Center for American Progress

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By Rebecca Vallas, Melissa Boteach, and Rachel West October 2014

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Contents

Introduction and summary

The Center for American Progress' Poverty to Prosperity team is exploring policy solutions that strengthen and modernize our nation's safety net to reflect 21st century realities and to better facilitate economic mobility for families on the brink.

The Earned Income Tax Credit, or EITC, is one of the nation's largest and most effective anti-poverty tools. It is a federal tax credit for low- and moderate-income workers that encourages work, boosts family income, and offsets federal payroll and income taxes. In 2012, it helped more than 6.5 million Americans—including 3.3 million children—avoid poverty.[1] The Child Tax Credit, or CTC, protected about 3 million people—1.6 million of them children—from poverty in the same year.[2] A growing body of research finds that these credits are effective tools for boosting economic mobility: Children whose families receive the EITC and other income supports have higher rates of high school completion and increased adult earnings.[3] In addition to mitigating economic hardship, these tax credits serve as a powerful source of economic stimulus. For example, the EITC generates some $1.50 to $2.00 in economic activity for every $1 that goes to working families.[4]

Both the EITC and CTC have enjoyed wide bipartisan support throughout their history. Presidents from both political parties have taken action to strengthen the EITC since its enactment in 1975, and more recently, Republicans and Democrats alike have joined in praising the program for its effectiveness as an anti-poverty tool.[5] However, while the EITC effectively boosts economic security among families headed by low-wage workers, it is not a substitute for a living wage. Efforts to strengthen the EITC and CTC must go hand in hand with minimum-wage policies to ensure that no one who works full time has to live in poverty.[6]

Congress should act on several existing proposals to strengthen the EITC and CTC, such as making permanent the improvements enacted as part of the American Recovery and Reinvestment Act of 2009, or ARRA; enhancing the EITC for workers without qualifying children and lowering the minimum age for EITC eligibility, as recommended in the new Generation Progress report "A Ladder Up"; and making the CTC fully refundable and tying its value to inflation. In addition, this report offers a set of new policy solutions that harnesses the EITC as a tool for financial empowerment and upward economic mobility. These recommendations include:

- Strengthening the EITC as an asset-building tool for families who wish to use their tax refunds to build savings

- Creating an early-access provision that allows workers to access a small portion of their EITC ahead of tax time so they do not have to rely on predatory lending products and can take advantage of mobility-enhancing opportunities

- Increasing access to higher education and training through categorical eligibility for the maximum Pell Grant for EITC recipients and reforms to strengthen the American Opportunity Tax Credit

Building on existing proposals to strengthen the EITC, these reforms would enhance the credit's effectiveness as a tool for promoting economic mobility.

Recent improvements must be made permanent

Several key improvements to the Earned Income Tax Credit and Child Tax Credit were enacted in 2009 as part of the American Recovery and Reinvestment Act. First, ARRA strengthened the EITC for families with three or more children, recognizing the fact that larger families face higher living costs and are much more likely to be poor than smaller families. Second, it lessened "marriage penalties" for dual-earner families, addressing the reduced tax credits that some couples face if they decide to marry. Simultaneously, eligibility for the CTC was extended to working parents with low earnings. The CTC is partially refundable, subject to an earned income threshold. The ARRA reduced this threshold from more than $12,500 to $3,000 starting in 2009.[7] This has enabled many more low-income families to benefit from the CTC and has increased the amount of credit for which they qualify.[8]

These reforms have had a powerful anti-poverty effect. The improvements made to the EITC helped an estimated 600,000 people avoid poverty in 2012; they lessened the severity of poverty for an additional 10 million people in the same year.[9] Likewise, the changes to the CTC lifted an estimated 900,000 people out of poverty in 2012.[10]

However, these important improvements are set to expire in December 2017.[11] Action is needed to make them permanent and to further strengthen the EITC and CTC.

