PRESENT LAW AND ANALYSIS RELATING TO THE EARNED INCOME CREDIT AND THE CHILD TAX CREDIT AS CONTAINED IN THE H.R. 2491 CONFERENCE AGREEMENT

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

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CONTENTS

INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the present-law earned income credit, its legislative history, a description of the provisions related to that credit and the child tax credit in the H.R. 2491 conference agreement,[2] and an analysis of the effects of those conference agreement provisions.

Part I of the document is a description of the present law, Part II is a legislative history of the earned income credit, Part III describes the conference agreement regarding that credit, Part IV describes the conference agreement regarding the child tax credit and Part V is an analysis of the effects of the child tax credit and the changes to the earned income credit contained in the conference agreement. The Appendix provides certain additional data relating to the earned income credit.

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[1] This document may be cited as follows: Present Law and Analysis Relating to the Earned Income Credit and the Child Tax Credit as Contained in the H.R. 2491 Conference Agreement (JCX-57-95), December 14, 1995.

[2] The H.R. 2491 conference agreement (see H.Rept. 104-350, November 16, 1995) was vetoed by President Clinton on December 6, 1995.

I. DESCRIPTION OF PRESENT-LAW EARNED INCOME CREDIT PROVISIONS

In general

Certain eligible low-income workers are entitled to claim a refundable credit on their income tax return. The amount of the credit an eligible individual may claim depends upon whether the individual has one, more than one, or no qualifying children and is determined by multiplying the credit rate by the filing unit's earned income up to an earned income amount. The maximum amount of the credit is the product of the credit rate and the earned income amount. For filing units with earned income (or adjusted gross income (AGI), if greater) in excess of the beginning of the phaseout range, the maximum credit amount is reduced by the phaseout rate multiplied by the amount of earned income (or AGI, if greater) in excess of the beginning of the phaseout range. For filing units with earned income (or AGI, if greater) in excess of the end of the phaseout range, no credit is allowed.

For taxable years beginning after December 31, 1995, an individual is not eligible for the credit if the aggregate amount of "disqualified income" of the filing unit for the taxable year exceeds $2,350. Disqualified income is the sum of:

(1) interest (taxable and tax-exempt),
(2) dividends, and
(3) net rent and royalty income (if greater than zero).

The parameters for the credit depend upon the number of qualifying children the individual claims. For 1995, the parameters are as follows:

	Two or more qualifying children--	One qualifying child--	No qualifying children--
Credit rate	36.00%	34.00%	7.65%
Earned income amount	$8,640	$6,160	$4,100
Maximum credit	$3,110	$2,094	$314
Phaseout begins	$11,290	$11,290	$5,130
Phaseout rate	20.22%	15.98%	7.65%
Phaseout ends	$26,673	$24,396	$9,230

For 1996, the parameters are given in the following table (dollar amounts are projections expressed in 1996 dollars):

	Two or more qualifying children--	One qualifying child--	No qualifying children--
Credit rate	40.00%	34.00%	7.65%
Earned income amount	$8,890	$6,330	$4,220
Maximum credit	$3,556	$2,152	$323
Phaseout begins	$11,610	$11,610	$5,280
Phaseout rate	21.06%	15.98%	7.65%
Phaseout ends	$28,495	$25,078	$9,500

For years after 1996, the credit rates and the phaseout rates will be the same as in the preceding table. The earned income amount and the beginning of the phaseout range are indexed for inflation; because the end of the phaseout range depends on those amounts as well as the phaseout rate and the credit rate, the end of the phaseout range will also increase if there is inflation.

Earned income consists of wages, salaries, tips, other employee compensation, and net self-employment income. To calculate earned income for purposes of the credit a filing unit must take into account several sources of income. First, the filing unit must take the amount reported on line 7 of the Form 1040. This amount is the total of wages, salaries and tips for the filing unit for the taxable year. Second, the filing unit then subtracts any taxable scholarship or fellowship grants. Third, the filing unit adds nontaxable earned income. Examples listed in the IRS instructions to the Form 1040 include these items: basic quarters and subsistence allowances and the value of in-kind quarters and subsistence received from the U.S. military, housing allowances or the rental value of a parsonage for clergy, meals and lodging provided for the convenience of the employer, certain voluntary salary deferrals (e.g., contributions to a 401(k) plan), excludable dependent care benefits, certain voluntary salary reductions, and excluded combat zone pay.

In the case of a self-employed individual, the self-employment income of the filing unit must be included. To compute self-employment income, the filing unit adds net profit or loss from Schedule C, Schedule C-EZ, Schedule F, and Schedule K-1 (Form 1065). There are special rules for ministers and members of religious orders.

A worker with qualifying children may elect to receive the credit on an advance basis by furnishing an advance payment certificate to his or her employer. For such a worker, the employer makes an advance payment of the credit at the time wages are paid. The amount of advance payment allowable in a taxable year is limited to 60 percent of the maximum credit available to an individual with one qualifying child.

In order to claim the credit, an individual must either have a qualifying child or meet other requirements. A qualifying child must meet a relationship test, an age test, an identification test, and a residence test.

In order to claim the credit without a qualifying child, an individual must not be a dependent and must be over age 24 and under age 65. In addition, the individual's principal place of abode must be located in the United States for more than one-half of the taxable year. For purposes of this test, a member of the Armed Forces stationed outside the United States on extended active duty is considered to be maintaining a principal place of abode in the United States.

Qualifying children

Under the relationship and age tests, an individual (or a married couple) is eligible for the credit with respect to another person only if that other person: (1) is a son, daughter, or adopted child (or a descendant of a son, daughter, or adopted child); a stepson or stepdaughter; or a foster child of the individual (a foster child is defined as a person whom the individual cares for as the individual's child; it is not necessary to have a placement through a foster care agency); (2) is under the age of 19 at the close of the taxable year (or is under the age of 24 at the end of the taxable year and was a full-time student during the taxable year), or is permanently and totally disabled; and (3) shares the same place of abode as the person claiming the credit for more than one-half the year (the entire year for foster children). Also, if the qualifying child is married at the close of the year, the individual may claim the credit for that child only if the individual may also claim that child as a dependent. Individuals who are married (as defined in Code sec. 7703) may claim the credit only if they file a joint return.

In addition to the above criteria, two "tiebreaker" rules apply:

(1) If more than one individual may claim the credit (if any) with respect to any qualifying child, then only the individual with the highest AGI may claim the credit with respect to the child. For example, assume a hypothetical household consisting of a grandmother, mother (age 25), and child (age 2). Both the grandmother and the mother are eligible to claim the credit with respect to the child. In this case, however, only the individual with the higher AGI is eligible to claim the credit (assuming the other requirements are met).

(2) An individual who is himself or herself a qualifying child may not claim the credit. If in the above example, the mother is age 17 (instead of age 25), then she is a qualifying child of the grandmother. In this case, only the grandmother could claim the credit, with respect to her own child (mother, age 17) and her grandchild (child, age 2).

To satisfy the identification test, individuals must include on their tax return the name and age of each qualifying child. For returns filed with respect to tax year 1995, individuals must provide a taxpayer identification number (TIN) for all qualifying children who were born on or before October 31, 1995. For returns filed with respect to tax year 1996, individuals must provide TINs for all qualifying children born on or before November 30, 1996. For returns filed with respect to tax year 1997 and all subsequent years, individuals must provide TINs for all qualifying children, regardless of their age. An individual's TIN is generally that individual's social security number. Some individuals are exempt from social security taxes because of their religious beliefs. These individuals do not have a social security number; instead, the Internal Revenue Service administratively assigns them a taxpayer identification number.

The residence test requires that a qualifying child must have the same principal place of abode as the taxpayer for more than one-half of the taxable year (for the entire taxable year in the case of a foster child), and that this principal place of abode must be located in the United States. For purposes of determining whether a qualifying child meets the residence test, for any period during which a member of the Armed Forces is stationed outside the United States while serving on extended active duty, the member is not subject to the requirement that the principal place of abode for a qualifying child and the member be in the United States.

<u>**Nonresidents and the credit**</u>

The credit may be claimed by an individual meeting the above requirements if the individual is a U.S. citizen or a resident alien.

