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ENCOURAGING SAVINGS UNDER THE EARNED INCOME TAX CREDIT: A NUDGE IN THE RIGHT DIRECTION

Vada Waters Lindsey*

During 2007, 3.6 million or 9.7% of people in the United States age 65 or older were below the poverty level. In light of the number of elderly people living below the poverty level, it is important that everyone, including low-income workers, have the opportunity to save for retirement. Low-income workers face many challenges to saving for retirement. The barriers to saving include the lack of access to retirement plans and lack of investment savvy. For example, only 42% of workers employed in service occupations in the private industry have access to employer retirement plans. The percentage drops to 39% for part-time employees.

This Article proposes that the earned income tax credit (EITC) be expanded to encourage saving to help reduce the poverty level. The Article argues that the EITC should be structured to “nudge” low-income workers to invest in retirement plans and individual retirement accounts to lower the likelihood that they will live below the poverty level at retirement. The Article then discusses the importance of saving and the ways in which the government has encouraged lower income workers to accumulate wealth. Because these efforts have not succeeded in increasing the savings rate of low-income workers, the government must take additional measures to encourage them to save. This Article outlines a detailed plan for the adoption of a saving component to the EITC and outlines the importance of automatic contributions in conjunction with the EITC to maximize the success of the saving component. The plan also includes a government match in certain circumstances but requires forfeiture of the match for early withdrawals.

I. INTRODUCTION

Generally, retirees rely on the “three-legged stool” of Social Security, pension plans, and personal savings.¹ However, while upper-income taxpayers frequently take advantage of the tax incentives provided by traditional 401(k) retirement plans and Individual Retirement Accounts (IRAs), lower-income taxpayers

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1. Stephen F. Befort, *The Perfect Storm of Retirement Insecurity: Fixing the Three-Legged Stool of Social Security, Pensions, and Personal Savings*, 91 MINN. L. REV. 938, 939 (2007).

generally do not invest in these tax-deferred savings vehicles.² Empirical data establishes that, of the baby boomers, the wealthiest 10% own more than two-thirds of the capital investments and private retirement assets.³ Significantly, of the balance of the baby boomers, 30% of them did not own any private retirement assets.⁴ This savings gap will have tremendous ramifications if not addressed.

For the first time since the Great Depression, the personal savings rate for Americans is negative.⁵ In 2006, one study found that 44% of retirees are at risk of falling below their current standard of living in retirement.⁶ The same study found that the situation is getting more serious over time. About 35% of baby boomers born between 1948 and 1954 will have insufficient retirement income.⁷ This number increases to 44% for baby boomers born between 1955 and 1964 and then rises to 48% for Generation Xers born between 1965 and 1974.⁸ In 2007, 3.6 million or 9.7% of people in the United States age sixty-five or older were below the poverty level, up from 9.4% in 2006.⁹ The number of people age sixty-five and over living below the poverty level grew by 200,000 between 2006 and 2007.¹⁰ In 2007, an additional 2.4 million or 6.4% of these individuals were considered to be “near poor” because their income was between the poverty level and 125% of the poverty level.¹¹ The poverty rate for women was startlingly high,¹² particularly among Hispanic and African American women. For 2007, the poverty rate

2. Karen C. Burke & Grayson M.P. McCouch, *Lipstick, Light Beer, and Back-Loaded Savings Accounts*, 25 VA. TAX REV. 1101, 1127–28 (2006).

3. John Burritt McArthur, *Private Pensions and the Justification for Social Security*, 48 S. TEX. L. REV. 1, 28–29 (2006).

4. *Id.* at 29.

5. RICHARD H. THALER & CASS R. SUNSTEIN, *NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WELFARE, AND HAPPINESS* 103 (2008).

6. Alicia H. Munnell et al., *Do Households Have a Good Sense of Their Retirement Preparedness?*, CTR. FOR RETIREMENT RES. AT B.C., 1 (Aug. 2008), http://ctr.bc.edu/images/stories/ib_8-11.pdf.

7. *Id.*

8. *Id.*

9. CARMEN DE NAVAS-WALT ET AL., U.S. CENSUS BUREAU, *INCOME, POVERTY, AND HEALTH INSURANCE COVERAGE IN THE UNITED STATES: 2007*, at 12-13 (2008), *available at* <http://www.census.gov/prod/2008pubs/p60-235.pdf>.

10. *Id.* at 12.

11. ADMIN. ON AGING, U.S. DEP'T OF HEALTH & HUMAN SERVS., *A PROFILE OF OLDER AMERICANS: 2008*, at 11 (2008), *available at* http://www.aoa.gov/AOARoot/Aging_Statistics/Profile/2008/docs/2008profile.pdf.

12. For a discussion of outlining proposals to the Social Security program to counter the poverty rate of elderly women, see Julia J. DiPasquale, *Social Security Reform: Keeping Elderly Women Out of Poverty*, 4 NAT'L ACAD. ELDER L. ATT'YS J. 183 (2008).

for Hispanic and African American women who resided alone was 39.5% and 39%, respectively.¹³

The number of elderly people living below the poverty level demonstrates the crucial nature of retirement savings. The earned income tax credit (EITC) can be a fundamental tool for encouraging saving to help reduce poverty among the elderly population. The EITC is the largest tax benefit program for working individuals.¹⁴ It provides substantial tax dollars to the working poor and other low-income workers. For example, for taxable year 2009, the maximum EITC was \$5,657.¹⁵ The Internal Revenue Service (IRS) granted EITC benefits of approximately \$48 billion to around 24 million taxpayers during taxable year 2007.¹⁶

The current unemployment rate is 9.7%.¹⁷ In light of current economic conditions,¹⁸ the IRS anticipates that, based on reduced wages, more taxpayers will be eligible to receive the EITC.¹⁹ It is therefore important to consider whether the EITC is an effective tax incentive or whether statutory modification is necessary to further enhance the credit to better achieve the policy goals of the EITC.

