NewYorkMakesWorkPay

Developing a path to employment for New Yorkers with disabilities

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Policy to Practice Brief # 11

The Federal Earned Income Tax Credit

A Work Incentive That Puts More Money in a Paycheck and Saves on Taxes

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About Policy-to-Practice Briefs

This document is one of a series of policy to practice briefs published as part of the New York Makes Work Pay initiative, a Comprehensive Employment Services Medicaid Infrastructure Grant funded by the U.S. Department of Health and Human Services, Centers for Medicare and Medicaid Services (CMS) to the New York State Office of Mental Health (OMH) and its management partners, the Burton Blatt Institute at Syracuse University and the Employment and Disability Institute (EDI) at Cornell University. The New York Makes Work Pay Initiative provides an array of services to employers and individuals with disabilities and the agencies and advocates that serve them, helping to remove obstacles to work and pave the way to self supporting employment.[1]

The thoughts and opinions expressed in these materials are those of the authors and do not necessarily reflect the viewpoints or official policy positions of the Social Security Administration (SSA), CMS, or OMH. The information, materials and technical assistance are intended solely as information guidance and are neither a determination of legal rights or responsibilities, nor binding on any agency implementation and/or administrative responsibilities.

This publication is based on federal Internal Revenue Service (IRS) laws, regulations, and policy. Although this is written for a New York audience, all of the IRS-related rules discussed are federally based and will play out the same in every state. Therefore, this will be a good resource for readers throughout the country.

1 A detailed description of the New York Makes Work Pay Project and its services can be found at http://www.NYMakesWorkPay.org.

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I. Introduction

Individuals with disabilities who work face many challenges. One challenge is making ends meet when transitioning from the world of receiving disability benefits to the world of work. A little-known federal work incentive, the Federal Earned Income Tax Credit (EITC) can help overcome that challenge. The EITC is a special tax benefit for working people who earn a low or moderate income, i.e., earnings up to $48,362 for a married couple with three children for the 2010 tax year. While the EITC potentially applies to any individual who works and has low income, it can certainly assist individuals with disabilities in the work force.

The Earned Income Tax Credit has several important purposes: offsetting a portion of living expenses and FICA contributions, providing much needed support to low-income workers and making work more attractive than government benefits. Individuals who qualify for the EITC and file a federal tax return can get back some or all of the federal income tax that was taken out of their pay during the year. They may also get extra money back from the Internal Revenue Service (IRS). Even individuals whose earnings are too low to owe income tax can get the EITC as a tax refund when their tax return is filed. The Earned Income Tax Credit may even offset any additional taxes individuals may otherwise owe at the end of the tax year. Amazingly, the EITC does not generally affect eligibility for Medicaid, food stamps, low-income housing subsidies, or Supplemental Security Income (SSI). The impact of the EITC on welfare benefits, including Temporary Assistance to Needy Families (TANF), will vary from state to state. In New York, EITC refunds or advance payments do not affect eligibility for welfare payments under either the Family Assistance or Safety Net programs.

This Policy-to-Practice Brief will explain what the Earned Income Tax Credit is and how it works. It will cover who is eligible for the EITC and how much it is worth. It will also explain how to use the EITC to get a tax refund. We will also provide information on the Earned Income Tax Credits available through New York State and the City of New York.

II. The Purpose of This Policy and Practice Brief

This Policy-to-Practice Brief, like others in this series, is directed primarily at benefits practitioners who provide some level of benefits planning services to Supplemental Security Income (SSI) and Social Security Disability Insurance (SSDI) beneficiaries. Our intent is not to provide a resource for either tax counseling or tax preparation. Rather, our intent is to provide a screening tool so that readers can educate SSI and SSDI beneficiaries about the potential benefits of the EITC and the general eligibility rules governing this special tax credit.

The authors are neither tax experts nor experts on the EITC criteria that will apply to any individual. For this reason, we will not provide citations to the law, regulation, and policy governing the EITC. We encourage readers, who should likewise encourage the beneficiaries they serve, to either consult with the IRS or a professional tax preparer to answer EITC questions as they apply to specific individuals. If the reader expects to screen their clients/consumers for potential EITC eligibility, including eligibility for advance EITC payments, we urge you to obtain IRS Publication 596, *Earned Income Credit*, which is available on the IRS website (65 pages in pdf format).[2] Again, your purpose in using this article and the IRS publication as reference materials is to help identify when a beneficiary might benefit from the EITC.