Building on recent proposals to strengthen the EITC and CTC

Policymakers have proposed several key reforms to strengthen these credits' ability to boost the economic security of working families. As currently structured, the Earned Income Tax Credit offers scant assistance to workers without qualifying children[12]—the only group of very low-income earners who still see their incomes substantially reduced by federal income taxes. The maximum EITC for workers without qualifying children is less than one-tenth of the credit available to families with two children. Policymakers of all political stripes[13]—as well as our colleagues at Generation Progress[14]—have called for strengthening the credit for workers without qualifying children.[15]

The very limited credit currently available to childless workers and noncustodial parents means that these workers are excluded from the demonstrated benefits of the EITC, which include increased income, reduced poverty rates, and increased labor-market participation. Furthermore, with the EITC'S current structure, this group of workers may actually be at a disadvantage, as research suggests that the EITC implicitly leads employers to pay somewhat lower wages.[16] Thus, workers with children who receive the EITC experience a net gain in income despite the wage decrease, but workers without qualifying children may end up with a net loss: They compete for the same jobs but are ineligible for a tax credit that more than offsets any reduction in market wages. Boosting the EITC for childless workers and noncustodial parents would largely address this problem. In addition, using minimum-wage policy to establish a strong wage floor would limit employers' ability to reduce overall market wages in response to the boost in labor supply the EITC creates.

Furthermore, many policymakers have proposed lowering the minimum age of eligibility for childless workers—currently 25 years of age—to allow young adults without qualifying children to benefit from the EITC.[17] When the EITC was first introduced, workers under age 25 without qualifying children were excluded due to the difficulty of determining student status for tax purposes. In light of improve-

Unregulated tax preparers put low-income taxpayers at risk

Despite the fact that paid tax preparers remain EITC filers' most common access point to the tax system, the federal government currently lacks the authority to regulate them. Although the IRS requires tax preparers to register with it, the courts have prohibited it from licensing and regulating them.[20] Regulation at the state level is scarce as well: Only four states regulate paid tax preparers.[21] A recent report from the Government Accountability Office, or GAO, found that paid preparers often make errors in filing.[22] But in Oregon—one of the states that regulate tax preparers—GAO found that paid preparers were 72 percent more likely to file accurate returns than the rest of the nation.[23] The GAO thus recommended that Congress consider legislation to allow the IRS to regulate the industry in order to "promote high-quality services from paid preparers, improve voluntary compliance, and … foster taxpayer confidence in the fairness of the tax system."[24]

In keeping with this recommendation, President Barack Obama's fiscal year 2015 budget proposal called for legislation that would give the U.S. Treasury Department and the IRS the authority to regulate paid preparers.[25] Congress should adopt such legislation to protect tax filers from costly errors; such regulatory authority would also enable the federal government to require increased transparency in paid preparers' fee structures. This would ensure that EITC filers are fully aware of how much they can expect to pay for tax preparation assistance and thus are able to make informed decisions when selecting a preparer to help them access their modest refunds.

ments in Internal Revenue Service data-collection procedures that make it possible to distinguish young people in the labor force from students, our colleagues at Generation Progress have recommended lowering the age of eligibility to 18 for young childless workers not claimed as dependents on others' tax returns.[18] This will enable young workers who are just starting out in their careers—and for whom labor-force participation and unemployment remain elevated following the 2008 recession—to benefit from the EITC. A further option—discussed in the Generation Progress report "A Ladder Up"—is to extend the EITC to low-income students who are nondependents for tax purposes and who are working to put themselves through school.[19]

In addition to these changes, two common-sense reforms should be made to the Child Tax Credit. First, it should be made completely refundable so that the most vulnerable families can benefit from its full value. Second, its value—currently $1,000 per child—should be indexed to the rate of inflation. Indexing is important to prevent the value of the CTC from continuing to erode, which shrinks the amount of assistance families receive with each passing year.

Building on these proposals, the following policy solutions would further boost the EITC's power to promote financial stability and economic mobility.

Enhancing the EITC as a tool to build savings

Savings are critical to help families weather unanticipated financial shocks. Even a small savings reserve can be a lifeline for families, allowing them to keep up on mortgage or rent payments, buy food for their children, or pay essential bills during financial emergencies. In addition, having savings to fall back on makes families less likely to need public assistance in order to make ends meet when faced with an income shock. Furthermore, savings help families plan for the future, enhancing their long-term financial security and prosperity.