One significant flaw of the EITC that suggests modification is warranted is that recipients currently are not encouraged to save or invest the increase in the after-tax income resulting from the receipt of the EITC. In fact, the EITC discourages such use by denying taxpayers with excessive investment income access to the credit.²⁰ Anecdotal evidence suggests that a lump sum payment may encourage the recipients to buy an unnecessary “big ticket” item rather than purchasing more practical consumable items such as food or paying for energy costs, as noted in the EITC’s legislative

13. ADMIN. ON AGING, *supra* note 11, at 11.

14. See, e.g., Lily L. Batchelder et al., *Efficiency and Tax Incentives: The Case for Refundable Tax Credits*, 59 STAN. L. REV. 23, 34 (2006); Timothy M. Smeeding, *The Earned Income Tax Credit: The EITC and USAs/IDAs: Maybe a Marriage Made in Heaven?*, 8 GEO. PUB. POL’Y REV. 7, 8 (2002).

15. Rev. Proc. 2009-21, 2009-16 I.R.B. 862.

16. I.R.S. News Release IR-2009-8 (Jan. 30, 2009).

17. *Jobs Still Elusive, 5 States Post Record Unemployment Rate in January*, N.Y. TIMES, Mar. 11, 2010, at B9. For detailed unemployment statistics, see BUREAU OF LABOR STATISTICS, U.S. DEPARTMENT OF LABOR, NEWS RELEASE USDL-10-0886, THE EMPLOYMENT SITUATION—JUNE 2010, at tbl.A-1 (2010), available at http://www.bls.gov/news.release/archives/empsit_07022010.pdf.

18. A significant motivation behind the EITC’s enactment in 1975 was an economy in a period of economic decline, with an unemployment rate of 8.2%, its highest level since 1941. S. REP. NO. 94-36, at 1 (1975), reprinted in 1975 U.S.C.C.A.N. 54, 54. A secondary consideration behind its enactment was the expected stimulation of the economy. *Id.* at 7-8.

19. I.R.S. News Release IR-2009-8 (Jan. 30, 2009).

20. See I.R.C. § 32(i) (West Supp. 2010).

history.²¹ In fact, this history indicates that Congress recognized the potential for the EITC to enable the working poor to purchase consumable products. Thus the purchase of a nonessential luxury item does not completely comport with the statutory intent to provide financial relief to EITC recipients.

An important question thus is whether the EITC should be modified to further encourage low-income workers to save for retirement. Professor Dorothy Brown recently wrote an article arguing that recipients of the EITC have been unfairly targeted and that tax scholars offered no hope to them.²² She challenged “politicians, journalists, and academics to acknowledge that we owe more to low-income taxpayers.”²³ I agree that the tax scheme needs to be modified for the benefit of low-income workers. Specifically, the EITC should be structured to “nudge” low-income workers to invest in retirement plans and IRAs to lower the likelihood that they will live below the poverty level during retirement.²⁴

The federal government recognized the significance of encouraging low-income individuals to engage in long-term savings when it enacted the saver’s credit and established the “Assets for Independence” program administered by the U.S. Department of Health and Human Services, Administration for Children and Families’ Office of Community Services.²⁵ Under the Assets for Independence program, participants save earned income in matched “Individual Development Accounts.”²⁶ Unfortunately, in recent years, only 10,000 people nationwide have enrolled in the program.²⁷ In addition, the number of taxpayers claiming the saver’s credit has generally declined since its enactment.²⁸ The federal EITC program should incorporate the positive aspects of the Assets for Independence program and the saver’s credit to create more widespread savings for the working poor and other low-income workers while eschewing their flaws.

21. *But cf. infra* text accompanying note 104.

22. Dorothy Brown, *Race and Class Matters in Tax Policy*, 107 COLUM. L. REV. 790, 801 (2007).

23. *Id.* at 802.

24. Thaler and Sunstein suggest that most workers who do not enroll in their employer’s retirement plan are simply procrastinating and may require a nudge, defined as “any factor that significantly alters the behavior of Humans” to get them to save for retirement. THALER & SUNSTEIN, *supra* note 5, at 8.

25. *See About Assets for Independence*, ADMIN. FOR CHILDREN & FAMILIES, <http://www.acf.hhs.gov/programs/ocs/afi/assets.html> (last visited Sept. 20, 2010) [hereinafter *About Assets*].

26. *See id.*

27. Michele Estrin Gilman, *Poverty and Communitarianism: Toward a Community-Based Welfare System*, 66 U. PITT. L. REV. 721, 816 (2005).

28. *See infra* note 64 and accompanying text.

Part II will discuss the importance of saving and the ways in which the government has encouraged low-income workers to accumulate wealth. The approaches adopted by the government involve both direct expenditures and tax incentives to promote the working poor and other low-income individuals to increase savings. Part III will outline federal programs created to promote savings. Part IV will explore the challenges to increased savings by low-income workers. The barriers to saving include lack of access to retirement plans and lack of investment savvy. Part V of this Article will discuss the EITC. It will consider the purpose of the credit and outline eligibility requirements. It will also extensively analyze the problems with the current EITC. Part VI will propose the adoption of a saving component to the EITC. Other scholars have suggested that the EITC be linked to an asset-building policy.²⁹ This Article proposes a detailed plan for such a policy's implementation. The proposal outlines the importance of automatic contributions in conjunction with the EITC to nudge low-income workers to save for retirement and to maximize the success of the saving component.

II. THE IMPORTANCE OF SAVING

During his tenure as a U.S. Senator, Rick Santorum stated that the significant causes of poverty were the lack of "access to capital and barriers to wealth creation."³⁰ According to Santorum, one of the greatest social problems during the last century was poverty among the elderly.³¹ He believed that welfare reform was an important first step towards establishing economic stability for former recipients, that the cause of the widening gap between the rich and poor is the asset gap rather than the income gap, and that low-income individuals must have a chance to accrue savings.³² The Office of Community Services, an agency of the U.S. Department of Health and Human Services has explained that asset building rather than income generation is instrumental to ending the cycle of poverty.³³ According to the agency, 25% of households would not be able to sustain themselves for more than three months if they lost their income source, and 47% of American children live in

29. See, e.g., Daniel P. Gitterman et al., *Expanding EITC for Single Workers and Couples Without Children: Tax Relief for All Low-Wage Workers*, 15 GEO. J. ON POVERTY L. & POL'Y, 245, 249-50 (2008); Smeeding, *supra* note 14.