Section 7701(b) defines a resident alien for income tax purposes. Aliens who do not meet this definition are nonresident aliens. For income tax purposes, an individual is generally considered a resident if the individual:

(1) has entered the United States as a lawful permanent U.S. resident (the "green card test"), or

(2) is present in the United States for 31 or more days during the current calendar year and has been present in the United States for 183 or more days during a three-year period weighted toward the present year (the "substantial presence test"). (An individual who is present in the United States for fewer than 183 days and establishes that he or she has a closer connection with a foreign country than with the United States is generally not subject to tax as a resident alien on account of the substantial presence test.)

Individuals who are nonresident aliens for any portion of the taxable year are not eligible to claim the credit for taxable years beginning after December 31, 1994, unless an election under Code section 6013(g) or (h) is in effect for the taxable year.

Under section 6013(g), a nonresident alien who is married to an individual who is either a citizen or resident alien of the United States at year end may elect to be treated as a resident for the entire year. The election applies to the year for which it is made and all subsequent years until terminated. The election will be suspended, however, if neither spouse is a U.S. citizen or resident at any time during a taxable year.

Under section 6013(h), an individual who (1) is a nonresident alien at the beginning of the year and a resident alien at the end of the year and (2) is married to an individual who is either a citizen or resident of the United States at the end of the year may elect to be treated as a resident for the entire year. Thus, this election can be made by a foreign married couple who arrive in the United States during the taxable year and who are resident aliens at year end.

Mathematical or clerical errors

The IRS may summarily assess additional tax due as a result of a mathematical or clerical error without sending the taxpayer a notice of deficiency and giving the taxpayer an opportunity to petition the Tax Court. Where the IRS uses the summary assessment procedure for mathematical or clerical errors, the taxpayer must be given an explanation of the asserted error and a period of 60 days to request that the IRS abate its assessment. The IRS may not proceed to collect the amount of the assessment until the taxpayer has agreed to it or has allowed the 60-day period for objecting to expire. If the taxpayer files a request for abatement of the assessment specified in the notice, the IRS must abate the assessment. Any reassessment of the abated amount is subject to the ordinary deficiency procedures. The request for abatement of the assessment is the only procedure a taxpayer may use prior to paying the assessed amount in order to contest an assessment arising out of a mathematical or clerical error. Once the assessment is satisfied, however, the taxpayer may file a claim for refund if he or she believes the assessment was made in error.

Return preparer penalties

An income tax return preparer is subject to a penalty of $250 if any part of an understatement of tax on a return or refund claim is due to the return preparer taking a position for which there was not a realistic possibility of the position being sustained. The return preparer must have known (or reasonably should have known) of the unrealistic position and not disclosed that position. In addition, an income tax return preparer is subject to a penalty of $1,000 if any part of an understatement of tax on a return or refund claim is due to the return preparer's willful attempt in any manner to understate tax or to the return preparer's negligent or intentional disregard of rules and regulations. An income tax return preparer is also subject to a penalty of $50 for each failure to (1) furnish a copy of a return or refund claim to the taxpayer, (2) sign the return or refund claim, (3) furnish his or her identifying number, (4) furnish certain copies or lists of returns or refund claims, or (5) file certain information returns regarding his or her employees. In addition, tax return preparers who endorse or negotiate checks made to taxpayers pay a penalty of $500 for each check endorsed or cashed.

II. LEGISLATIVE HISTORY OF THE EARNED INCOME CREDIT

Legislative Background

The credit (Code sec. 32) was enacted in 1975 as a means of targeting tax relief to working low-income individuals with children, providing relief from the social security payroll tax for these individuals, and improving incentives to work. As originally enacted,[3] the credit equaled 10 percent of the first $4,000 of earned income (i.e., a maximum credit of $400). The credit began to be phased out for filing units with earned income (or AGI, if greater) above $4,000, and was entirely phased out for filing units with income of $8,000.

The Revenue Act of 1978 increased the maximum credit to $500 (10 percent of the first $5,000 of earned income). Also, the income level at which the phaseout began was raised to $6,000, with a complete phaseout not occurring until an income level of $10,000. The Deficit Reduction Act of 1984 increased the maximum credit to $550 (11 percent of the first $5,000 of earned income) and the credit was phased out beginning at $6,500 of income and ending at $11,000.

The Tax Reform Act of 1986 increased the maximum credit to $800 (14 percent of the first $5,714 of earned income), beginning in 1987. The maximum credit was reduced by 10 cents for each dollar of earned income (or AGI, if greater) in excess of $9,000 ($6,500 in 1987). These $5,714 and $9,000 amounts (stated above in 1985 dollars) were indexed for inflation.

The Omnibus Budget Reconciliation Act of 1990 (OBRA 1990) substantially increased the maximum amount of the basic credit and added an adjustment to reflect family size. OBRA 1990 also created two additional credits as part of the credit: the supplemental young child credit and the supplemental health insurance credit. Both of these supplemental credits used the same base as the basic credit.

OBRA 1990 also modified the definition of individuals eligible for the credit. Under prior law, individuals were required to file a joint return or file as a head of household or surviving spouse in order to be eligible for the credit. OBRA 1990 generally broadened the set of eligible individuals and set out uniform requirements for qualifying children. The definition of "qualifying child" enacted in OBRA 1990 is described in the present-law section.

The Omnibus Budget Reconciliation Act of 1993 (OBRA 1993) expanded the credit in several ways. For individuals with one qualifying child, the credit was increased to 26.3 percent of the first $7,750 of earned income in 1994. For 1995 and thereafter, the credit rate was increased to 34 percent. In 1995, the earned income amount is $6,160 (this is a $6,000 base in 1994, adjusted for inflation). The phaseout rate for 1994 and thereafter is 15.98 percent.

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[3] Table A-2 in the Appendix shows the parameters of the credit over its history.

For individuals with two or more qualifying children, the credit was increased to 30 percent of the first $8,425 of earned income in 1994. The maximum credit for 1994 was $2,527 and was reduced by 17.68 percent of earned income (or AGI, if greater) in excess of $11,000. The credit rate increases over time and equals 36 percent for 1995 and 40 percent for 1996 and thereafter. The phaseout rate is 20.22 percent for 1995 and 21.06 percent for 1996 and thereafter.

OBRA 1993 also extended the credit to individuals with no qualifying children. This credit for individuals with no qualifying children is available to individuals over age 24 and below age 65. Finally, OBRA 1993 repealed the supplemental young child credit and the supplemental health insurance credit.

The implementing legislation for the General Agreements on Tariffs and Trade enacted in 1994 made a number of modifications to the credit. First, it removed from the definition of earned income in Code section 32(c)(2) any amount received for services provided by an inmate of a penal institution. Second, it generally made nonresident aliens ineligible to claim the credit. Third, it deemed that a member of the Armed Forces stationed outside the United States while serving on extended active duty would satisfy the test that the principal place of abode be within the United States. Fourth, it required that members of the Armed Forces receive annual reports from the Department of Defense of earned income (which includes nontaxable earned income such as amounts received as basic allowances for housing and subsistence). Fifth, it phased in a requirement that individuals provide a TIN for each qualifying child regardless of the dependent's age. Prior to the legislation, individuals had to provide a TIN only for qualifying children who attained the age of one before the close of the individual's taxable year.

Under Public Law 104-7 (H.R. 831), effective for taxable years beginning after December 31, 1995, an individual is not eligible for the credit if the aggregate amount of disqualified income (i.e., taxable and tax-exempt interest, dividends, and (if greater than zero) net rent and royalty income) of the filing unit for the taxable year exceeds $2,350.

Administration's Budget Proposals

Credit denied to individuals not authorized to be employed in the United States[4]

Individuals would not be eligible for the credit if they do not include their taxpayer identification number (and, if married, their spouse's taxpayer identification number) on their tax return. Solely for these purposes and for purposes of the present-law identification test for a qualifying child, a taxpayer identification number would be defined as a social security number issued to an individual by the Social Security Administration other than a number issued under

[4] Included the President's fiscal year 1996 budget proposal and in the President's December 1995 budget proposal. Also in H.R. 981, "Tax Compliance Act of 1995," as introduced by Representatives Gephardt and Gibbons (by request) on February 16, 1995, and in S. 453, "Tax Compliance Act of 1995," as introduced by Senators Daschle and Moynihan on February 16, 1995.

section 205(c)(2)(B)(I)(II) (or that portion of 205(c)(2)(B)(I)(III) relating to it) of the Social Security Act (regarding the issuance of a number to an individual applying for or receiving Federally funded benefits). Thus, if an individual obtained a social security number solely because that individual is an applicant for, or a recipient of, Federally funded benefits, the individual would be ineligible to claim the credit.