Yet, despite the critical importance of building savings, many American families are unable to do so due to a variety of challenges. Tight budgets, daily financial strain, and unexpected emergencies—as well as lack of access to affordable savings mechanisms—make it particularly difficult for low-income families to regularly set aside money. According to the FINRA Investor Education Foundation's 2012 National Financial Capability Study, two in five American families report that they would "probably not" or "certainly not" be able to come up with $2,000 in 30 days in the event of an emergency or unexpected expense.[26] Among families at the bottom third of the income ladder, this share rises to 68 percent.[27] According to a separate report from the Federal Reserve, nearly half—45 percent—of respondents reported that they did not save any share of their income in 2012.[28] These figures highlight the high degree of economic vulnerability among many American households.

Tax time can provide a platform for helping recipients of the Earned Income Tax Credit build crucial savings. The majority of EITC recipients get money back at tax time in the form of a refund.[29] In fact, the EITC is often the largest lump-sum payment that low-income families receive all year: The average EITC received in 2013 was $2,335.[30] Studies indicate that people are more likely to save part of large lump sums such as tax refunds than to save smaller, incremental amounts such as paychecks.[31] This may be particularly true for low-income families who live paycheck to paycheck.

Indeed, many EITC recipients already opt to save at tax time. A recent survey found that saving was among the most common uses of tax refunds for EITC recipients: 47 percent reported saving a portion of their refunds.[32] However, an even higher percentage of EITC recipients would like to save a portion—or save a greater portion—of their refund at tax time: 69 percent of recipients planned to save a share of their EITC.

Policymakers could take several steps to make it easier for EITC recipients to build savings during tax time. As this report outlines, policymakers could further support those already engaged in saving or planning to save and could provide additional opportunities and incentives to those who may want to do so. A recent Center for American Progress report, "Helping Families Build Wealth at Tax Time," outlines how Congress, the IRS, and state policymakers can promote savings among low-income families at tax time.[33] Drawing upon these recommendations, the steps outlined in the following sections could make saving more rewarding, automatic, and flexible for EITC recipients.

Make saving more rewarding

In order to make saving more rewarding for EITC recipients, Congress should make two modifications to the Saver's Credit, which provides a partial match for the first $2,000 of savings—$4,000 for married couples filing jointly—deposited in a retirement account.[34] In its current form, the credit is not refundable, meaning that the many recipients who have little or no federal income tax liability are unable to benefit from it. Congress should make the Saver's Credit fully refundable.

Second, although the Saver's Credit matches savings at a rate of 50 percent for filers with adjusted gross incomes of $27,000 or less—$36,000 for married couples—the matching rate drops off steeply as earnings increase, to 20 percent and 10 percent for single and married filers, respectively.[35] This means that incomes still land well below the EITC threshold. Smoothing these "cliffs" in the matching rate would spur more EITC recipients to take advantage of the credit, encouraging and bolstering savings for a greater share of low-income families.

In addition to modifying the Saver's Credit, reforming the asset limits that remain in certain public assistance programs is necessary to remove significant savings barriers for EITC recipients. These counterproductive asset limits, or eligibility requirements that penalize savings and ownership, can make it difficult—if not impossible—for families to get the help they need when they fall on hard times and can effectively prohibit families from building savings as long as they continue to receive assistance. Moreover, the existence of asset limits discourages savings among low-income families who cannot afford to lose access to vital public programs. This is detrimental, as greater savings will bolster family economic security and enable progress toward economic self-sufficiency. As recommended in a recent CAP report, "Asset Limits Are a Barrier to Economic Security and Mobility," asset limit reform is needed to remove barriers to savings.[36]

In 2010, Congress excluded the EITC from consideration as income or as an asset for one year in federally funded, means-tested programs; it made this important step permanent in 2013. In states that have not already done so, policymakers should exempt families' EITC refunds from state-funded programs. Additionally, Congress and state policymakers should exclude tax-time savings from counting against asset limits in all public assistance programs.

Make saving automatic

Recognizing that making saving easy and widely available can greatly encourage people to save, the IRS allows tax filers to designate a portion of their tax refund for the purchase of U.S. savings bonds.[37] Additionally, the IRS provides filers with the option of direct deposit of their tax refunds.[38] Going forward, the findings of pilot programs such as Refund to Savings—an experiment launched in 2012 to test ways to present tax-time savings options—may offer further lessons for the design of automated savings opportunities.[39] As a growing number of Americans utilize free online software to complete their taxes, integrating recommendations from such experiments into IRS-approved software, such as Turbo Tax and H&R Block, could reach an expanding audience.