III. Who Is Eligible for the EITC?

A. A Wide Range of Single and Married Wage Earners, With or Without Children, Will Qualify for the EITC

Single or married people who worked full-time or part-time at some point in 2010, can qualify for the Earned Income Tax Credit, depending on their income. Workers who were raising one child in their home and had family income of less than $35,535 (or $40,545 for married workers) in 2010 can get an EITC, ranging from $3 to $3,050 for the tax year. Workers who were raising two children in their home and had family income of less than $40,363 (or $45,373 for married workers) in 2010 can get an EITC, ranging from $1 to $5,036. Workers who were raising three children in their home and had family income of less than $43,352 (or $48,362 for married workers) in 2010 can get an EITC, ranging from $1 to $5,666. Even workers between the ages of 25 and 64, who were not raising children in their home and had income below $13,460 (or $18,470 for married workers), can get an EITC, ranging from $1 to 457.

Example.[3] Jaime and Nancy are married and have two children, ages 20 and 21, who both attend college. Jaime is a former SSI recipient who is working despite his continuing severe disability. Jaime gets continuing Medicaid coverage under the work incentive known as 1619(b).

During 2010, Jaime worked full time and earned $15,523 in gross wages while Nancy worked part time and earned $10,000 in gross wages. They received $2 in bank interest during the 2010 tax year, but had no investment income or any additional source of taxable income. They reported $25,525 as their Adjusted Gross Income (AGI) on line 21 of

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2 See www.irs.gov/publications then select "Publication 596."

3 The authors have consulted with the IRS's tax resources and a tax specialist to make our examples as realistic as possible. Readers must keep in mind, however, that tax liability will always vary with individual circumstances.

IRS Form 1040A. Their children meet the relationship, age, residency and joint return tests to be Jaime and Nancy's qualifying children.

Now, let's apply the Earned Income Tax Credit to this scenario. Jaime and Nancy's adjusted gross income of $25,525 makes them eligible for an EITC of $4,180.[4] The EITC will eliminate any monies owed to the IRS and of course provide the couple with a refund.

The EITC is a tax credit and not a tax deduction. As a "refundable credit," once the value of the Earned Income Tax Credit is determined the tax savings are equal to the full value of the credit. So, in the example of Jaime and Nancy, this couple gets the full benefit of the $4,180 in combined tax savings and refund. By contrast, if the $4,180 were a tax deduction (such as mortgage interest for those who itemize), the tax savings would only be a percentage of the deduction (e.g., $418.00 for those in a 10 percent tax bracket). Also, with a deduction the greatest benefit is to reduce taxes owed to $0; the taxpayer would never receive a refund when they owe no taxes and no federal taxes were withheld from their paycheck.

IV. The Special Rules

By now, you are thinking that the EITC sounds too good to be true and there must be some special qualification rules. You are right! First, there are the qualification rules for everyone and then there are three sets of rules, depending on the individual: rules if you have a qualifying child, rules if you do not have a qualifying child, and the earnings rules.

A. Rules for Everyone

In addition to meeting the adjusted gross income requirements, individuals filing for the EITC must meet six other rules:

1. The Individual, Their Spouse (if Filing Jointly) and Any Qualifying Child Must Have a Valid Social Security number.

The individual seeking the EITC must have a valid Social Security number. In addition, the spouse if filing jointly, and the qualifying child, must have valid Social Security numbers. If the Social Security card of the individual claiming the tax credit (or the card of the spouse if filing a joint return) states "Not valid for Employment" and the Social Security card was issued so that the individual or the spouse could qualify for a federally funded benefit, like Medicaid, the individual with the notation on his or her card will not qualify for the EITC.

[4] See 2010 IRS Earned Income Credit Table, online at http://www.irs.gov/pub/irs-pdf/p596.pdf

2. The Individual's Filing Status Cannot Be "Married Filing Separately."

If the individual filing for the EITC is married, then he or she usually must file a joint return to claim the credit. The one exception is for the individual whose spouse has not lived with them at any time in the last six months of the year. Under those circumstances, the individual can file as head of the household instead of married filing separately and still qualify for the EITC.

3. The Individual Must Be a U.S. Citizen or Resident Alien all Year.

An individual who is resident alien in any part of the year cannot claim the credit unless he or she is married to a U.S. citizen or another resident alien and chooses to be treated as a resident alien for the entire year by filing a joint tax return. This means that the individual and spouse will be taxed on their worldwide income for the year.

4. The Individual Cannot File Form 2555, Foreign Earned Income, or Form 2555-EZ, Foreign Earned Income Exclusion.

This is a follow-up to the rule above regarding taxation of worldwide income. The individual who plans to exclude income earned in foreign countries from their gross income cannot claim the EITC.

