all U.S. ZIP codes). Brookings and other organizations will be looking more closely at the methodology behind these estimates. In the meantime, interested organizations should contact their IRS-SPEC representative for more information.

  Note that these state-level participation estimates do not reflect local-level differences that may prevail within states, and using them in combination with data on total EITC claims may fail to account for returns that claimed the EITC in error (see below).

More on the Problems

First, a note on the participation rate itself. To determine a participation rate for the EITC, we need to know how many families and workers are *eligible* for the credit, and *of those*, how many *claimed* the credit.

$$\textit{Participation rate} \quad = \quad \frac{\text{(a) } \textit{eligible EITC claims}}{\text{(b) } \textit{EITC-eligible taxpayers}}$$

A. Some people who claim the EITC aren't technically eligible for it.

On our website, we publish IRS data showing the total number of taxpayers claiming the EITC down to the ZIP code level.[2] As is the case with all tax provisions, not all taxpayers who claim the EITC are technically eligible to receive the credit. The proportion of taxpayers who claim

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[1] The methodology employed in that study featured rare direct matching of IRS tax return data to Census Bureau survey data, thereby obviating the need to take into account EITC claimed in error in calculating participation rates.

[2] See http://apps89.brookings.edu:89/EITC/

the credit but do not meet all of the eligibility requirements represents the program's "error rate." The IRS studied this error-rate issue in 2002, concluding that in tax year 1999, between 27 and 32 percent of EITC claims nationwide were paid in error.[3] This finding gave impetus to the "precertification" pilots now underway at IRS to reduce overclaims.

Serious shortcomings in the IRS methodology, as well as subsequent changes to the credit to improve compliance and reduce complexity, mean that the error rate today is likely lower than that estimated by the IRS, but its true magnitude is not known.[4]

In order to know the level of *eligible* EITC claimants, then, one must know the level of *ineligible* claims, or the error rate. But even if one did know the true level of error in the program, the methodology the IRS uses to estimate error relies on a nationally representative sample of audited returns that does not reveal useful *local-level* information on overclaims. For example, even if we knew that 10 percent of all EITC claimants received the credit in error in tax year 2002, it would be inaccurate to assume that error rate applied to every county, city, and/or ZIP code in the United States. So at both a national and local level, we cannot truly know how many EITC-eligible taxpayers claimed the credit.

B. We can't know how many eligible families there are at a local level.

To arrive at an accurate estimate of the denominator in the participation rate equation, we must have data that detail the various taxpayer characteristics that determine eligibility for the EITC. Most notably, these include family income, family structure, and living arrangements (specifically, how many months during the tax year qualifying children lived in the home).

Various participation rate studies have used data sources such as the Current Population Survey, the Survey of Income and Program Participation, and state administrative records to derive estimates of the size of the EITC-eligible population.[5] None of these data sources, however, is of sufficient size to support eligibility estimates for geographies smaller than states or very large metropolitan areas. As with the EITC error rate, it would be erroneous to conclude that even a state-level eligibility estimate was mirrored in every city, town, and neighborhood throughout the state, since demographic and economic characteristics that influence participation vary widely.

Additionally, it bears noting that IRS data themselves do not provide information suitable for estimating the size of the eligible population. This is because IRS data reflect information only from those individuals and families that filed tax returns. The vast majority of eligible workers who fail to claim the EITC do not file a tax return, and thus lie "outside the lines" of IRS data.

C. Eligible people who claim the credit differ from eligible people who don't.

One further caution applies to attempts to estimates the dollar amount of unclaimed EITC at a local level. The limited research on participation rates has consistently found that the credit

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[3] Internal Revenue Service, "Compliance Estimates for Earned Income Tax Credit Claimed on 1999 Returns." February 28, 2002. http://www.irs.gov/pub/irs-soi/compeitc.pdf [accessed February 2005]

[4] Robert Greenstein, "What is the Magnitude of EITC Overpayments?" (Washington: Center on Budget and Policy Priorities, 2003). http://www.cbpp.org/5-20-03eitc3.htm [accessed February 2005] Work underway as part of the IRS's National Research Program may provide more up-to-date, accurate assessments of the EITC error rate.

[5] A brief catalog of these studies is available in Alan Berube, "Rewarding Work Through the Tax Code: The Power and Potential of the Earned Income Tax Credit in 27 Cities and Rural Areas" (Washington: Brookings Institution, 2003). http://www.brook.edu/es/urban/publications/berubetaxcode.htm [accessed February 2005]

amounts left unclaimed by nonparticipants are smaller than those claimed by program participants. For instance, IRS research found that in tax year 1996, the average credit claimed by eligible taxpayers was $1,384, while the average credit available to eligible nonfilers was $1,015.[6] This makes intuitive sense—the incentive to file a return and claim the credit should increase as the value of the available credit increases. Thus, assuming that the average EITC *claimed* in a given geography and tax year applies to eligible *nonclaimants* as well would likely lead one to overstate the amount of unclaimed credits.

In the future, new and expanded data sources may enable researchers to answer these pressing questions with greater accuracy. In the meantime, Brookings will continue to provide and interpret basic data on the EITC and other tax credits that can assist local leaders in their efforts to reach eligible taxpayers and enhance families' financial security.

[6] SB/SE Research, "Participation in the Earned Income Tax Credit Program for Tax Year 1996" (Internal Revenue Service, 2002). http://taxpolicycenter.org/TaxFacts/papers/irs_eitc.pdf [accessed February 2005]