Importantly, one barrier to saving during tax time is that many EITC recipients do not have checking or savings accounts and thus have no place to directly deposit a portion of their refunds.[40] The IRS could address this problem by making it easy for those who do not already have bank accounts to open safe, affordable savings accounts at tax time.

Make saving flexible

Furthermore, filers must have a 401(k) or IRA in order to take advantage of the Saver's Credit. This excludes many low-income families who do not have pre-established retirement accounts or who may have more immediate savings goals than retirement. Extending the Saver's Credit to accommodate a wider range of savings objectives and safe, affordable account types could enable more families to take advantage of this matching opportunity. These accounts could include savings bonds, certificates of deposit, and higher-education savings accounts such as Section 529 and Coverdell accounts. In particular, extending savings opportunities to help families reach their education-related goals could have the additional benefit of encouraging low-income children to seek out higher education. Research suggests that dedicating even very small amounts of savings to higher education can significantly increase the likelihood that children attend college.[41]

Reforming the Treasury Offset Program to protect low-income Americans and their families

The Treasury Offset Program, or TOP, is a mechanism for collecting certain kinds of federal and state debts via the withholding of federal payments such as federal tax refunds.[42] Each year, many low-income workers see their EITC refund partly or entirely withheld through the TOP to pay old debts.[43] As much as 100 percent of an individual's federal tax refund—including the EITC—can be withheld to repay certain types of debts, such as federal student debt and child support arrears.

As a result, the TOP unintentionally erodes the EITC's power as an anti-poverty tool for low-income workers and their families. Protections are needed so that low-income workers do not see their earned EITC refunds seized, thus diminishing this important boost to their household incomes.

Recognizing the hardship that can result from the garnishment of federal payments, the TOP already includes limits on the percentage of certain types of payments that can be withheld. For example, Social Security payments can only be withheld up to a cap of 15 percent of the monthly benefit.[44] To protect low-income workers, Congress should adopt a similar cap of 15 percent for TOP withholding of the federal tax refunds of EITC recipients and other low-income filers who live under 150 percent of the federal poverty level.

Harnessing the EITC as a financial stability tool

As discussed above, the lump-sum nature of the EITC can make it a powerful tool to help families build savings. However, because workers must wait until after the end of the year to claim the credit that they have spent the entire year earning, they may fall behind on expenses in the meantime. Many families are forced to turn to predatory lending products, which can result in a downward debt spiral. Families may also find themselves short on cash needed to invest in timely opportunities that promote upward mobility, such as afterschool enrichment programs for their children.

While other in-kind work supports such as the Supplemental Nutrition Assistance Program—formerly called food stamps—or Medicaid can help offset some of low-wage workers' basic expenses, the EITC provides one of the few significant sources of discretionary income that struggling families can use to pay for expenses ranging from car repairs to investments in their children's education. However, for families living paycheck to paycheck, a broken radiator or unexpected medical bill may not be able to wait until tax time. This leads some to turn to predatory lending products, such as payday or auto title loans, to make ends meet. While these types of loans average only about $375, they can send families spiraling into poverty: The inability to repay loans with usurious interest rates can trap borrowers in a cycle of debt, cause people to lose the cars they need to get to work, and present other barriers to getting or keeping jobs.[45]

A potential solution is to introduce a partial "Early Refund" element into the EITC. This feature would preserve the EITC's ability to help families build savings, while at the same time giving them access to discretionary income to meet financial challenges or opportunities outside of tax season. CAP's Early Refund proposal is discussed in detail below.

Lessons from past policies

The ability to access EITC funds ahead of tax time is not a new idea. Until 2010, an EITC option called the Advance EITC allowed workers with qualifying children to access funds earlier.[46] Workers could choose to claim up to 60 percent of their anticipated EITC as part of their routine pay; employers used tables similar to withholding tables to determine how much money they should add to employees' paychecks each pay period.

However, less than 3 percent of eligible workers took advantage of the program, and there were several downsides to its approach.[47] First, the program was difficult to administer and had a high error rate. Some Advance EITC recipients did not have a valid Social Security number, some did not have a qualifying child, and some did not file the required federal tax return at the end of the year. Among those who did file, many failed to report receiving the Advance EITC—perhaps forgetting they had participated, as the money came as part of their regular paychecks. Some employers reported providing the Advance EITC—which lowered the amount of payroll taxes they were required to deposit—but did not add the payments to workers' paychecks. Given the very small amounts of money workers received through the Advance EITC, the IRS rarely took action against participants in the program who erroneously received funds.