30. Rick Santorum, *Wealth Creation in the New Millennium: Transforming Poverty in America*, 16 NOTRE DAME J.L. ETHICS & PUB. POL'Y 383, 383 (2002).

31. See *id.*

32. *Id.* at 383-85.

33. *About Assets, supra* note 25.

households without significant financial assets.³⁴ Finally, research conducted by the agency has established that the divorce rate is lower for families with assets, that families with assets are healthier, and that future generations of families with assets are less likely to live in poverty.³⁵

There are numerous reasons why individuals must also have sufficient savings for retirement. Several factors impact the amount of savings that are necessary to sustain a retiree for the duration of retirement, including the expected post-retirement living expenses, anticipated future investment returns, and life expectancy and other relevant mortality statistics.³⁶ As individuals age, an unexpected and catastrophic medical condition may deplete their life savings. Individuals must also plan for long-term care needs in retirement, which are frequently ignored in retirement planning.³⁷ The current unemployment rate of 9.7% will undoubtedly impact retirement savings and may require the unemployed to exhaust long-term savings in order to pay for basic necessities and living expenses.

Many state and municipal public pension plans are underfunded.³⁸ The increase in life expectancies means that retirees will need a higher level of savings to sustain themselves during their retirement. One of the biggest reasons people need to have retirement savings is that the “pay as you go” Social Security program is in jeopardy of having a negative balance beginning in 2017, at which point benefits to retirees will exceed Social Security revenue.³⁹ Moreover, the average Social Security benefits of \$13,836 for retired workers⁴⁰ is only slightly greater than the \$13,014 poverty

34. *Id.*

35. *Id.*

36. Richard L. Kaplan, *Retirement Planning's Greatest Gap: Funding Long-Term Care*, 11 LEWIS & CLARK L. REV. 407, 409 (2007).

37. *See generally id.* (providing an in-depth discussion of types of long-term care and the different ways to fund such care).

38. *See, e.g.*, Terry Savage, *Battle Brewing over Pensions; Stock Market Crash Leaves State's Plans Critical Just as Baby Boomers Set to Retire*, CHI. SUN-TIMES, Jan. 25, 2009, at A20 (stating that the Illinois state-funded pension system is more underfunded than any other state and that the plans were approximately 50% of the required funding level); Jeff Shields, *City Not Behind Pa. Idea on Pensions*, PHILA. INQUIRER, July 4, 2009, at B01 (stating that the Philadelphia municipal pension plan is currently funded at 53% but projected to go below 50% by June 2010 and remain so for many years).

39. *See* Befort, *supra* note 1, at 943. Professor Befort explains that the negative balance in the Social Security program will arise because of the increasing life spans and retirement of impending baby boomers and the decline in the number of future wage earners resulting from the decline in birth and immigration rates. *Id.* at 943–44.

40. SOC. SEC. ADMIN., SSA PUB. NO. 13-11785, FAST FACTS & FIGURES ABOUT SOCIAL SECURITY, 2009, at 15 (2009), available at http://www.ssa.gov/policy/docs/chartbooks/fast_facts/2009/fast_facts09.pdf.

threshold for a householder 65 years and older for 2008.⁴¹ The Social Security program has succeeded in reducing the level of poverty among the elderly.⁴² However, according to Santorum, demographic changes in family sizes, life-spans, and the retirement of baby boomers will continue to thwart the effectiveness of the “pay-as-you-go” scheme.⁴³ By 2050, 20% of Americans will be over age sixty-five.⁴⁴ The demographic changes will result in an unfunded liability in the program of at least \$3.2 trillion by 2030.⁴⁵ As a result, Social Security benefits should not be relied on as a retiree’s only revenue stream during retirement.

III. FEDERAL PROGRAMS TO PROMOTE SAVINGS

The federal government has implemented both direct expenditures and tax incentive programs to promote increased savings by the working poor and other low-income individuals. It is important to understand how the EITC fits within the context of other federal programs. Any modification to the EITC to encourage savings will supplement these existing programs. The Internal Revenue Code contains numerous tax incentives encouraging retirement saving and other forms of investments.⁴⁶ An employee is entitled to defer income for contributions made by the employer and employee to a qualified⁴⁷ defined contribution or defined benefit⁴⁸

41. *Poverty Thresholds for 2008 by Size of Family and Number of Related Children Under 18 Years*, U.S. CENSUS BUREAU (2008), <http://www.census.gov/hhes/www/poverty/threshold/thresh08.html> (last visited May 12, 2010).

42. See Santorum, *supra* note 30, at 387–88.

43. *Id.* at 388. According to Santorum, “[i]n 1960, there were over five workers for every beneficiary. Today there are three and a half workers per beneficiary, and by 2030 there will be just over two.” *Id.*

44. *Id.*

45. *Id.*

46. Unfortunately, the tax subsidies have primarily benefited upper income taxpayers. See Creola Johnson, *Welfare Reform and Asset Accumulation: First We Need a Bed and a Car*, 2000 WIS. L. REV. 1221, 1228 (stating that the rich and middle class are able to take advantage of the tax benefits of retirement savings but the low income individuals do not have the same opportunities); Deborah M. Weiss, *Paternalistic Pension Policy: Psychological Evidence and Economic Theory*, 58 U. CHI. L. REV. 1275, 1275–76 (1991) (“The highest subsidies are paid to affluent consumers who need pensions the least, while those most in need often have no pension coverage at all.”).