5. Investment Income Must Be $3,100 or Less.

An individual cannot claim the EITC unless the investment income (Form 1040, Form 1040A or Form 1040EZ) is $3,100 or less.

6. The Individual Must Have Earned Income.

This credit is called the Earned Income Tax Credit because to qualify an individual must work and have earned income. A married couple filing jointly meets this rule if one spouse works and has earned income. Earned income includes wages, salaries and tips, as well as net earnings from self-employment. Interestingly, strike benefits paid by a union to its members are treated as earned income for EITC purposes.

Disability benefits. If an individual is retired on disability, taxable benefits received under an employer's disability retirement plan are considered earned income until he or she reaches minimum retirement age. Minimum retirement age generally is the earlier age at which the individual could have received a pension or annuity if enrolled. By contrast, payments received from a disability insurance policy paid for by the employee are not earned income. Also, SSDI and railroad retirement benefits based on disability are not considered earned income for EITC purposes.

B. Rules If You Have a Qualifying Child

An individual who has a qualifying child and meets all the rules for everyone must also meet four more rules to qualify for the earned income tax credit:

1. The Child Must Meet the Definition of "Qualifying Child," As Broadly Defined.

To be a qualifying child, a child must be the son, daughter, adopted child, stepchild, or descendant of any of them (for example, a grandchild); or an eligible foster child for whom the individual cared for as if they were their own child; or a brother, sister, stepbrother, stepsister, or descendant of any of them (for example, a niece or nephew) for whom the individual cared for as if they were their own child. A child does not have to be the dependent of the individual to be a qualifying child of the individual claiming the EITC.

2. A Qualifying Child Must Be Age Eligible and Must Have Lived With the Individual in the United States for at Least Half of the Year.

The child must be under age 19 at the end of the year, or a full-time student under age 24 at the end of the year, or permanently and totally disabled as defined by SSA, at any time during the year, no matter what age. The child must have lived in the United States with the individual, claiming the EITC, for at least half of the year. United States means the 50 states and the District of Columbia. It does not include Puerto Rico and Guam, which are considered U.S. possessions. A child who was born or died during the year is treated as having lived with the individual the entire year, if the individual's home was the child's home the entire time the child was alive during the year.

3. The Individual's Qualifying Child Cannot Be Used by Another Person to Claim the EITC.

Often, a child meets the rules to be a qualifying child of more than one person. Only one person, however, can treat the child as a qualifying child and access the EITC using that child. If two individuals have the same qualifying child, the two individuals can choose who will claim the EITC using that qualifying child. Sometimes, the two individuals cannot agree and both claim the EITC using the same child. Then, the government applies the following rules to decide who can treat the child as a qualifying child.

- If only one is the child's parent, only the parent can treat the child as a qualifying child.
- If both are the child's parents, only the parent with whom the child lived the longest during the year can treat the child as a qualifying child.

- If both are the child's parents and the child lived with each parent the same amount of time during the year, only the parent with the highest adjusted gross income can treat the child as a qualifying child.
- If neither is the child's parent, only the person with the highest adjusted gross income can treat the child as a qualifying child.

Example. An example will help illustrate the qualifying child rule. Ed and his five-year-old son, Jay, lived with Ed's mom (i.e., Jay's grandmother) all year. Ed is 25 years old and his only income was $13,500 from a part-time job. Ed's mom's only income was $21,999 from her job. Jay is a qualifying child of both Ed and Ed's mother as Jay meets the relationship, age, and residency tests for both Ed and his mother. Only one of the two can use Jay to claim the EITC. Ed and his mother may choose which will treat Jay as a qualifying child to claim the credit. If they cannot agree and both use Jay to claim the EITC, Ed as Jay's parent will be the only one allowed to treat Jay as a qualifying child to claim the credit.

Note: At age 25, Ed is not the qualifying child of his mother unless he is permanently and totally disabled. As noted in the next section, if Ed was the qualifying child of his mother, he could not claim the EITC.

4. The Individual Claiming the EITC Cannot Be a Qualifying Child of Another Person.

As already noted, an individual is the qualifying child of another person if: he or she is the son, daughter, adopted child, stepchild, grandchild or eligible foster child; or if he or she is the brother, sister, stepbrother, stepsister (or the child or grandchild of that person's brother, sister, stepbrother or stepsister) and that person cared for the individual as if they were their own child. Additionally, the qualifying child must meet the age and U.S. residency criteria as described above.

If the individual (or spouse if filing a joint return) is a qualifying child of another person, the individual cannot claim the EITC. This rule applies even if the person, for whom the individual is a qualifying child, does not meet all of the rules to claim the EITC or does not claim the credit.