Use mathematical or clerical error procedures for certain omissions[5]

If an individual fails to provide a correct taxpayer identification number, such omission would be treated as a mathematical or clerical error. Thus, any notification that the individual owes additional tax because of that omission would not be treated as a notice of deficiency. If an individual who claims the credit with respect to net earnings from self-employment fails to pay the proper amount of self-employment tax on such net earnings, the failure would be treated as a mathematical or clerical error for purposes of the amount of credit allowed.

Credit denied to individuals with substantial unearned income[6]

An individual would not be eligible for the credit if the aggregate amount of interest and dividends includible in his income for the taxable year exceeds $2,500. For taxable years beginning after 1996, the $2,500 limit would be indexed for inflation with rounding to the nearest multiple of $50.

Effective date

The Administration proposals would be effective for taxable years beginning after December 31, 1995.

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[5] Included in the President's December 1995 budget proposal. This provision, absent the portion relating to self-employment taxes, was included in the President's fiscal year 1996 budget proposal and also in H.R. 981, "Tax Compliance Act of 1995," as introduced by Representatives Gephardt and Gibbons (by request) on February 16, 1995, and in S. 453, "Tax Compliance Act of 1995," as introduced by Senators Daschle and Moynihan on February 16, 1995.

[6] Public Law 104-7 (H.R. 831) enacted a similar provision with more stringent limits.

III. DESCRIPTION OF CONFERENCE AGREEMENT REGARDING THE EARNED INCOME CREDIT

Deny eligibility for individuals without qualifying children

In order to claim the credit, an individual must have a qualifying child.

Modify definition of adjusted gross income used for phasing out the credit

The conference agreement modifies the definition of AGI used for phasing out the credit by including certain nontaxable income and by disregarding certain losses. The nontaxable items included are:

(1) tax-exempt interest,
(2) social security benefits not subject to income tax,
(3) nontaxable distributions from pensions, annuities, and individual retirement arrangements (but only if not rolled over into similar vehicles during the applicable rollover period), and
(4) child support payments received pursuant to a divorce or separation instrument, but only in excess of $6,000.

The losses disregarded are:

(1) net capital losses (if greater than zero),
(2) net losses from sole proprietorships (other than in farming),
(3) net losses from sole proprietorships in farming,
(4) net losses from other trades and businesses,
(5) net losses from nonbusiness rents and royalties,
(6) net losses from trusts and estates, and
(7) net operating losses.

Credit rate for individuals with two or more qualifying children

The conference agreement provides that the credit rate for individuals with two or more qualifying children is maintained at 36 percent for 1996 and future years. The base to which this rate is applied, however, is changed for some individuals. In general, the maximum amount of the credit an eligible individual with two or more qualifying children may claim is determined by multiplying an enhancement factor times the credit rate times the filing unit's earned income up to the earned income amount.

For married couples filing joint returns for whom earned income (or modified AGI, if greater) is less than or equal to $17,000, the enhancement factor is 10/9ths. For married couples filing joint returns for whom earned income (or modified AGI, if greater) is greater than $21,000, the enhancement factor is 1. For married couples filing joint returns for whom earned income (or modified AGI, if greater) is greater than $17,000 but less than or equal to $21,000, the enhancement factor is ratably reduced from 10/9ths to 1. For example, a married couple filing a joint return with an earned income (and modified AGI) of $18,000 has an income one-fourth [= ($18,000 - $17,000)/($21,000 - $17,000)] of the way into the ratable reduction. Thus, the enhancement factor for this couple is 13/12ths [= (10/9) - (1/4)((10/9) - 1)]. The $17,000 and $21,000 amounts are indexed for inflation after 1996.

For unmarried individuals for whom earned income (or modified AGI, if greater) is less than or equal to $14,000, the enhancement factor is 10/9ths. For unmarried individuals for whom earned income (or modified AGI, if greater) is greater than $18,000, the enhancement factor is 1. For unmarried individuals for whom earned income (or modified AGI, if greater) is greater than $14,000 but less than or equal to $18,000, the enhancement factor is ratably reduced from 10/9ths to 1. For example, an unmarried individual with an earned income (and modified AGI) of $16,500 has an income five-eighths [= ($16,500 - $14,000)/($18,000 - $14,000)] of the way into the ratable reduction. Thus, the enhancement factor for this individual is 25/24ths [= (10/9) - (5/8)((10/9) - 1)]. The $14,000 and $18,000 amounts are indexed for inflation after 1996.

The conferees do not intend that individuals will have to do the above calculations to determine enhancement factors; these rules will be reflected in the credit tables provided with the tax return materials.

Phaseout of the credit

The conference agreement increases the phaseout rate of the credit for filing units with earned income (or modified AGI, if greater) in excess of the beginning of the second-tier phaseout. For individuals with two or more qualifying children, the second-tier phaseout begins at $17,750 and the phaseout rate for income in excess of that threshold is 25 percent. For individuals with one qualifying child, the second-tier phaseout threshold begins at $14,850 and the phaseout rate for income in excess of that threshold is 20 percent. The beginning of these second-tier phaseouts is indexed for inflation after 1996. The phaseout rate applied to income between the beginning of the present-law phaseout and the beginning of the new, second-tier phaseout is the same as would apply under present law for 1996 and future years. With these changes, the parameters of the credit for 1996 will be as follows:

	Two or more qualifying children--	One qualifying child--
Credit rate*	36.00%	34.00%
Earned income amount	$8,910	$6,340
Maximum credit	$3,564	$2,156
First-tier phaseout begins	$11,630	$11,630
First-tier phaseout rate	21.06%	15.98%
Second-tier phaseout begins	$17,750	$14,850
Second-tier phaseout rate	25.00%	20.00%
Phaseout ends	$25,425	$23,055

* Subject to an enhancement factor for individuals with two or more qualifying children.

For years after 1996, the credit rates and the phaseout rates will be the same as in the preceding table. The dollar values will continue to be indexed, as under present law.

Expand definition of disqualified income

For purposes of the disqualified income test for taxable years beginning after December 31, 1995, net passive income (if greater than zero) is added to the definition of disqualified income.

Deny credit to individuals not authorized to be employed in the United States

Under the conference agreement, individuals are not eligible for the credit if they do not include their taxpayer identification number (and, if married, their spouse's taxpayer identification number) on their tax return. Solely for these purposes and for purposes of the present-law identification test for a qualifying child, a taxpayer identification number is defined as a social security number issued to an individual by the Social Security Administration other than a number issued under section 205(c)(2)(B)(I)(II) (or that portion of sec. 205(c)(2)(B)(I)(III) relating to it) of the Social Security Act (regarding the issuance of a number to an individual applying for or receiving Federally funded benefits).

Use mathematical or clerical error procedures for certain omissions

If an individual fails to provide a correct taxpayer identification number, such omission will be treated as a mathematical or clerical error. If an individual who claims the credit with respect to net earnings from self-employment fails to pay the proper amount of self-employment tax on such net earnings, the failure will be treated as a mathematical or clerical error for purposes of the amount of credit allowed.

Increase return preparer penalties

The conference agreement doubles the civil penalties applicable to income tax return preparers. The conferees encourage the Secretary of the Treasury to use the maximum feasible review process to insure that originators of electronic income tax returns involving the credit comply with the law.

Effective date

The provision is effective for taxable years beginning after December 31, 1995.

IV. DESCRIPTION OF CONFERENCE AGREEMENT REGARDING THE CHILD TAX CREDIT

In general

The conference agreement allows taxpayers a nonrefundable tax credit of $500 for each qualifying child under the age of 18 (as of the close of the calendar year in which the taxpayer's taxable year begins). The amount of the credit is not indexed for inflation.

To be a qualifying child, an individual has to satisfy a relationship test and a dependency test. An individual satisfies the relationship test if the individual is a son or daughter of the taxpayer, a descendant of a son or daughter of the taxpayer, a stepson or stepdaughter of the taxpayer, or an adopted child of the taxpayer. An adopted child includes a child who is legally adopted or who is placed with the taxpayer by an authorized placement agency for adoption by the taxpayer. A foster child also satisfies the relationship test if, for the taxpayer's entire taxable year, the foster child (1) is a member of the taxpayer's household and (2) has as his principal place of abode the home of the taxpayer.