47. The requirements for qualification are set forth in I.R.C. § 401(a).

48. Defined benefit plans provide employees with lifelong retirement benefits based on how long they have been with the employer and how much money they have made. They place the investment risk on the employer while defined contribution plans place the investment risk on the employee. Befort, *supra* note 1, at 947. According to the U.S. Bureau of Labor Statistics, most employers are now offering defined contribution plans rather than defined benefit plans. U.S. BUREAU OF LABOR STATISTICS, U.S. DEP’T OF LABOR, NATIONAL COMPENSATION SURVEY: EMPLOYEE BENEFITS IN PRIVATE INDUSTRY IN THE UNITED STATES,

retirement plan until the contributions are distributed because contributions are deductible.⁴⁹ A key benefit of the qualified retirement plan is that the employee is not required to forfeit employer contributions once the employee meets the vesting requirements. Under the Internal Revenue Code, an employee must be fully vested in the employee's own contributions in order for the plan to be considered a qualified defined benefit or defined contribution plan.⁵⁰ In other words, an employee's contributions to a pension plan must be nonforfeitable; hence, the employee is entitled to 100% of these contributions. An employee, however, may forfeit employer contributions to a retirement plan if the employee does not satisfy the requisite years of service. The determination of when an employee becomes vested in employer contributions depends on whether the plan is a defined benefit or defined contribution one, the employee's length of service, and the vesting schedule.⁵¹

The minimum vesting requirements for a defined benefit plan are satisfied where an employee is 100% vested in employer contributions and for any accrued benefit from the employer contributions if the employee has completed at least five years of service.⁵² The vesting requirements are also satisfied where an employee is 20% vested after three years of service with increases of an additional 20% each year until the employee has completed seven years of service at which time the employee becomes 100% vested in the employer contributions.⁵³ Consequently, under the latter vesting schedule, if the employee is terminated from a job after five years of service, the employee is vested in 60% of the employer contributions but forfeits the additional 40% of employer

MARCH 2006, at 6 (2006) [hereinafter NATIONAL COMPENSATION SURVEY], available at <http://www.bls.gov/ncs/ebs/sp/ebsm0004.pdf>. For example, there are about 38,000 active defined benefit plans in effect today, compared to a high of about 114,000 in 1985. *Choosing a Retirement Plan: Defined Benefit Plan*, IRS.GOV, <http://www.irs.gov/retirement/article/0,,id=108950,00.html> (last updated Aug. 5, 2010). During 2006, 21% of workers had access to defined benefit plans, and 54% of workers had access to defined contribution plans. NATIONAL COMPENSATION SURVEY, *supra*, at 6. The 401(k) plans are the most common form of defined contribution plans. Under a defined contribution plan, the employee contributes a percentage of earnings into the employee's individual 401(k) account and the employer has the option to "match" a portion of the contribution with its own funds. The employee must not only determine the contribution percentage but also the investment allocation and specifics of withdrawal upon retirement. Befort, *supra* note 1, at 946.

49. See I.R.C. § 402(g)(1). The maximum amount that can be contributed to a retirement plan is \$16,500 in 2009 unless the employee is aged 50 and over where an additional \$5500 "catch-up" contribution is allowed in 2009. See *id.* § 402(g)(1)(C).

50. *Id.* § 411(a)(1).

51. See *id.* § 411(a)(2).

52. *Id.* § 411(a)(2)(A)(ii).

53. *Id.* § 411(a)(2)(A)(iii).

contributions. With respect to a defined contribution plan, an employee must be entitled to a nonforfeitable interest in 100% of employer contributions after three years of service, or 20% of employer contributions after two years of service, with an increase of 20% each year until six years of employment at which time the employee is 100% vested.⁵⁴

In addition to employer retirement plans, an individual is also entitled to claim a deduction for contributions to a traditional IRA subject to an adjusted gross income phase-out.⁵⁵ Although not targeted at low-income workers, the deferral of income for contributions to 401(k) plans and traditional IRAs is the most significant tax incentive that promotes retirement saving under the Code. In addition, the Roth IRAs provide a valuable tax incentive that encourages retirement saving. Congress changed the landscape of retirement saving by enacting the Roth IRA under the Taxpayer Relief Act of 1997.⁵⁶ In contrast to traditional IRAs, contributions to Roth IRAs are made on an after-tax basis and are not deductible.⁵⁷ While taxpayers are not entitled to a deduction for the amount contributed to a Roth IRA, distributions are excluded from gross income if they are made after the contributor reaches age 59 ½ or becomes disabled, are made to a beneficiary after the death of the contributor, or are made to a contributor for the purchase of a first home.⁵⁸

Another tax incentive under the Code that is intended to encourage retirement savings is the “saver’s credit.” The saver’s credit is a nonrefundable credit intended to encourage low-income

54. *Id.* § 411(a)(2)(B).

55. *See id.* § 219(a). The maximum deduction is \$5000 for individuals under age fifty and \$6000 for individuals age fifty and older. *Id.* § 219(b)(5).

56. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 302, 111 Stat. 788, 825–29.

57. I.R.C. § 408A(c)(1). The Roth IRA is completely phased out for married taxpayers filing a joint return with adjusted gross income of \$176,000 or more and for taxpayers using the filing status of single or head of household with adjusted gross income of \$120,000 or more. IRS, DEP’T OF TREASURY, PUB. 17, YOUR FEDERAL INCOME TAX: FOR INDIVIDUALS 131 tbl.17-3 (2009) [hereinafter YOUR FEDERAL INCOME TAX], available at <http://www.irs.gov/pub/irs-pdf/p17.pdf>. For taxpayers who use the filing status of married filing separately, the maximum adjusted gross income is either \$10,000 or \$120,000, depending on whether the spouse lived with the taxpayer during the taxable year. *Id.* A taxpayer may convert a regular IRA to a Roth IRA if the taxpayer: (a) transfers the money during the tax year; (b) has a modified AGI, for Roth purposes, of less than \$100,000; and (c) is not married filing separately. I.R.C. § 408A(c)(1). During taxable year 2010, income limits on converting a traditional IRA to a Roth IRA have been eliminated. *See* STAFF OF JOINT COMM. ON TAXATION, 109TH CONGRESS, GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN THE 109TH CONGRESS 311–13 (Comm. Print 2007), available at <http://www.jct.gov/s-1-07.pdf>.

