

**DESCRIPTION OF EARNED INCOME CREDIT  
PROVISIONS CONTAINED IN AN  
AMENDMENT IN THE NATURE OF A SUBSTITUTE  
TO BE OFFERED BY CHAIRMAN ARCHER**

Scheduled for Markup

by the

HOUSE COMMITTEE ON WAYS AND MEANS

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## INTRODUCTION

This document,<sup>1</sup> 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 House Committee on Ways and Means on June 12, 1996. The Committee has scheduled a markup of welfare reform for June 12, 1996, and these provisions are contained in an amendment in the nature of a substitute to be offered by Chairman Archer.

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<sup>1</sup> This document may be cited as follows: Joint Committee on Taxation, *Description of Earned Income Credit Provisions Contained in an Amendment in the Nature of a Substitute to be Offered by Chairman Archer* (JCX-28-96), June 11, 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 taxpayer'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 taxpayers 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 taxpayers 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:

	<b>Two or more qualifying children--</b>	<b>One qualifying child--</b>	<b>No qualifying children--</b>
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.

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 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.

### **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 taxpayer 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 would not be eligible for the credit would be reduced from \$2,350 to \$2,250, and the threshold would be indexed for inflation after 1997.

### **Effective Date**

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

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

### **Present Law**

For taxpayers 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 taxpayers 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 disregarding certain losses. 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) 50 percent of the net loss from businesses, computed separately with respect to sole proprietorships (other than in farming), sole proprietorships in farming, and other businesses.

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

#### Effective Date

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

#### **4. Second-tier phaseout of the credit**

##### Present Law

Under present law, for taxpayers 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 taxpayers 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 increase the phaseout rate of the credit for individuals with earned income (or modified AGI, if greater) in excess of a second-tier phaseout threshold. This second-tier phaseout would not apply to individuals with no qualifying children. For individuals with two or more qualifying children, the second-tier phaseout threshold would be \$21,360 and the phaseout rate for income in excess of that threshold would be 23.00 percent. For individuals with one qualifying child, the second-tier phaseout threshold would be \$17,340 and the phaseout rate for income in excess of that threshold would be 18.00 percent. These second-tier phaseout thresholds would be indexed for inflation after 1997. The phaseout rate applied to income between the present-law phaseout threshold and the new, second-tier phaseout threshold would be the same as would apply under present law for 1997 and future years. With these changes, the parameters of the credit for 1997 for individuals with one qualifying child and for individuals with two or more qualifying children will be as follows:

	<b>Two or more qualifying children</b>	<b>One qualifying child</b>
Credit rate (percent) .....	40.00	34.00
Earned income threshold .....	\$9,120	\$6,500
Maximum credit .....	\$3,648	\$2,210
First-tier phaseout threshold .....	\$11,910	\$11,910
First-tier phaseout rate (percent) .....	21.06	15.98
Second-tier phaseout threshold .....	\$21,360	\$17,340
Second-tier phaseout rate (percent) .....	23.00	18.00
Phaseout limit .....	\$28,568	\$24,797

**Effective Date**

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