Importantly, workers also feared owing money to the IRS at the end of the year if their earnings differed from initial expectations.[48] These fears were largely unfounded, since the advance payment was pegged to earnings in the contemporaneous pay period, adjusted to reflect changes in hours or pay, and stopped if the job ended. However, additional earnings by a spouse, from a second job, or from self-employment could change the amount of EITC for which workers qualified, and if workers were found ineligible for the EITC at tax time, they would owe advance payments to the IRS. Uncertain of the eligibility rules, many workers feared that by accepting an Advance EITC, they risked owing money at tax time. This reinforced the idea that waiting for the lump-sum refund was the safest option.

Another drawback of the Advance EITC is that it delivered the credit in the form of an ongoing wage supplement. Structuring the credit in this way could undermine efforts to raise the minimum wage. Research indicates that approximately 25 percent of the EITC is effectively passed on to employers in the form of lower employee wages.[49] Providing the EITC as a routine part of workers' paychecks risks reinforcing—or even increasing—the role the EITC plays in allowing employers to offer lower wages. Instead, the EITC should be viewed as an important complement to the minimum wage in boosting the earnings of low-wage workers.[50]

Policies that create an avenue to access part of the EITC ahead of tax time must address these challenges and limitations.

Insurance against predatory lending and a chance to invest in mobility opportunities

To address the problem of insufficient access to income at financially sensitive points throughout the year—which leaves families vulnerable to predatory lending—while mitigating the shortcomings of the Advance EITC, CAP proposes a partial "Early Refund" option within the current EITC.

Under this option, workers would be able to access the part of the EITC accrued in the first half of the year at some point during the second half of the year. Starting on July 1 of a given year, workers could access the portion of the EITC they earned up to that point, subject to a cap of $500 and indexed to the rate of inflation in future years. Since the value of the typical payday loan is about $375,[51] this amount would be sufficient to prevent many instances of predatory lending—and thus preclude the high costs and cycles of debt associated with such lending practices.[52]

Because the Early Refund option would require workers to project their estimated EITC, workers who use the option should be required to file taxes at the year's end under the same status—single or joint—that they declared for purposes of the Early Refund option. That is, in the event of a filing status change throughout the year—such as marriage—the worker's filing status for tax purposes would not reflect the change until the following year.

Enabling workers to access a partial refund six months into the year would make it unlikely that changed circumstances could cause them to owe the IRS money at tax time: Potential recipients would already have worked for half the year, establishing an income base. Moreover, workers who ended up receiving a smaller EITC than they originally expected likely would still be protected against indebtedness to the IRS because they would have received only a fraction of their projected credits.[53]

Given that most families receive a lump-sum tax refund between February and April for their previous year's work, those that experience financial distress generally have a small financial cushion to get them through to July 1. At this point, they would be able to access the earned portion of the current year's credit if the need arose. In addition, approximately two-thirds of workers' EITC would still be available the following year in a lump sum, preserving their ability to use it as a savings tool.

Under this model, a family facing eviction, scrambling to get the heat turned back on, or struggling to come up with cash for car repairs could access money at the time of the emergency, rather than waiting weeks or months to get help and potentially turning to payday lenders in the meantime.

Such a policy must go hand in hand with an expansion in the EITC for adults without qualifying children, which is currently significantly lower than the EITC for households with custodial children. If an expansion in the EITC for childless adults were not put in place in tandem with an Early Refund option, access to these small advance lump sums would be limited to families with children, the only group whose credit is large enough to merit receiving up to $500 in advance.

Under this proposed expansion of the childless workers' credit, the cap of $500 would be slightly less than half of the maximum credit available. In 2011, the average EITC claimed by childless workers—$270—was about 58 percent of the maximum possible credit of $464.[54] Presuming this pattern continues under the expanded childless worker credit, which would raise the maximum EITC for this group to $1,005 per year, the average EITC claimant without qualifying children would receive about $585—well above the $500 maximum Early Refund. For workers with children, the $500 cap is much lower relative to the average anticipated EITCs. In 2011, the average EITC for workers with one or more qualifying children was about $3,050 in today's dollars;[55] the maximum Early Refund would be only about 16 percent of that amount.