58. I.R.C. § 408A(d)(2); *see also id.* § 72(t)(8) (providing the eligibility rules for the first-time homebuyer including lifetime maximum homebuyer distributions of \$10,000).

workers to make contributions to an IRA or retirement plan. In order to compute the credit, the taxpayer must multiply an applicable percentage by the taxpayer's contribution.⁵⁹ The maximum credit for individual taxpayers is \$1000 because the maximum credit is 50% of the contribution and the maximum contribution taken into account is \$2000.⁶⁰ Where married taxpayers each make eligible contributions, each spouse is entitled to the credit, for a maximum credit of \$2000. Congress enacted the saver's credit because it recognized that low-income individuals may have difficulty saving; a large portion of their disposable income is used to acquire necessities of life, and the tax credit may provide additional resources to save.⁶¹

Originally enacted as a temporary credit in 2001, Congress made the credit permanent in 2006.⁶² IRS statistics establish that between 2002 and 2006, the number of returns claiming the credit has decreased by over 9% and the total amount of the credit claimed by all taxpayers has decreased over 8%.⁶³ During taxable year 2007, there was a substantial increase in the number of taxpayers claiming the saver's credit over the number of taxpayers who claimed it in 2006 and a substantial increase in the actual credit amount; however, the increased 2007 credit amount was still lower than the

59. See *id.* § 25B. The credit, adjusted for inflation, is claimed on Form 8880 "Credit for Qualified Retirement Savings Contributions." That form contains the applicable percentages. For taxable year 2009, the credit is completely phased out for married taxpayers filing joint returns with adjusted gross income of at least \$55,501, for taxpayers using the filing status of head of household with adjusted gross income of at least \$41,626, and for single taxpayers with adjusted gross income of at least \$27,751. See YOUR FEDERAL INCOME TAX, *supra* note 57, at 260.

60. I.R.C. § 25B(b).

61. Specifically, the legislative history states:

The Committee recognizes that the rate of private savings in the United States is low; in particular many low- and middle-income individuals have inadequate savings or no savings at all. A key reason for these low levels of saving is that lower-income families are likely to be more budget constrained with competing needs such as food, clothing, shelter, and medical care taking a larger portion of their income. The Committee believes providing an additional tax incentive for low- and middle-income individuals will enhance their ability to save adequately for retirement.

S. COMM. ON FINANCE, RESTORING EARNINGS TO LIFT INDIVIDUALS AND EMPOWER FAMILIES (RELIEF) ACT OF 2001, S. Rep. No. 107-30 § VI(B) (h) (2001); see also Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 618, 115 Stat. 38, 106.

62. Pension Protection Act of 2006, Pub. L. No. 109-280, § 812, 120 Stat. 780, 997.

63. See *Selected Historical and Other Data*, SOI BULL., Spring 2009, at 121, 128 tbl.1 [hereinafter *Historical Data*], available at <http://www.irs.gov/pub/irs-soi/09sprbul.pdf>. The number of taxpayers that claimed the credit during 2002 was 5,307,176 but only 5,192,133 claimed it in 2006. *Id.* The amount of the credit claimed in 2002 was \$1,058,219,000; however, the amount claimed during taxable year 2006 was only \$893,957,000. *Id.*

amount claimed in 2002.⁶⁴ The nonrefundable aspect of the saver's credit may impact the amount of saver's credits claimed. According to Professor Befort, the saver's credit does not encourage low-income workers to claim it because more than 80% of return eligible filers do not have any tax liability.⁶⁵ To resolve this issue, he proposes that the federal government convert the saver's credit to a refundable one.⁶⁶ Making the credit refundable will enable an eligible taxpayer without a tax liability to receive the credit as a refund on the taxpayer's tax return.

In addition to the tax incentives for retirement saving, in 1998 the federal government also established the "Assets for Independence" program, a direct expenditure program, to promote savings and asset accumulation for low-income individuals.⁶⁷ Under the program, low-income individuals are able to invest earned income in "Individual Development Accounts" (IDA) sponsored by "community-based [nonprofit organizations] and State, local, and Tribal governmental agencies" and receive a match on the amount invested.⁶⁸

As of 2007, state-supported IDA programs have been established in 22 states.⁶⁹ The targeted population under this program includes recipients of the EITC.⁷⁰ The program is designed to encourage low-income individuals to save for the acquisition of a first home,⁷¹ capitalization of a small business, training, or enrollment in

64. See *id.* at 112 fig.A. The number of taxpayers claiming the saver's credit was approximately six million, and the total credit amount was \$997,343,000 in tax year 2007—representing increases from tax year 2006 of 13.5% and 9.8%, respectively. *Id.*

65. Befort, *supra* note 1, at 985.

66. *Id.* at 986.

67. Community Opportunities, Accountability, and Training and Educational Services Act of 1998, Pub. L. No. 105-285, §§ 401-416, 112 Stat. 2702, 2759-72.

68. *About Assets*, *supra* note 25. For a detailed discussion of the IDA program, see generally Johnson, *supra* note 46. See also Emily Marroquin, Note, *Alleviating Women's Poverty Through Asset Development: Promising Directions*, 11 DUKE J. GENDER L. & POL'Y 157 (2004) (exploring how the IDA program can be used as a tool to alleviate the increasing poverty rate of women).

69. *State IDA Policy Summary Tables*, CTR. FOR SOC. DEV., 2-3 tbl.1 (Feb. 28, 2007), http://www.community-wealth.org/_pdfs/articles-publications/individuals/paper-csd.pdf.

70. See *About Assets*, *supra* note 25.

71. In light of the numerous foreclosures of subprime loans, the Corporation for Enterprise Development (CFED) conducted a survey of IDA participants to see whether they had lost their homes through foreclosure. See *IDA Program Survey on Homeownership and Foreclosure*, CORP. FOR ENTER. DEV. (June 2008), http://cfed.org/assets/pdfs/ida_program_survey_homeown_foreclose.pdf. The CFED surveyed 1212 of the 8000 individuals who used an IDA account to help acquire a home within the last five years, and respondents reported that there had been three defaults and four foreclosures. *Id.* The low foreclosure rate was attributable to financial education and homeownership counseling both prior and subsequent to the acquisition and review of loan documents by sponsors of the IDA programs. *Id.*

post-secondary education.⁷² A key service provided under the IDA program is financial education.⁷³ This is a valuable service for individuals who may lack banking and investment experience. Significantly, however, saving for other purposes, including retirement saving, is not one of the stated objectives.⁷⁴ Additional programs are needed to encourage retirement saving by low-income workers because the Assets for Independence program does not promote participant retirement saving.

