

**DESCRIPTION OF CHAIRMAN'S MARK
OF PROVISIONS RELATING TO
THE EARNED INCOME CREDIT**

Scheduled for Markup

by the

SENATE COMMITTEE ON FINANCE

on

June 26, 1996

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

June 25, 1996

JCX-32-96

CONTENTS

	<u>Page</u>
INTRODUCTION	1
EARNED INCOME CREDIT PROVISIONS	2
1. Deny credit to individuals not authorized to be employed in the United States	2
2. Change test for disqualified income	4
3. Modify definition of adjusted gross income used for phasing out the credit	5
4. Suspend inflation adjustments for individuals with no qualifying children	6

INTRODUCTION

This document,¹ prepared by the staff of the Joint Committee on Taxation, contains a description of proposed modifications to the earned income credit to be considered by the Senate Committee on Finance on June 26, 1996. The Committee has scheduled a markup of welfare reform (S. 1795) for June 26, 1996.

¹ This document may be cited as follows: Joint Committee on Taxation, *Description of Chairman's Mark of Provisions Relating to the Earned Income Credit* (JCX-32-96), June 25, 1996.

EARNED INCOME CREDIT PROVISIONS

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

Present Law

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 individual's² 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 individuals 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 individuals with earned income (or AGI, if greater) in excess of the end of the phaseout range, no credit is allowed.

The parameters for the credit depend upon the number of qualifying children the individual claims. For 1996, the parameters are given in the following table:

	Two or more qualifying children--	One qualifying child--	No qualifying children--
Credit rate (percent)	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 (percent)	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

² In the case of a married individual who files a joint return with his or her spouse, the income for purposes of these tests is the combined income of the couple.

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.

Thus, for 1997 the parameters are projected to be as follows:

	Two or more qualifying children--	One qualifying child--	No qualifying children--
Credit rate (percent)	40.00	34.00	7.65
Earned income amount	\$9,120	\$6,500	\$4,330
Maximum credit	\$3,648	\$2,210	\$331
Phaseout begins	\$11,910	\$11,910	\$5,420
Phaseout rate (percent)	21.06	15.98	7.65
Phaseout ends	\$29,232	\$25,740	\$9,750

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.

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 1996, individuals must provide a taxpayer identification number (TIN) 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.

Mathematical or clerical errors

The Internal Revenue Service 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.

Description of Proposal

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 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).

If an individual fails to provide a correct taxpayer identification number, such omission would 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 would be treated as a mathematical or clerical error for purposes of the amount of credit allowed.

Effective Date

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

2. Change test for disqualified income

Present Law

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 individual for the taxable year exceeds \$2,350. This threshold is not indexed. 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).

Description of Proposal

For purposes of the disqualified income test, the following items would be added to the definition of disqualified income: capital gain net income and net passive income (if greater than zero) that is not self-employment income.

The threshold above which an individual is not eligible for the credit would be reduced from \$2,350 to \$2,200, and the threshold would be indexed for inflation after 1996.

Effective Date

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

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

Present Law

For individuals with earned income (or 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 individuals with earned income (or AGI, if greater) in excess of the end of the phaseout range, no credit is allowed.

Description of Proposal

The proposal would modify the definition of AGI used for phasing out the credit by including certain nontaxable income and by disregarding certain losses. The nontaxable items included would be:

- (1) tax-exempt interest, and
- (2) nontaxable distributions from pensions, annuities, and individual retirement arrangements (but only if not rolled over into similar vehicles during the applicable rollover period).

The losses disregarded would be:

- (1) net capital losses (if greater than zero),
- (2) net losses from trusts and estates,
- (3) net losses from nonbusiness rents and royalties, and
- (4) net losses from businesses, computed separately with respect to sole proprietorships (other than in farming), sole proprietorships in farming, and other businesses.

For purposes of disregard loss item (4), above, amounts attributable to a business that consists of the performance of services by the individual as an employee would not be taken into account.

Effective Date

The provisions including certain nontaxable income and disregarding certain losses would be effective for taxable years beginning after December 31, 1995.

4. Suspend inflation adjustments for individuals with no qualifying children

Present Law

To claim the credit, an individual must either have a qualifying child or meet other requirements. In order to claim a credit without a qualifying child, an individual must not be a dependent and must be over age 24 and under age 65.

The earned income amount and the beginning of the phaseout range are indexed for inflation; because the end of the phaseout range depends on these amounts as well as the phaseout rate and the credit rate, the end of the phaseout range will also increase if there is inflation.

Description of Proposal

In the case of individuals with no qualifying children there would be no adjustment for inflation after 1996 to the earned income amount and the beginning and ending points of the phaseout range.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1996