The goal of the Early Refund option would not be to act as a wage supplement, as earlier models of the Advance EITC envisioned. In fact, the default option would still be for families to receive 100 percent of their tax refund as a lump sum at the normal time. The Early Refund would instead be a form of earned insurance against the types of unexpected expenses that can lead to a downward spiral of reduced income and debt. Additionally, it could serve as a sort of earned opportunity fund, enabling families to capitalize on timely upward mobility opportunities, such as summer enrichment programs for their children. The success of the proposal would not be measured by its take-up rate but rather by a decline in the share of families turning to predatory lenders.

Conceiving of the Early Refund EITC in this way, as opposed to an ongoing wage supplement, distinguishes it from policies that allow employers to pay poverty-level wages. In order to maximize their effectiveness, enhancements to the EITC should be made in tandem with an increase in the minimum wage.

Administration of the partial Early Refund option

CAP proposes piloting the EITC Early Refund to observe how it performs. The pilot programs could be rolled out in several areas throughout the year to test several different kinds of approaches. One type could be administered through a system similar to the quarterly filing that self-employed Americans utilize, in which a filer sends a form to the IRS for processing on or after a certain date with income verification information, making it easier for the IRS to track and identify people who did not subsequently file a tax return. In at least one of these models, the pilot should be funded to include additional support for keeping Volunteer Income Tax Assistance, or VITA,[56] available after tax season to help people take advantage of this option at no cost. Chicago is currently testing a quarterly advance EITC system, which engages VITA sites to provide filing support; its findings could inform program design.[57] Other pilot programs could explore what happens when families do not receive VITA support and either file independently or with an entity such as H&R Block.

Another pilot option is administration through employers, who would require their employees to fill out a W-5 form formerly used for the Advance EITC. In the event that an employee elected to use the Early Refund option, the employer would advance the money to them and offset the amount by reducing payroll tax deposits. This was what happened in the Advance EITC.

The Early Refund could be evaluated both in terms of its goals—reducing the need for families to turn to predatory loans and reducing material hardship—as well as its administration. The results of the pilot programs would inform the design of an Early Refund option that could be brought to scale.[58]

Harnessing the EITC to increase access to education and training

Many low-wage workers cannot realistically afford to go back to school, get their GED, or obtain the additional qualifications or licensure they need to advance in the job market. As discussed in the recent CAP report "Harnessing the Tax Code to Promote College Affordability," both prohibitive costs and lack of awareness regarding the aid available to low-income students present significant barriers to accessing higher education,[59] precluding upward economic mobility among these workers and their families. The following policy solutions would harness the EITC to increase access to education and training, helping low-wage workers gain the skills and qualifications they need to climb the economic ladder.

Categorical eligibility for Pell Grants for workers who receive the EITC and reforms to increase Pell Grants' reach

Pell Grants are a form of need-based education assistance that, along with other forms of federal student aid, put higher education within the financial reach of millions of low-income students every year. Nearly 10 million undergraduate students received Pell Grants in 2013.[60] To qualify, a student must be enrolled or accepted for enrollment in an eligible certificate or degree program and must already have completed high school or obtained a GED. Students and their parents complete the Free Application for Federal Student Aid, or FAFSA, for the upcoming academic year, and Pell Grants are then paid directly to the educational institution on behalf of qualifying students in order to meet educational expenses. Pell Grant funds go first to tuition, fees, room, and board; any remaining funds are disbursed directly to the student. The maximum Pell Grant was $5,645 per year for the 2013–14 school year.[61]

Many workers are unaware that they may qualify for Pell Grants or that the funds can be used for programs beyond those of traditional four-year colleges. In addition, requiring workers to complete an additional federal form—the FAFSA—likely remains a barrier. Students who receive federal assistance through

Supplemental Security Income, or SSI; the Supplemental Nutrition Assistance Program; free or reduced-price school lunches; Temporary Assistance for Needy Families, or TANF; or the Special Supplemental Nutrition Program for Women, Infants, and Children, or WIC, are categorically eligible to receive the maximum Pell Grant under a simplified eligibility process. Making workers who receive the EITC similarly categorically eligible for the maximum Pell Grant in the following year would create a new opportunity to connect low-wage workers with the education and training they need to access higher-paying jobs and would reduce barriers to accessing Pell Grants.