Example. How does this rule work in real life? Let's look at Ed once again, changing the facts slightly. Ed and Jay live with Ed's mom all year. Ed is 22 years old and attended a trade school full time. Ed also had a part-time job and earned $6,800 for the tax year. Ed is a qualifying child of his mother as he meets the relationship, age (i.e., under age 24 and a student), and residency tests. Ed's mom can claim the EITC if she meets all the other requirements. Ed, however, cannot claim the EITC as he is his mother's qualifying child. Ed cannot claim the EITC even if his mother cannot or does not claim it.

C. Rules If You Do Not Have a Qualifying Child

An individual who does not have a qualifying child and meets all the rules for everyone must also meet the following four rules to qualify for the EITC:

1. The Qualifying Individual Must Be At Least Age 25, But Under Age 65, at the End of the Year.

If married and filing a joint return, either the individual or the individual's spouse must meet this requirement.

2. The Qualifying Individual Cannot Be the Dependent of Another Person.

If another person can claim the individual filing for the EITC (or their spouse if filing a joint return) as a dependent on his or her return but does not, the individual still cannot claim the credit.

3. The Qualifying Individual Cannot Be a Qualifying Child of Another Person.

The same rules that apply to an individual with a qualifying child apply to an individual with no qualifying children. If the individual (or spouse if filing a joint return) is a qualifying child of another person, the individual cannot claim the EITC. This rule applies even if the person, for whom the individual is a qualifying child, does not meet all of the rules to claim the EITC or does not claim the EITC.

4. The Qualifying Individual Must Have Lived in the United States at Least Half the Year.

The qualifying individual (and spouse, if filing jointly) must have lived in the U.S. for at least half of the year. United States means the 50 states and the District of Columbia. It does not include Puerto Rico and Guam, which are considered U.S. possessions. The home can be any location in which the individual regularly resides and need not be a traditional home. This means that if the individual lived in one or more homeless shelters for more than half the year, the individual meets this rule.

V. Rules for Computing and Claiming the Credit

A. The Individual's or Married Couple's Earned Income and Adjusted Gross Income Must Both Be Below the Limits Set by the IRS.

An individual or couple must know their gross earned income and then calculate adjusted gross income (AGI) in order to determine eligibility for the credit. In most cases, earned income and AGI will be nearly the same. However, in some cases, AGI (line 21 of IRS Form 1040A) could be significantly higher than earned income because the individual or couple must report some additional form of unearned income, such as stock dividends or unemployment benefits (see lines 9a and 13 of IRS Form 1040A). In other cases, AGI could be significantly lower than earned income because the individual or couple is allowed adjustments from gross income for items like an IRA deduction or a student loan interest deduction (see lines 17 and 18 of IRS Form 1040A).

To claim the Earned Income Tax Credit, both the earned income **and** the AGI of the individual or couple must be below the following designated amounts for 2010:

- for an individual with one qualifying child, less than $35,535 (or $40,545 if married, filing jointly); or
- for an individual with two qualifying children, less than $40,363 (or $45,373 if married, filing jointly); or
- for an individual with three qualifying children, less than $43,352 (or $48,362 if married, filing jointly); or
- for an individual with no qualifying child, between the ages of 25 and 64, less than $13,460 (or $18,470 if married, filing jointly).

B. The Amount of the EITC is Determined After Figuring AGI and Using the IRS's Earned Income Credit Table.

After determining that the individual or couple can claim the credit, the IRS's EITC table must be used to determine the amount of the credit. For example, we used that table in the example of Jaime and Nancy (part I, above) to determine they had a credit of $4,180 with an AGI of $25,525 and two qualifying children. A copy of the EITC table for tax year 2010 is available online at http://www.irs.gov/pub/irs-pdf/p596.pdf.

C. Taxpayers Will No Longer Get Advance EITC Payments.

As noted earlier, after 2010, individuals can no longer receive advance payments of the EITC in their pay as they could in 2010 and earlier years. This is because the law has changed. However, if an individual is eligible for the EITC, he or she will still be able to claim the credit on their return, filed in 2012.

VI. The EITC Can be Combined With Other Work Incentives When an SSI or SSDI Beneficiary Works

Individuals with disabilities will look to benefits practitioners to assist them in determining what special benefits and incentives may be available to make their transition into paid employment more realistic. In many cases, if the SSI or SSDI beneficiary looks to one program or benefit in isolation, the ability to succeed in employment and be self-supporting may not be evident. However, if the benefits specialist can assist the individual to identify multiple sources or program benefits and work incentives, the benefits of going to work may quickly emerge. The Earned Income Tax Credit is a special incentive that can be used in tandem with other incentives and program benefits to ease the transition into paid employment.