An individual satisfies the dependency test if the individual is a dependent of the taxpayer with respect to whom the taxpayer is entitled to claim a dependency deduction. For this purpose, the term "dependent" does not include an individual who is a resident of a country contiguous to the United States unless (1) that individual is an adopted child of a taxpayer who is a U.S. citizen or national and (2) for the taxpayer's entire taxable year, the individual is a member of the taxpayer's household and has as his principal place of abode the home of the taxpayer.

Except in the case of a taxable year closed by reason of the taxpayer's death, the credit is not allowable in the case of a taxable year covering a period of less than 12 months.

Income phaseout

For taxpayers with AGI in excess of certain thresholds, the allowable child credit is reduced by $25 for each $1,000 of AGI (or fraction thereof) in excess of the threshold. Thus, the size of the phaseout range is proportional to the number of qualifying children. For married taxpayers filing joint returns, the threshold is $110,000. For taxpayers filing single or head of household returns, the threshold is $75,000. For married taxpayers filing separate returns, the threshold is $55,000. These thresholds are not indexed for inflation.

1995 credit amounts

The credit is effective October 1, 1995. The portion of the child credit that is effective for the period from October 1, 1995, through December 31, 1995, will be provided to taxpayers through a special procedure. The Internal Revenue Service has raised significant concerns about making the credit available through the normal return filing process for the 1995 income tax return. In light of these concerns, the conferees have directed the IRS to use a special procedure to help taxpayers obtain their 1995 child credit. Under this procedure, the IRS is directed to issue a form on which taxpayers can file for their 1995 child credit following the completion of the normal tax return filing season (i.e., after April 15, 1996). The IRS is directed to mail a notice to taxpayers on or before February 1, 1996.

The text of the notice will read as follows: "The Balanced Budget Act of 1995 was recently passed by the Congress. The Act's child tax credit allows taxpayers to reduce their taxes by $500 per child. The credit is effective October 1, 1995. You may wish to check with your employer about changing your tax withholding to take immediate advantage of the credit to which you are entitled for the current tax year. In addition, the Internal Revenue Service will be sending you a form in June of this year which you may use to claim the credit to which you are entitled for the period from October 1 through December 31, 1995 ($125 per child for 1995). In order to obtain your 1995 credit, you should file this form by August 15, 1996. Your refund will be sent to you sometime after October 1, 1996."

Taxpayers will be directed to file their requests for their 1995 child credit on or before August 15, 1996. The IRS is directed to begin issuing checks to taxpayers entitled to the 1995 child credit on October 1, 1996.

In the case where a taxpayer's 1995 income tax liability had been reduced by a refundable credit, the amount of the 1995 child credit that is allowable would be calculated as if the taxpayer had been able to claim the 1995 child credit at the time that the taxpayer filed his or her 1995 income tax return. For example, suppose a taxpayer had a 1995 income tax liability of $110 prior to the application of a $1,000 refundable tax credit. The refundable credit would reduce the income tax liability to zero and a refund of $890 would be paid to the taxpayer. If the taxpayer has one qualifying child for the 1995 portion of the child credit, the taxpayer may receive an additional $110 refund, since he would have been able to use $110 of the $125 of 1995 child credit to offset his or her 1995 income tax liability, had the child credit been available on the 1995 income tax return.

The amount of the 1995 child credit will be treated as an overpayment of taxes for purposes of the appropriation of funds to pay the credit amounts.

Effective date

The provision is effective for taxable years beginning after December 31, 1995.

V. ANALYSIS OF THE CHANGES TO THE EIC INCLUDED IN THE CONFERENCE AGREEMENT

A. Changes to the Earned Income Credit

Under present law, approximately 17.1 million households would receive the earned income credit for tax year 1996. The cost of this credit would equal approximately $24 billion (see Table 1, below). More than 97 percent of dollars spent on this credit go to households with qualifying children. Households without qualifying children account for only a small fraction of the cost of the program but make up approximately 20 percent of the households receiving the credit. The changes that the conference agreement makes to the credit would reduce the number of households receiving the credit by 5.3 million; 67 percent of the reduction in the number of EIC returns would come from individuals with no qualifying children.

Table 1.--
Distribution of the Earned Income Credit[7]
Under Present Law and the Conference Agreement,
Tax Year 1996

Income category[8]	Present Law Returns	Present Law Amount	Conference Agreement Returns	Conference Agreement Amount
Less than $10,000	5,665	$6,190	3,019	$5,688
$10,000 - $20,000	5,882	11,548	5,058	10,920
$20,000 - $30,000	4,440	5,298	3,476	3,310
$30,000 - $40,000	1,045	837	292	158
$40,000 - $50,000	83	68	8	9
$50,000 - $75,000	25	32	5	2
More than $75,000	0	0	0	0
Total	17,140	23,970	11,858	20,094

Returns are in thousands and amounts are in millions of dollars.

The provisions in the conference agreement, excluding the compliance-related provisions, would reduce the total cost of the credit by $3.9 billion in 1996. These provisions would (1) deny the credit to households with no qualifying children, (2) use modified AGI to phase out the credit, (3) expand the definition of disqualified income, (4) maintain the maximum credit rate for households with two or more qualifying children at 36 percent, (5) use a two-tiered phaseout for the credit, and (6) apply an enhancement factor to the earned income of filing units with two or more

7 All of the tables in this section and in the Appendix reflect the updated estimates of the budget baselines released by the Congressional Budget Office on December 12, 1995. Those estimates revised downward the projections of credit usage in future years, in part because of Administration actions to improve compliance with credit rules.

8 For this table and subsequent tables in this section, the income concept used to place tax returns into income categories is AGI plus: (1) tax-exempt income, (2) employer contributions for heath and life insurance, (3) employer share of FICA tax, (4) workers' compensation, (5) nontaxable social security benefits, (6) insurance value of Medicare benefits, (7) alternative minimum tax preference items, and (8) excluded income of U.S. citizens living abroad. Returns with negative income are included neither in any of the income categories nor in the total.

qualifying children. Denying the credit to households with no qualifying children accounts for 16 percent of the $3.9 billion reduction in the cost of the credit. The affluence tests, which consist of the modified AGI provision and the expansion of the definition of disqualified income, account for 39 percent of the reduction. The last three provisions explain the remaining 45 percent of the decrease in the cost of this credit.

Most of the benefits of the credit go to households with income[9] less than $20,000. Under present law, 74 percent of the benefits of the credit go to households with income below $20,000. While the changes made to the credit by the conference agreement would reduce the total cost of the credit, a greater percentage of the total benefit would go to households with income less than $20,000. Under the conference agreement, 83 percent of the benefits from the credit would go to households with income less than $20,000.

Table 2 contrasts the projected growth in the credit under present law with the growth in the credit under the conference agreement. Under present law, the credit is projected to increase by 13 percent in fiscal year 1996 and by 8 percent in fiscal year 1997. The growth rate for the next five years is projected to be approximately 4 percent per year. Legislative changes to the credit enacted in OBRA 1993 account for the substantial increase in the cost of the program in fiscal years 1996 and 1997. The large increase in the growth rate in fiscal 1996 is mainly due to the increase in the maximum credit rates for households with children in tax year 1995. The maximum credit rate for households with one qualifying child increased from 26.3 percent to 34 percent,[10] and the maximum credit for households with two or more qualifying children rose from 30 percent to 36 percent. For fiscal 1997, the projected 8-percent growth rate results from the scheduled increase in the maximum credit for households with two or more qualifying children from 36 percent to 40 percent. Under the conference committee report, expenditures on the credit are projected to decline by 9.5 percent in fiscal year 1997 and increase at a rate below 4 percent in the following years.

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[9] See footnote 8 for an explanation of the income concept used throughout the discussion in this section to classify the tax returns into income categories.

[10] At the same time that the credit rate for individuals with one qualifying child was increased, the earned income amount was reduced. The combination of the increase in the credit rate and the reduction in the earned income amount left the maximum credit for individuals with one qualifying child virtually unchanged in real (inflation-adjusted) dollars. For filing units with earned income (and AGI) below the earned income amount, however, the increase in the credit rate resulted in an increase in the size of the credit in real dollars.