Broadening categorical eligibility for Pell Grants to include EITC recipients is unlikely to expand the population of those who are technically eligible because the two programs serve individuals in similar income ranges. However, it would streamline access to Pell Grants, increase awareness of them, and remove the barriers associated with a separate and burdensome application process. As previously noted, research suggests that children who have even a small amount of dedicated higher-education savings are significantly more likely to attend and graduate from college.[62] The knowledge that one is automatically eligible for the maximum Pell Grant may have a similar effect on low-income students' college attendance.

This policy should go hand in hand with reforms to increase the reach of Pell Grants. Under current law, a student must be enrolled in an academic program that lasts at least a full academic year, defined as 30 weeks of instructional time.[63] Many training and certificate programs last fewer than 30 weeks, making their participants ineligible for Pell Grants. Reducing the number of weeks of instructional time required to access Pell Grants from 30 weeks to 15 weeks would boost their reach, benefiting many low-wage workers seeking to obtain additional skills and qualifications to advance in the job market. The Department of Education is conducting an experiment to test the impact of such a change;[64] if the experiment's findings demonstrate positive effects, it is imperative to create a structure for expanding this policy as soon as the results are available. In addition, restoring Pell Grants for students without a high school diploma through a rigorous "ability to benefit" process—while expanding the definition of qualifying educational or training activities to include GED programs, adult basic education, and certified training programs—would boost Pell Grants' power to promote upward economic mobility.

Enhancing access to training and education through reforms to strengthen the AOTC

The American Opportunity Tax Credit, or AOTC, serves as a complement to Pell Grants, providing qualifying students and families with a credit of up to $2,500 per academic year to partially offset educational expenses. As much as 40 percent of a filer's AOTC is refundable. While individuals who earn up to $90,000 per year and joint filers who earn up to $180,000 may qualify for the AOTC, the vast majority who receive it earn less than $60,000 per year.[65] As described in a recent CAP report, the following reforms would make the AOTC more effective as a tool for increasing access to training and education.[66]

First, the AOTC should be made fully refundable; at present, the credit is only 40 percent refundable.[67] Full refundability is most important for individuals and families with incomes so low that they owe no federal income tax but nonetheless pay payroll, state, and local taxes. Second, the scope of qualifying educational and training activities should be broadened to match the proposed expansion for Pell Grants outlined above. Third, as currently structured, the AOTC presents timing problems for many low-income individuals seeking to access education and training, as people must front the money for tuition and other costs and wait until tax time to be reimbursed by the AOTC. An Advance AOTC option should be explored to address this limitation. Finally, the ban on the AOTC for individuals with felony drug convictions should be removed. The current lifetime ban unjustly singles out students with a particular type of criminal record, effectively hindering their ability to move on with their lives after completing the terms of their sentences.[68] These reforms would strengthen the AOTC and broaden its reach to more low-wage workers, enabling them to obtain the additional skills and qualifications they need to advance their careers.

Conclusion

The Earned Income Tax Credit and the Child Tax Credit are two of the nation's most effective anti-poverty tools. Congress should act to ensure that the improvements made under the American Recovery and Reinvestment Act do not expire in 2017 and take the common-sense steps of indexing the CTC's value to inflation and making it fully refundable. Furthermore, Congress should strengthen the EITC so it does not exclude millions of hardworking Americans without qualifying children. It should also lower the eligibility age for these workers to 18.

Congress and states should also take steps to enhance the EITC's power as a savings tool. Actions that would make saving more rewarding, automated, and flexible include modifying the Saver's Credit; creating safe, affordable savings vehicles for EITC recipients; and removing counterproductive penalties for saving from public assistance programs. Early access to a small portion of the credit, through the creation of an Early Refund option, could reduce the use of predatory lending products and put mobility-enhancing opportunities within reach.

Finally, increasing access to training and education opportunities by making EITC recipients categorically eligible for Pell Grants—coupled with reforms to broaden the reach of both Pell Grants and the AOTC—would further boost the EITC's power to promote economic opportunity. All of these changes would strengthen the EITC and CTC as tools for increasing financial security and upward economic mobility.

About the authors

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Endnotes

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15 For more information, see notes and sources in endnote 13.

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