IV. CHALLENGES TO INCREASED SAVINGS BY LOW-INCOME WORKERS—BARRIERS TO SAVING

A. Lack of Investment Savvy

It is uncontroverted that there is a correlation between a person's education level and wages.⁷⁵ Hence, many recipients of the EITC may lack the educational background, investment savoir-faire, or resources to set up a traditional or Roth IRA unaided by an investment professional. Because it is unlikely that a low-income worker will utilize the services of a financial consultant, special measures must be established to nudge low-income workers to save for retirement.

First, in order for the federal government to encourage low-income retirement saving, the worker must appreciate the significance of retirement saving, and the worker must understand the different types of retirement savings vehicles. Four federal agencies

72. See *About Assets*, *supra* note 25.

73. *Id.*

74. Professor Creola Johnson argues that the program should be expanded to include savings for the purchase of automobiles and household durables. See Johnson, *supra* note 46, at 1244–45. Professor Johnson is particularly concerned about creating an opportunity for current and former welfare recipients to accumulate assets for the purchase of durable goods, and she explains the inability of the use of IDA funds to acquire such goods as the reason for low participation among welfare or former welfare recipients. *Id.* Professor Johnson cited Michael Sherraden, the creative force behind the IDA program, for the proposition that there are substantial national economic benefits with the development of an asset accumulation program for welfare recipients. *Id.* at 1229–30. The economic benefits include “(1) a permanent reduction in poverty, (2) the development of a more economically savvy and productive citizenry, (3) an improvement in the nation’s savings rate, and (4) the advancement of the nation as a competitor in a global economy.” *Id.* at 1230.

75. According to the U.S. Census Bureau, the median incomes during 2008 for workers twenty-five to sixty-four years old were as follows: \$25,689 for workers without a high school diploma; \$33,806 for workers with a high school diploma; \$55,729 for workers with a Bachelor’s degree; and \$100,000 for workers with a professional degree. See *Current Population Survey*, U.S. CENSUS BUREAU, http://www.census.gov/hhes/www/cpstables/032009/perinc/new03_028.htm (last visited Sept. 21, 2010).

are involved in educating individuals to save for retirement: the Department of Labor, the Securities and Exchange Commission, the Department of the Treasury, and the Social Security Administration.⁷⁶ The administrative agencies must continue to educate the low-income worker about the importance of retirement saving. The IRS, an agency within the Department of the Treasury, routinely issues notices and fact sheets explaining various tax incentives.⁷⁷ It has a user-friendly website that contains all of its publications.⁷⁸ However, it is unlikely that the average layperson visits the site to research tax incentives. More direct communication is required to promote retirement saving amongst the working poor and other low-income workers.

Lessons can be learned from the recent reforms in the credit card industry. One of the consequences of those reforms is that credit card companies must include a disclosure on a statement about the amount of interest and the required length of repayment where the debtor only pays the minimum balance.⁷⁹ The statement must also contain the amount a debtor must pay in order to pay off the debt in three years.⁸⁰ Congress enacted the Credit Card Reform Law out of concern that minimum payment practices enhance the problem of unmanageable debt faced by many debtors today and that disclosure will help consumers regain control of cascading credit card debt in a manner that is “not too onerous for credit card companies.”⁸¹ In light of the challenges that low-income workers face in accruing sufficient funds for retirement, administrative agencies charged with educating individuals about retirement need to develop a plan that incorporates direct communication to low-income workers in a manner that is easy to understand. Low-income workers need the same type of transparency that has been established in the credit card business to help them make informed choices about saving for retirement.

Second, the IRS must continue to promote the Voluntary Income Tax Assistance (VITA) Program and electronic filing. The \$1.75 billion in EITC benefits paid to commercial tax providers

76. Colleen E. Medill, *Transforming the Role of the Social Security Administration*, 92 CORNELL L. REV. 323, 348 (2007).

77. For example, in January 2010 the IRS issued fact sheet 2010-12 to outline taxable year 2009 EITC eligibility rules. See *EITC Eligibility Rules for 2009 Tax Year Outlined*, IRS.GOV (Jan. 29, 2010), <http://www.irs.gov/newsroom/article/0,,id=218830,00.html>.

78. See *Publications and Notices*, IRS.GOV, <http://www.irs.gov/app/picklist/list/publicationsNoticesPdf.html> (last visited Sept. 20, 2010).

79. 15 U.S.C.A. § 1637(b)(11) (West 2010); Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub. L. No. 111-24, 123 Stat. 1734.

80. 15 U.S.C.A. § 1637(b)(11)(B)(iii).

81. 155 CONG. REC. H5030 (daily ed. Apr. 30, 2009) (statement of Rep. Miller).

undermines the purpose of the EITC and transfers much needed dollars from the intended recipients.⁸² By utilizing the VITA Program, an EITC recipient is able to take advantage of the free tax preparation services and electronic filing. When a taxpayer files electronically, particularly where the refund is to be directly deposited into an account at a bank or other financial institution, the IRS's payment of the tax refund is significantly accelerated. According to the IRS, one of the benefits of electronic filing over paper returns is that, where the refund is directly deposited, refunds may be issued in half the time and within 10 days of electronic filing.⁸³ An added benefit of electronic filing is that the tax returns are more accurate as a result of transmission checks.⁸⁴ Consequently, increasing the number of electronic returns may reduce the number of errors on the EITC returns.

B. Means-Tested Benefit Programs

Low-income individuals may lose entitlement to government benefits if their investments and other assets exceed a certain amount. As a result, a recipient of these benefits is encouraged to spend rather than save. In order to qualify for several direct expenditure programs, an individual must be limited in the amount of resources or assets owned, including bank accounts. For example, individuals cannot have a net worth exceeding \$10,000 (excluding a home and one automobile) when they enroll in the Assets for Independence program.⁸⁵ In order for a recipient to be eligible to receive Supplemental Nutrition Assistance Program benefits (also known as food stamps),⁸⁶ a household is generally not permitted to have assets greater than \$2000 (\$3000 if a member of the household is age sixty or older or disabled) or a vehicle with a fair market value over \$4650, unless the vehicle is used to produce income or the vehicle falls under another allowable exemption.⁸⁷ Assets held in retirement accounts, including defined

82. See Ronald H. Silverman, *Toward Curing Predatory Lending*, 122 BANKING L.J. 483, 490 (2005).

83. *E-File, Free File and Other Electronic Options for 2010*, IRS.GOV (Jan. 2010), <http://www.irs.gov/newsroom/article/0,,id=217790,00.html>.