Table 2.--
Earned Income Credit Projections
Under Present Law and the Conference Agreement,
Fiscal Years 1995-2000

	Fiscal Years					
	1995	1996	1997	1998	1999	2000
EIC under present law						
Total cost ($ millions)	19,775	22,299	24,073	24,928	25,896	26,954
Percent change		12.8%	8.0%	3.6%	3.9%	4.1%
Outlays ($ millions)	16,674	19,116	20,588	21,310	22,115	22,851
Percent change		14.6%	7.7%	3.5%	3.8%	3.3%
EIC after conference agreement						
Total cost ($ millions)	19,775	22,094	19,996	20,618	21,367	22,168
Percent change		11.7%	-9.5%	3.1%	3.6%	3.7%
Outlays ($ millions)	16,674	18,961	17,496	18,080	18,711	19,280
Percent change		13.7%	-7.7%	3.3%	3.5%	3.0%

The provisions for the credit contained in the conference agreement, excluding the compliance-related provisions, would affect 14.5 million households.[11] Because the maximum earned income to which the credit rate applies and the income level at which the credit begins to phase out is slightly greater under the conference agreement than under present law, 3.7 million of the 14.5 million households affected by the conference agreement would receive a slightly larger credit. The EIC would increase by $7 on average for these households. Over 70 percent of the reduction in the credit is borne by households with income over $20,000. The distribution of the changes to the credit is reflected in Table 3.

[11] The compliance-related provisions contained in the conference agreement are excluded from the analysis in the remainder of this discussion.

Table 3.--
Distribution of Returns Affected by the Changes to the EIC Not Relating to Compliance Under the Conference Agreement, Tax Year 1996

	Returns Affected	
Income category	**Returns**	**Amount**
Less than $10,000	3,588	$502
$10,000 - $20,000	5,398	628
$20,000 - $30,000	4,398	1,977
$30,000 - $40,000	1,040	679
$40,000 - $50,000	82	59
$50,000 - $75,000	25	30
More than $75,000	0	0
Total	14,531	3,876

Returns are in thousands and amounts are in millions of dollars.

Tables 4 through 6 present the distribution of returns affected by the EIC provisions contained in the conference agreement. Table 4 shows the distribution of returns affected by the affluence tests. As expected, the affluence tests mainly affect households with income above $20,000. Approximately 80 percent of the reduction in the credit from these provisions is from households with income greater than $20,000.

Table 4.--
Distribution of Returns Affected by the Affluence Tests
Under the Conference Agreement,
Tax Year 1996

	Returns with Qualifying Children	
Income category	Returns	Amount
Less than $10,000	29	$24
$10,000 - $20,000	462	277
$20,000 - $30,000	806	735
$30,000 - $40,000	353	417
$40,000 - $50,000	64	54
$50,000 - $75,000	19	26
More than $75,000	0	0
Total	1,729	1,533

Returns are in thousands and amounts are in millions of dollars.

Under present law, households without qualifying children cannot receive the credit if the greater of their earned income or AGI exceeds $9,500 in 1996. Thus, virtually all of the reduction in the credit due to eliminating the credit for childless workers comes from households with income below $20,000. This is shown in Table 5.

Table 5.--
Distribution of Returns Affected by
Denying the EIC to Workers Without Qualifying Children
Under the Conference Agreement,
Tax Year 1996

Income category	Returns	Amount
Less than $10,000	2,642	$480
$10,000 - $20,000	777	119
$20,000 - $30,000	109	16
$30,000 - $40,000	19	3
$40,000 - $50,000	1	[*]
$50,000 - $75,000	0	0
More than $75,000	0	0
Total	3,548	619

Returns are in thousands and amounts are in millions of dollars.
[*] Less than $500,000.

The conference agreement maintains the credit rate for households with two or more qualifying children at 36 percent and establishes a two-tiered phaseout of the credit. In addition, an enhancement factor is applied to the earned income of households with two or more qualifying children. The enhancement factor is designed to increase the credit for low-income households with two or more qualifying children. The distribution of returns affected by these provisions is shown in Table 6. Approximately 87 percent of the reduction in the credit due to these provisions comes from households with income above $20,000. The enhancement factor benefits low-income households with two or more qualifying children. Without the enhancement factor, 40 percent of the reduction in the credit from the combination of the two-tier phaseout and maintaining the credit rate at 36 percent for individuals with two or more qualifying children would come from households with income below $20,000.

Table 6.--
Distribution of Returns Affected by the Changes to the Credit Rate, the Credit Phaseout, and the Enhancement Factor Under the Conference Agreement, Tax Year 1996

Income category	Returns	Amount
Less than $10,000	6	$1
$10,000 - $20,000	1,708	230
$20,000 - $30,000	3,784	1,174
$30,000 - $40,000	947	307
$40,000 - $50,000	77	21
$50,000 - $75,000	17	5
More than $75,000	0	0
Total	6,539	1,739

Returns are in thousands and amounts are in millions of dollars.

B. Interaction Between the EIC Changes and the $500 Child Tax Credit

For EIC recipients with qualifying children, the $500 per child tax credit may offset the changes in the EIC. In 1996, the standard deduction is expected to be $5,900 for individuals filing as head of household and $6,700 for joint filers. Each personal exemption will provide a $2,550 deduction from AGI. Hence, a single parent with two dependents who claims the standard deduction will pay income taxes on income only in excess of $13,550 in 1996. Joint filers with two dependents taking the standard deduction will not begin to pay income taxes until AGI exceeds $16,900. Since the $500 child credit contained in the conference agreement can only be used to offset income taxes, maintaining the credit rate at 36 percent for households with two or more qualifying children could adversely affect households with low income when compared with present law. The enhancement-factor adjustment increases the earned income of households with two or more qualifying children by 10/9ths for the purpose of calculating the EIC. The enhancement factor is reduced for households with income above $14,000 for individuals filing as head of household and $17,000 for joint filers. The enhancement factor is intended to ensure that most households with two children will not be affected adversely by the changes to the EIC compared to present law. Tables 7a-7d present the changes in income taxes, payroll taxes, and net change in taxes (including any refundable EIC) for hypothetical households under the conference agreement. These examples assume that (1) the households take the standard deduction, (2) the qualifying children are eligible for the child credit, (3) the qualifying children are the households' only dependents, (4) the households do not receive any other tax credits, and (5) the households are not affected by the affluence tests.

Under these assumptions, a household would benefit under the conference agreement if the household has one qualifying child and income above $6,330 or the household has two qualifying children and income above $8,890. Other households with one or two qualifying children would have no change in taxes under the conference agreement if the five conditions outlined above apply.

Also, a comparison between the EIC and the FICA payroll taxes is shown in Tables 7a-7d. Under both present law and the conference agreement, households with one qualifying child and income less than $12,810 will receive an EIC greater than the employee's and employer's share of FICA taxes. For households with two or more qualifying children, the EIC will exceed the employee's and employer's share of FICA taxes if the household's income is less than $16,500.

Table 7a.--
Earned Income Credit and $500 Child Credit
Under the Conference Agreement,
Head of Household with One Child
Tax Year 1996