Example. Let's go back to the example of Jaime and Nancy from part I, above. Here, we'll introduce a few more facts about Jaime. His disability is quadriplegia, having been injured in an automobile accident many years ago. In May 2009, he graduated from college and began searching for work. Prior to taking his first job after college, however, he sought the advice of a benefits practitioner.

The benefits practitioner helped identify:

- Jaime's extended eligibility for Medicaid under the 1619(b) benefit after he loses SSI benefits due to wages;
- The potential eligibility for a Plan for Achieving Self Support (PASS) to purchase a van, using wages that would otherwise be counted in determining SSI eligibility;
- The use of funding through his state's vocational rehabilitation (VR) agency, New York's Office of Vocational and Educational Services to Individuals with Disabilities (VESID) to pay for modifications to the van to allow Jaime to drive it from his wheelchair;
- The ability to take advantage of the Section 8 Housing Choice Voucher Program's earned income disregard to maintain a consistent housing subsidy payment and avoid immediate rent increases when he finds his first job; and
- The ability to use the Earned Income Tax Credit to reduce his family's tax liability and even get extra money in his paycheck.

We will not attempt to specify how each of these incentives or program benefits would work in Jaime's case. We will point out, however, that all of these additional benefits or incentives, the 1619(b) Medicaid provisions, the PASS, VESID's funding of van modifications, and the housing subsidy program's incentives are items that should routinely be a part of the benefits planning assistance that benefits practitioners can offer to beneficiaries like Jaime. While benefits practitioners will not be expected to demonstrate the same expertise on the EITC that they have developed on things like 1619(b) or the PASS, identification of the potential benefits of the EITC will aide Jaime and others like him to make fully informed decisions as they move into paid employment.

VII. Receipt of EITC and Effect on SSI

SSA excludes all federal tax refunds and tax credits, including EITC, from countable income. Additionally, SSA excludes any unspent federal tax refund, including credits, from being counted as a resource for the 12 calendar months following the month the refund or payment is received. Finally, these funds do not have to be kept in a separate account to be excluded.

VIII. Rules Governing Misuse of the EITC

If the IRS denies an EITC and determines that the error was due to reckless or intentional disregard of the rules, then the individual cannot claim the credit for the next two years. If the IRS determines that the error was fraudulent, then the individual cannot claim the credit for the next 10 years.

IX. Residents of New York State and/or the City of New York May be Entitled to Additional Earned Income Tax Credits

New York State and New York City have enacted Earned Income Tax Credit (EITC) programs modeled on the federal program of the same name as a way to reduce taxes and supplement wages for low- and moderate-income working families. A large body of evidence has shown that the federal, state and city EITCs serve a number of important public policy goals. States that enact EITCs can reduce child poverty, cut taxes for low-income families, and increase the incentive to work.

The New York State EITC is 30% of the federal EITC and the New York City EITC is 5% of the federal EITC. Thus, if an individual lives in Manhattan and if their federal EITC is $1000, their New York State EITC will be an additional $300 and their New York City EITC will be an additional $50.

A. How To Claim This Credit

An individual can claim the New York State and New York City EITC by completing Form IT-215, Claim for Earned Income Credit and filing it with their New York State personal income tax return. An individual cannot file Form IT-215 separately.[5]

X. Conclusion

For individuals with disabilities, every penny counts. This brief provides an overview of the EITC and how an individual might qualify for it either upon filing a tax return at the end of the year or as an advance payment throughout the year. To assist benefits practitioners helping individuals determine whether they might be eligible for the credit, we recommend obtaining a copy of IRS Publication 596, *Earned Income Credit*, which includes checklists that can be used to screen for eligibility.[6]

5 http://www.tax.state.ny.us/pit/income_tax/earned_income_credit.htm

6 See footnote 2.

Finally, we wish to remind our readers that the authors of this brief are not tax attorneys or even specialists in the tax area. An individual with tax questions should consult a tax specialist or contact the IRS Taxpayer Assistance Centers. To find the number of the Taxpayer Assistance Centers go to www.irs.gov or look in the phone book under "U.S. Government, Internal Revenue Service." An individual with unresolved tax concerns should consult either the Taxpayer Advocate or a tax specialist. The Taxpayer Advocate independently represents an individual's interests and concerns within the IRS by protecting that individual's rights and resolving problems that have not been corrected through normal channels. To contact the Taxpayer Advocate, dial 1-877-777-4778 or 1-800-829-4059 (TTY/TDD user) or visit the IRS web site at www.irs.gov/advocate.

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