84. *Id.*

85. *About Assets*, *supra* note 25.

86. During 2009, the U.S. Governmental Accountability Office estimated that 33.7 million people receive Supplemental Nutrition Assistance Program benefits each month. See *Support for Low-Income Individuals and Families: A Review of Recent GAO Work*, GAO, 5 (Feb. 22, 2010), <http://www.gao.gov/new.items/d10342r.pdf>.

87. *Supplemental Nutrition Assistance Program: Eligibility*, FOOD & NUTRITION SERV., U.S. DEP'T OF AGRIC., http://www.fns.usda.gov/snap/applicant_recipients/eligibility.htm (last

benefit and contribution plans and IRAs, and the value of a home are not counted toward the allowable assets.⁸⁸ In order to determine eligibility for Medicaid, resources such as bank accounts and real estate are considered.⁸⁹ The eligibility ceiling varies from state to state and depends on the eligible group of which the individual is a member.⁹⁰ Finally, all states with the exception of Virginia limit the amount of assets a recipient can have in order to receive the modern form of welfare benefits, Temporary Assistance for Needy Families (TANF) cash assistance.⁹¹ Most states have asset limits ranging from \$1000 to \$3000 and allow some form of vehicle exemption.⁹²

C. Low-Percentage of Participation in Employer Qualified 401(k) Plans

1. Percentage of Workers with Access to Retirement Plans

One of the most economically beneficial aspects of many retirement plans is the employer match. Between 1995 and 2005, the amount of employer contributions to employee pension plans and insurance funds has grown by almost 100%.⁹³ However, based on statistics from the U.S. Bureau of Labor Statistics, only 65% of all workers employed in private industry had access to employer retirement benefits in March 2010.⁹⁴ In addition, workers in service industries, part-time workers, and workers in the lowest 25 percentile had less access to employer retirement plans than other types of workers. According to the U.S. Bureau of Labor Statistics, the

visited Sept. 21, 2010). The additional vehicular exemptions include a vehicle with little equity because it is encumbered with a debt or the use of the car as a home, transport for a disabled household member, and transportation for long distance travel for work. *Id.*

88. *See id.*

89. *Overview Medicaid Program: General Information*, CTRS. FOR MEDICARE & MEDICAID SERVS., U.S. DEP'T OF HEALTH & HUMAN SERVS., <http://www.cms.hhs.gov/MedicaidGenInfo/> (last visited Sept. 21, 2010).

90. *Id.*

91. *See OFFICE OF FAMILY ASSISTANCE, U.S. DEP'T OF HEALTH & HUMAN SERVS., TEMPORARY ASSISTANCE FOR NEEDY FAMILIES PROGRAM: EIGHTH ANNUAL REPORT TO CONGRESS*, at XII-101 to XII-102 tbl.12:6 (2008), *available at* http://www.acf.hhs.gov/programs/ofa/data-reports/annualreport8/TANF_8th_Report_111908.pdf.

92. *Id.*

93. *See Historical Data*, *supra* note 63, at 189 tbl.4. The total employer contributions have grown each year since 1995. *Id.* The total employer contributions for tax year 1995 was \$493.6 billion, and the employer contributions made during tax year 2005 was \$927.7 billion. *Id.*

94. *Retirement Benefits: Access, Participation, and Take-Up Rates*, U.S. BUREAU OF LABOR STATISTICS (Mar. 2010), <http://data.bls.gov/cgi-bin/print.pl/news.release/ebs2.t01.htm>.

percent of private industry workers with access to retirement benefits is as follows:⁹⁵

Characteristics	Defined Benefit or Defined Contribution Plans
Management, business and financial workers	85
Natural resources, construction and maintenance workers	64
Service occupations	42
Full-time	74
Part-time	39
Union	88
Non-union	62
Wages in the lowest 25 percentile	40
Wages in the highest 25 percentile	84
Goods producing	72
Service producing	63
1 to 99 workers	51
100 workers or more	81

As these statistics show, approximately 40% of workers in service industries, part-time workers, and workers earning wages in the lowest 25 percentile, and 51% of workers employed at small businesses have the opportunity to contribute to an employer retirement plan. This lack of access will continue to serve as a barrier to saving for workers meeting these characteristics.

2. Percentage of Employee Participation in Retirement Plans Based on Private Industry Workers

In addition to the gap in access to private industry retirement plans, there is also a disparity in the actual percent of employees participating in these plans.⁹⁶ For example, the participation rates for low-income employees remain low in comparison to higher income employees. Only 20% of workers earning wages in the lowest 25 percentile participate in employer retirement plans, while 75% of employees with earnings in the highest 25 percentile participate in employer retirement plans.⁹⁷ Statistics from the Bureau of Labor Statistics establish that a participation rate disparity also exists

95. *Id.*

96. *Id.*

97. *See id.*

based on whether the employee is a full-time or part-time worker. While 59% of full-time private industry employees participate in employer retirement plans, only 21% of part-time employees participate.⁹⁸ Moreover, only 23% of employees working in service occupations participate in employer retirement plans, compared to 76% of management, business, and financial workers.⁹⁹

3. Percentage of Participation Based on Ethnic Group

A recent study entitled the “Ariel/Hewitt Study” established that in fifty-seven of the largest businesses in the United States, 401(k) participation rates across racial and ethnic groups for individuals earning less than \$30,000 were substantially lower than for individuals earning a higher income.¹⁰⁰ The participation rate for individuals in all ethnic groups earning less than \$30,000 is between 50% and 56%, while the participation rate for individuals earning higher incomes ranges from 75% to 94%.¹⁰¹ The study concluded that African Americans and Hispanics had the lowest participation rates, while Caucasians and Asians had the highest participation rates.¹⁰²

V. THE EARNED INCOME TAX CREDIT

A. Purpose of the EITC and Eligibility Requirements

The EITC¹⁰³ was enacted in 1975 to offset the impact of Social Security taxes, to provide an incentive for low-income individuals to work, “to stimulate the economy by funneling funds to persons likely to spend the money immediately, and to provide relief for low-income families hurt by rising food and energy prices.”¹⁰⁴ Congress

98. *See id.*

99. *See id.*

100. *See The Ariel/Hewitt Study: A Study of 401(k) Savings Disparities Across Racial and Ethnic Groups*, ARIEL INVS., 4, http://www.arielinvestments.com/images/stories/PDF/arielhewittslides_finalweb_7.3.pdf (last visited Sept. 21, 2010).