AGI = Earned Income	Federal Income Tax Before Credits, Present Law	Federal Income Tax Before Credits, Conference Agreement	Child Credit	EIC Present Law	EIC Conference Agreement	Change in EIC	Employee's Share FICA Payroll Taxes	Employer's Share FICA Payroll Taxes	Refundable EIC Present Law	Refundable EIC Conference Agreement	Change in Refundable EIC	Net Change in Taxes Including Refundable EIC
1,000	0	0	0	340	340	0	77	77	340	340	0	0
2,000	0	0	0	680	680	0	153	153	680	680	0	0
3,000	0	0	0	1,020	1,020	0	230	230	1,020	1,020	0	0
4,000	0	0	0	1,360	1,360	0	306	306	1,360	1,360	0	0
5,000	0	0	0	1,700	1,700	0	383	383	1,700	1,700	0	0
6,000	0	0	0	2,040	2,040	0	459	459	2,040	2,040	0	0
7,000	0	0	0	2,152	2,156	3	536	536	2,152	2,156	3	-3
8,000	0	0	0	2,152	2,156	3	612	612	2,152	2,156	3	-3
9,000	0	0	0	2,152	2,156	3	689	689	2,152	2,156	3	-3
10,000	0	0	0	2,152	2,156	3	765	765	2,152	2,156	3	-3
11,000	0	0	0	2,152	2,156	3	842	842	2,152	2,156	3	-3
12,000	150	150	150	2,090	2,096	7	918	918	1,940	2,096	157	-157
13,000	300	300	300	1,930	1,937	7	995	995	1,630	1,937	307	-307
14,000	450	450	450	1,770	1,777	7	1,071	1,071	1,320	1,777	457	-457
15,000	600	600	500	1,610	1,611	1	1,148	1,148	1,010	1,511	501	-501
16,000	750	750	500	1,451	1,411	-40	1,224	1,224	701	1,161	460	-460
17,000	900	900	500	1,291	1,211	-80	1,301	1,301	391	811	420	-420
18,000	1,050	1,050	500	1,131	1,011	-120	1,377	1,377	81	461	380	-380
19,000	1,200	1,200	500	971	811	-160	1,454	1,454	0	111	111	-340
20,000	1,350	1,350	500	811	611	-200	1,530	1,530	0	0	0	-300
21,000	1,500	1,500	500	652	411	-241	1,607	1,607	0	0	0	-259
22,000	1,650	1,650	500	492	211	-281	1,683	1,683	0	0	0	-219
23,000	1,800	1,800	500	332	11	-321	1,760	1,760	0	0	0	-179
24,000	1,950	1,950	500	172	0	-172	1,836	1,836	0	0	0	-328
25,000	2,100	2,100	500	12	0	-12	1,913	1,913	0	0	0	-488
26,000	2,250	2,250	500	0	0	0	1,989	1,989	0	0	0	-500
27,000	2,400	2,400	500	0	0	0	2,066	2,066	0	0	0	-500
28,000	2,550	2,550	500	0	0	0	2,142	2,142	0	0	0	-500
29,000	2,700	2,700	500	0	0	0	2,219	2,219	0	0	0	-500
30,000	2,850	2,850	500	0	0	0	2,295	2,295	0	0	0	-500
40,000	4,350	4,350	500	0	0	0	3,060	3,060	0	0	0	-500
50,000	6,741	6,741	500	0	0	0	3,825	3,825	0	0	0	-500

Details may not add to totals due to rounding.

Table 7b.--
Earned Income Credit and $500 Child Credit Under the Conference Agreement, Head of Household with Two Children Tax Year 1996

AGI = Earned Income	Federal Income Tax Before Credits, Present Law	Federal Income Tax Before Credits, Conference Agreement	Child Credit	EIC Present Law	EIC Conference Agreement	Change in EIC	Employee's Share FICA Payroll Taxes	Employer's Share FICA Payroll Taxes	Refundable EIC Present Law	Refundable EIC Conference Agreement	Change in Refundable EIC	Net Change in Taxes Including Refundable EIC
1,000	0	0	0	400	400	0	77	77	400	400	0	0
2,000	0	0	0	800	800	0	153	153	800	800	0	0
3,000	0	0	0	1,200	1,200	0	230	230	1,200	1,200	0	0
4,000	0	0	0	1,600	1,600	0	306	306	1,600	1,600	0	0
5,000	0	0	0	2,000	2,000	0	383	383	2,000	2,000	0	0
6,000	0	0	0	2,400	2,400	0	459	459	2,400	2,400	0	0
7,000	0	0	0	2,800	2,800	0	536	536	2,800	2,800	0	0
8,000	0	0	0	3,200	3,200	0	612	612	3,200	3,200	0	0
9,000	0	0	0	3,556	3,564	8	689	689	3,556	3,564	8	-8
10,000	0	0	0	3,556	3,564	8	765	765	3,556	3,564	8	-8
11,000	0	0	0	3,556	3,564	8	842	842	3,556	3,564	8	-8
12,000	0	0	0	3,474	3,486	12	918	918	3,474	3,486	12	-12
13,000	0	0	0	3,263	3,275	12	995	995	3,263	3,275	12	-12
14,000	68	68	68	3,053	3,065	12	1,071	1,071	2,985	3,065	80	-80
15,000	218	218	218	2,842	2,765	-77	1,148	1,148	2,625	2,765	141	-141
16,000	368	368	368	2,631	2,465	-166	1,224	1,224	2,264	2,465	202	-202
17,000	518	518	518	2,421	2,166	-255	1,301	1,301	1,903	2,166	262	-262
18,000	668	668	668	2,210	1,856	-354	1,377	1,377	1,543	1,856	313	-313
19,000	818	818	818	2,000	1,606	-393	1,454	1,454	1,182	1,606	424	-424
20,000	968	968	968	1,789	1,356	-433	1,530	1,530	822	1,356	535	-535
21,000	1,118	1,118	1,000	1,578	1,106	-472	1,607	1,607	461	989	528	-528
22,000	1,268	1,268	1,000	1,368	856	-512	1,683	1,683	100	589	488	-488
23,000	1,418	1,418	1,000	1,157	606	-551	1,760	1,760	0	189	189	-449
24,000	1,568	1,568	1,000	947	356	-590	1,836	1,836	0	0	0	-410
25,000	1,718	1,718	1,000	736	106	-630	1,913	1,913	0	0	0	-370
26,000	1,868	1,868	1,000	525	0	-525	1,989	1,989	0	0	0	-475
27,000	2,018	2,018	1,000	315	0	-315	2,066	2,066	0	0	0	-685
28,000	2,168	2,168	1,000	104	0	-104	2,142	2,142	0	0	0	-896
29,000	2,318	2,318	1,000	0	0	0	2,219	2,219	0	0	0	-1,000
30,000	2,468	2,468	1,000	0	0	0	2,295	2,295	0	0	0	-1,000
40,000	3,968	3,968	1,000	0	0	0	3,060	3,060	0	0	0	-1,000
50,000	6,027	6,027	1,000	0	0	0	3,825	3,825	0	0	0	-1,000

Details may not add to totals due to rounding.

Table 7c.--
Earned Income Credit and $500 Child Credit
Under the Conference Agreement,
Joint Return with One Child
Tax Year 1996

AGI = Earned Income	Federal Income Tax Before Credits, Present Law	Federal Income Tax Before Credits, Conference Agreement	Child Credit	EIC Present Law	EIC Conference Agreement	Change in EIC	Employee's Share FICA Payroll Taxes	Employer's Share FICA Payroll Taxes	Refundable EIC Present Law	Refundable EIC Conference Agreement	Change in Refundable EIC	Net Change in Taxes Including Refundable EIC
1,000	0	0	0	340	340	0	77	77	340	340	0	0
2,000	0	0	0	680	680	0	153	153	680	680	0	0
3,000	0	0	0	1,020	1,020	0	230	230	1,020	1,020	0	0
4,000	0	0	0	1,360	1,360	0	306	306	1,360	1,360	0	0
5,000	0	0	0	1,700	1,700	0	383	383	1,700	1,700	0	0
6,000	0	0	0	2,040	2,040	0	459	459	2,040	2,040	0	0
7,000	0	0	0	2,152	2,156	3	536	536	2,152	2,156	3	-3
8,000	0	0	0	2,152	2,156	3	612	612	2,152	2,156	3	-3
9,000	0	0	0	2,152	2,156	3	689	689	2,152	2,156	3	-3
10,000	0	0	0	2,152	2,156	3	765	765	2,152	2,156	3	-3
11,000	0	0	0	2,152	2,156	3	842	842	2,152	2,156	3	-3
12,000	0	0	0	2,090	2,096	7	918	918	2,090	2,096	7	-7
13,000	0	0	0	1,930	1,937	7	995	995	1,930	1,937	7	-7
14,000	0	0	0	1,770	1,777	7	1,071	1,071	1,770	1,777	7	-7
15,000	98	98	98	1,610	1,611	1	1,148	1,148	1,513	1,611	98	-98
16,000	248	248	248	1,451	1,411	-40	1,224	1,224	1,203	1,411	208	-208
17,000	398	398	398	1,291	1,211	-80	1,301	1,301	893	1,211	318	-318
18,000	548	548	500	1,131	1,011	-120	1,377	1,377	584	964	380	-380
19,000	698	698	500	971	811	-160	1,454	1,454	274	614	340	-340
20,000	848	848	500	811	611	-200	1,530	1,530	0	264	264	-300
21,000	998	998	500	652	411	-241	1,607	1,607	0	0	0	-259
22,000	1,148	1,148	500	492	211	-281	1,683	1,683	0	0	0	-219
23,000	1,298	1,298	500	332	11	-321	1,760	1,760	0	0	0	-179
24,000	1,448	1,448	500	172	0	-172	1,836	1,836	0	0	0	-328
25,000	1,598	1,598	500	12	0	-12	1,913	1,913	0	0	0	-488
26,000	1,748	1,748	500	0	0	0	1,989	1,989	0	0	0	-500
27,000	1,898	1,898	500	0	0	0	2,066	2,066	0	0	0	-500
28,000	2,048	2,048	500	0	0	0	2,142	2,142	0	0	0	-500
29,000	2,198	2,198	500	0	0	0	2,219	2,219	0	0	0	-500
30,000	2,348	2,348	500	0	0	0	2,295	2,295	0	0	0	-500
40,000	3,848	3,848	500	0	0	0	3,060	3,060	0	0	0	-500
50,000	5,348	5,348	500	0	0	0	3,825	3,825	0	0	0	-500

Details may not add to totals due to rounding.

Table 7d.--
Earned Income Credit and $500 Child Credit Under the Conference Agreement, Joint Return with Two Children Tax Year 1996

AGI = Earned Income	Federal Income Tax Before Credits, Present Law	Federal Income Tax Before Credits, Conference Agreement	Child Credit	EIC Present Law	EIC Conference Agreement	Change in EIC	Employee's Share FICA Payroll Taxes	Employer's Share FICA Payroll Taxes	Refundable EIC Present Law	Refundable EIC Conference Agreement	Change in Refundable EIC	Net Change in Taxes Including Refundable EIC
1,000	0	0	0	400	400	0	77	77	400	400	0	0
2,000	0	0	0	800	800	0	153	153	800	800	0	0
3,000	0	0	0	1,200	1,200	0	230	230	1,200	1,200	0	0
4,000	0	0	0	1,600	1,600	0	306	306	1,600	1,600	0	0
5,000	0	0	0	2,000	2,000	0	383	383	2,000	2,000	0	0
6,000	0	0	0	2,400	2,400	0	459	459	2,400	2,400	0	0
7,000	0	0	0	2,800	2,800	0	536	536	2,800	2,800	0	0
8,000	0	0	0	3,200	3,200	0	612	612	3,200	3,200	0	0
9,000	0	0	0	3,556	3,564	8	689	689	3,556	3,564	8	-8
10,000	0	0	0	3,556	3,564	8	765	765	3,556	3,564	8	-8
11,000	0	0	0	3,556	3,564	8	842	842	3,556	3,564	8	-8
12,000	0	0	0	3,474	3,486	12	918	918	3,474	3,486	12	-12
13,000	0	0	0	3,263	3,275	12	995	995	3,263	3,275	12	-12
14,000	0	0	0	3,053	3,065	12	1,071	1,071	3,053	3,065	12	-12
15,000	0	0	0	2,842	2,854	12	1,148	1,148	2,842	2,854	12	-12
16,000	0	0	0	2,631	2,644	12	1,224	1,224	2,631	2,644	12	-12
17,000	15	15	15	2,421	2,433	12	1,301	1,301	2,406	2,433	27	-27
18,000	165	165	165	2,210	2,124	-87	1,377	1,377	2,045	2,124	78	-78
19,000	315	315	315	2,000	1,784	-215	1,454	1,454	1,685	1,784	100	-100
20,000	465	465	465	1,789	1,445	-344	1,530	1,530	1,324	1,445	121	-121
21,000	615	615	615	1,578	1,106	-472	1,607	1,607	963	1,106	143	-143
22,000	765	765	765	1,368	856	-512	1,683	1,683	603	856	253	-253
23,000	915	915	915	1,157	606	-551	1,760	1,760	242	606	364	-364
24,000	1,065	1,065	1,000	947	356	-590	1,836	1,836	0	291	291	-410
25,000	1,215	1,215	1,000	736	106	-630	1,913	1,913	0	0	0	-370
26,000	1,365	1,365	1,000	525	0	-525	1,989	1,989	0	0	0	-475
27,000	1,515	1,515	1,000	315	0	-315	2,066	2,066	0	0	0	-685
28,000	1,665	1,665	1,000	104	0	-104	2,142	2,142	0	0	0	-896
29,000	1,815	1,815	1,000	0	0	0	2,219	2,219	0	0	0	-1,000
30,000	1,965	1,965	1,000	0	0	0	2,295	2,295	0	0	0	-1,000
40,000	3,465	3,465	1,000	0	0	0	3,060	3,060	0	0	0	-1,000
50,000	4,965	4,965	1,000	0	0	0	3,825	3,825	0	0	0	-1,000

Details may not add to totals due to rounding.

Not all households receiving the EIC meet the assumptions stipulated in the examples in Tables 7a through 7d. Table 8 shows the effect on households receiving the EIC when the changes in that credit are combined with the $500 child credit.

Table 8.--
Distribution of the Combined Effect of the Modification of the EIC and the Child Credit on EIC Recipients Under the Conference Agreement, Tax Year 1996

	All Recipients		Recipients with Children	
Income category	Returns	Change in Taxes*	Returns	Change in Taxes*
Less than $10,000	5,673	$503	3,024	$21
$10,000 - $20,000	5,886	3	5,105	-116
$20,000 - $30,000	4,443	344	4,334	328
$30,000 - $40,000	1,049	114	1,030	111
$40,000 - $50,000	83	28	82	28
$50,000 - $75,000	25	24	25	24
More than $75,000	0	0	0	0
Total	17,159	1,016	13,600	397

Returns are in thousands and changes are in millions of dollars.
*Including refundable portion of the earned income credit

When the changes to the EIC under the conference agreement are combined with the $500 child credit, the average detriment to an EIC recipient is $59. For households with qualifying children, the average detriment is $29. Many households with qualifying children are affected by the affluence tests. If the households affected by the affluence tests are not included, then households with qualifying children benefit by an average of $95. Table 9 shows the distributional effect of these change for households that have qualifying children and that are not affected by the affluence tests.

Table 9.--
Distribution of the Combined Effect of the Modification of the EIC and the Child Credit on EIC Recipients Not Affected by the Affluence Tests Under the Conference Agreement, Tax Year 1996

	Recipients with Children	
Income category	Returns	Change in Taxes*
Less than $10,000	2,800	$-4
$10,000 - $20,000	4,345	-406
$20,000 - $30,000	3,479	-439
$30,000 - $40,000	672	-226
$40,000 - $50,000	18	-7
$50,000 - $75,000	6	0
More than $75,000	0	0
Total	11,320	-1,081

Returns are in thousands and changes are in millions of dollars.
*Including refundable portion of the earned income credit

Most households (10.3 million) receiving the credit under present law would be better off or unaffected under the conference agreement. The remaining 6.8 million EIC recipients would be adversely affected by the combined impact of the EIC changes and the child credit contained in the conference agreement. Over half of these households do not have qualifying children. Of the 3.2 million households with qualifying children that would be adversely affected by the changes to the credit, 1.6 million are affected by the affluence tests, 0.3 million itemize rather than choosing the standard deduction, 0.6 million have more dependents than qualifying children, 0.6 million have qualifying children that are not eligible for the child credit, and 0.2 million claim the dependent care credit. Ninety percent of the 6.8 million households adversely affected by the combined effect of the EIC changes and the child credit would not pay more in income taxes to the federal government; instead, they would receive a smaller refundable EIC. Some of those households adversely affected would nevertheless receive an EIC in 1996 and thereafter that was the same as or in excess of the EIC they received in 1995. A summary of the effects that the changes in the EIC and child credit made by the conference agreement would have on present-law EIC recipients is shown in Table 10.

Table 10.--
Summary of the Combined Effect of the Modification of the EIC and the Child Credit on EIC Recipients Under the Conference Agreement, Tax Year 1996

Returns unaffected or better off:			10.3 million
Returns worse off:			6.8 million
Without qualifying children:		3.5 million	
With qualifying children:		3.3 million	
Affected by the affluence tests:	1.6 million		
Itemize deductions:	0.3 million		
Have more dependents than qualifying children:	0.6 million		
Have a qualifying child not eligible for the child credit:	0.6 million		
Receive the dependent care credit:	0.2 million		
Total Returns:			17.1 million

Table 11 shows the distribution of the 6.8 million EIC recipients adversely affected by the combined effect of the EIC changes and the child credit contained in the conference agreement.

Table 11.--
Distribution of the Combined Effect of the Modification of the EIC and the Child Credit on EIC Recipients Adversely Affected Under the Conference Agreement, Tax Year 1996

	All Recipients		Recipients with Children	
Income category	Returns	Change in Taxes*	Returns	Change in Taxes*
Less than $10,000	2,672	$506	31	$26
$10,000 - $20,000	1,753	493	976	374
$20,000 - $30,000	1,875	1,057	1,765	1041
$30,000 - $40,000	455	409	435	406
$40,000 - $50,000	53	41	53	41
$50,000 - $75,000	18	27	18	27
More than $75,000	0	0	0	0
Total	6,826	2,533	3,278	1,914

Returns are in thousands and changes are in millions of dollars.
*Including refundable portion of the earned income credit

Most households receiving the credit under present law would be better off or unaffected under the conference agreement. On average, these households would have a benefit of $147 compared to present law. The distribution of the changes for credit recipients favorably affected or unaffected by the conference agreement is presented in Table 12.

Table 12.--
Distribution of the Combined Effect of the Modification of the EIC and the Child Credit on EIC Recipients Favorably Affected or Unaffected Under the Conference Agreement, Tax Year 1996

Income category	Returns	Change in Taxes*
Less than $10,000	3,001	$-4
$10,000 - $20,000	4,132	-489
$20,000 - $30,000	2,568	-713
$30,000 - $40,000	595	-296
$40,000 - $50,000	29	-13
$50,000 - $75,000	7	-3
More than $75,000	0	0
Total	10,332	-1,518

Returns are in thousands and changes are in millions of dollars.
*Including refundable portion of the earned income credit

APPENDIX

The Appendix contains tables and charts providing additional information about the earned income credit.

Table A-1 is based on data from the Internal Revenue Service's Statistics of Income Division and shows over the history of the credit the number of families who received the credit, the total amount of credit claimed, and the portion of the credit in excess of income tax liability. The dollar amounts are not adjusted for inflation. Information for 1994 through 2000 is a projection by the staff of the Joint Committee on Taxation.

Table A-2 shows the credit parameters over the history of the credit in dollar amounts unadjusted for inflation.

Table A-3 converts the information for the earnings limit, the maximum credit, and the phaseout ranges from Table A-2 into 1995 dollars. It also converts the information on the total amount of credit and the average credit per family from Table A-1 into 1995 dollars.

Table A-1.--Data on Earned Income Credits Claimed, 1975-2000

Calendar year to which credit applies	Number of families who received (thousands)	Total amount of credit (millions)	Refunded portion of credit (millions)	Average credit per per family
1975	6,215	$1,250	$900	$201
1976	6,473	1,295	890	200
1977	5,627	1,127	880	200
1978	5,192	1,048	801	202
1979	7,135	2,052	1,395	288
1980	6,954	1,986	1,370	286
1981	6,717	1,912	1,278	285
1982	6,395	1,775	1,222	278
1983	7,368	1,795	1,289	224
1984	6,376	1,638	1,162	257
1985	7,432	2,088	1,499	281
1986	7,156	2,009	1,479	281
1987	8,738	3,391	2,930	450
1988	11,148	5,896	4,257	529
1989	11,696	6,595	4,636	564
1990	12,612	6,928	5,303	549
1991	13,105	10,589	7,849	808
1992	14,097	13,028	9,959	926
1993	15,117	15,537	12,028	945
1994[1]	17,156	18,666	15,722	1,088
1995[1]	17,376	22,208	19,040	1,278
1996[1]	17,228	24,031	20,552	1,395
1997[1]	17,423	24,880	21,270	1,428
1998[1]	17,581	25,844	22,079	1,470
1999[1]	17,817	26,902	22,807	1,510
2000[1]	18,061	27,664	23,303	1,532

[1] Projected

Source: 1975-1993: Internal Revenue Service, Statistics of Income, various years;
1994-2000: Joint Committee on Taxation calculations

Table A-2.--Earned Income Credit Parameters, 1975-1996
(dollar amounts unadjusted for inflation)

Calendar year	Credit rate	Minimum income for maximum credit	Maximum credit	Phaseout rate	Phaseout range: Beginning income	Ending income
1975-78	10.00%	$4,000	$400	10.00%	$4,000	$8,000
1979-84	10.00	5,000	500	12.50	6,000	10,000
1985-86	11.00	5,000	550	12.22	6,500	11,000
1987	14.00	6,080	851	10.00	6,920	15,432
1988	14.00	6,240	874	10.00	9,840	18,576
1989	14.00	6,500	910	10.00	10,240	19,340
1990	14.00	6,810	953	10.00	10,730	20,264
1991:						
One child	16.70	7,140	1,192	11.93	11,250	21,250
Two children	17.30	7,140	1,235	12.36	11,250	21,250
1992:						
One child	17.60	7,520	1,324	12.57	11,840	22,370
Two children	18.40	7,520	1,384	13.14	11,840	22,370
1993:						
One child	18.50	7,750	1,434	13.21	12,200	23,050
Two children	19.50	7,750	1,511	13.93	12,200	23,050
1994:						
No children	7.65	4,000	306	7.65	5,000	9,000
One child	26.30	7,750	2,038	15.98	11,000	23,755
Two children	30.00	8,425	2,528	17.68	11,000	25,296

Table A-2.--Earned Income Credit Parameters, 1975-1996
(dollar amounts unadjusted for inflation)

Calendar year	Credit rate	Minimum income for maximum credit	Maximum credit	Phaseout rate	Phaseout range: Beginning income	Ending income
1995:						
No children	7.65%	$4,100	$314	7.65%	$5,130	$9,230
One child	34.00	6,160	2,094	15.98	11,290	24,396
Two children	36.00	8,640	3,110	20.22	11,290	26,673
1996:						
No children	7.65	4,220	323	7.65	5,280	9,500
One child	34.00	6,330	2,152	15.98	11,610	25,078
Two children	40.00	8,890	3,556	21.06	11,610	28,495

Source: Compiled by staff of the Joint Committee on Taxation

Table A-3.--Earned Income Credit Parameters, 1975-1995 in 1995 Dollars

Calendar year		Adjusted to 1995 dollars by CPI-U					
		Minimum income for maximum credit	Maximum credit	Phaseout range		Total amount of credit (millions)	Average credit per per family
				Beginning income	Ending income		
1975		$11,352	$1,135	$11,352	$22,704	$3,548	$570
1976		10,734	1,073	10,734	21,467	3,475	537
1977		10,078	1,008	10,078	20,157	2,840	504
1978		9,367	937	9,367	18,734	2,454	473
1979		10,516	1,052	12,619	21,031	4,316	606
1980		9,265	926	11,118	18,530	3,680	530
1981		8,399	840	10,078	16,797	3,212	479
1982		7,911	791	9,493	15,822	2,808	440
1983		7,665	766	9,198	15,330	2,752	343
1984		7,348	735	8,817	14,695	2,407	378
1985		7,095	780	9,224	15,609	2,963	399
1986		6,966	766	9,055	15,324	2,799	391
1987		8,172	1,144	9,301	20,742	4,558	605
1988		8,054	1,128	12,700	23,975	7,610	683
1989		8,004	1,121	12,609	23,814	8,121	694
1990		7,956	1,113	12,535	23,673	8,093	641
1991						11,871	906
	One child	8,004	1,336	12,612	23,822		
	Two children	8,004	1,384	12,612	23,822		
1992						14,178	1,008
	One child	8,184	1,441	12,885	24,345		
	Two children	8,184	1,506	12,885	24,345		
1993						16,417	999
	One child	8,189	1,515	12,891	24,356		
	Two children	8,189	1,597	12,891	24,356		
1994						20,242	1,121
	No children	4,121	315	5,151	9,272		
	One child	7,985	2,100	11,333	24,474		
	Two children	8,680	2,605	11,333	26,062		
1995						23,310	1,265
	No children	4,100	314	5,130	9,230		
	One child	6,160	2,094	11,290	24,396		
	Two children	8,640	3,110	11,290	26,673		

Source: Joint Committee on Taxation calculations