101. *See id.* Approximately 3 million employees were included in the study, and the data was collected as of December 31, 2007. *The Ariel/Hewitt Study: 401(k) Plans in Living Color*, ARIEL INVS. (July 7, 2009), <http://www.arielinvestments.com/content/view/1223/1173> [hereinafter *Ariel/Hewitt Study*].

102. *See Ariel/Hewitt Study*, *supra* note 101.

103. For an excellent discussion of the early history of the EITC, see Jonathan Barry Forman, *Improving the Earned Income Credit: Transition to a Wage Subsidy Credit for the Working Poor*, 16 FLA. ST. U. L. REV. 41 (1988).

104. *Sorenson v. Sec’y of the Treasury*, 475 U.S. 851, 864 (1986).

also enacted the credit to reduce the welfare rolls.¹⁰⁵ Unlike many other credits,¹⁰⁶ the EITC is refundable and a taxpayer receives the credit even if the taxpayer has no tax liability. It was intended to provide an incentive for low-income individuals to work by resulting in an increase of the worker's after-tax income.¹⁰⁷ The original EITC was allowed only for taxable year 1975.¹⁰⁸ Congress then extended the credit for the first six months of 1976.¹⁰⁹ The EITC became permanent in 1978.¹¹⁰

The Internal Revenue Code allows a taxpayer to claim the EITC when the taxpayer meets the eligibility requirements if the taxpayer has at least one qualifying child¹¹¹ or is between the ages of 25 and 65.¹¹² Congress has made several modifications to the EITC since its enactment. As originally enacted in 1975, eligible recipients of the credit had to have a qualifying child.¹¹³ However, in 1993 the federal government enacted a small credit for childless workers.¹¹⁴ The maximum EITC depends on the amount of the taxpayer's earned income, the number of taxpayer's qualifying children, credit percentage, and the taxpayer's marital status. The maximum EITC is determined by multiplying the taxpayer's earned income amount by a fixed percentage of earnings up to an earned income ceiling amount.¹¹⁵ Once the earned income reaches the threshold earned income phase-out, the credit is reduced by a

105. See S. REP. NO. 94-36, at 33 (1975), *reprinted in* 1975 U.S.C.C.A.N. 54, 84 (“[T]he most significant objective of the provision should be to assist in encouraging people to obtain employment, reducing the unemployment rate and reducing the welfare rolls.”).

106. Nonrefundable credits include the Hope Scholarship Credit and Lifetime Learning Credit, child tax credit, credit for dependent care expenses, and the Saver's Credit. See I.R.C. §§ 21, 24, 25A, 25B.

107. S. REP. NO. 94-36, at 11.

108. Tax Reduction Act of 1975, Pub. L. No. 94-12, § 209, 89 Stat. 26, 35.

109. Revenue Adjustment Act of 1975, Pub. L. No. 94-164, § 2, 89 Stat. 970, 971-72.

110. Revenue Act of 1978, Pub. L. No. 95-600, § 103, 92 Stat. 2763, 2771.

111. I.R.C. § 32(c)(1)(A)(i). Per § 32(c)(3)(A), a “qualifying child” is defined under I.R.C. § 152(c).

112. The taxpayer and any qualifying children must have Social Security numbers, the taxpayer cannot be a qualifying child or dependent for another taxpayer, the taxpayer's principal place of abode must be in the United States for more than one-half of the taxable year, and the taxpayer cannot have investment income greater than a certain amount. I.R.C. §§ 32(c)(1)(A)(ii), 32(c)(1)(E), 32(i). For tax year 2009, the investment income cannot exceed \$3100. Rev. Proc. 2008-66, 2008-45 I.R.B. 1111.

113. Tax Reduction Act of 1975 § 204.

114. Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 13131, 107 Stat. 433, 433-35.

115. See I.R.C. § 32(b)(1)(A). The credit percentage is 7.65% where the taxpayer does not have any qualifying children, 34% where the taxpayer has one child, and 40% where the taxpayer has two or more qualifying children. *Id.*

phase-out percentage until the credit is reduced to zero.¹¹⁶ The maximum credit and phase-out amounts for unmarried taxpayers for taxable year 2009 are as follows:¹¹⁷

	No Children	One Child	Two Children	Three or More Children
Maximum EITC	\$457	\$3,034	\$5,028	\$5,657
Earned Income Amount	\$5,970	\$8,950	\$12,570	\$12,570
Threshold Earned Income Phaseout	\$7,470	\$16,420	\$16,420	\$16,420
Earned Income Ceiling Amount	\$13,440	\$35,463	\$40,295	\$43,279

Prior to taxable year 2009, the largest possible credit amount was granted to taxpayers with at least two children. The American Recovery and Reinvestment Tax Act of 2009 (ARRTA) temporarily increased the EITC for taxpayers with three or more children for taxable years 2009 and 2010.¹¹⁸

Married taxpayers are also eligible to claim the EITC. In order for a married couple to claim the EITC, the couple must file a joint income tax return.¹¹⁹ The maximum credit and phase-out amounts for a married couple filing a joint return for taxable year 2009 are as follows:¹²⁰

	No Children	One Child	Two Children	Three or More Children
Maximum EITC	\$457	\$3,034	\$5,028	\$5,657
Required Earned Income	\$5,970	\$8,950	\$12,570	\$12,570
Threshold Earned Income Phaseout	\$12,470	\$21,420	\$21,420	\$21,420
Earned Income Ceiling Amount	\$18,440	\$40,463	\$45,295	\$48,279

116. The phaseout percentage is 7.65% where the taxpayer does not have any qualifying children, 15.98% where the taxpayer has one child, and 21.06% where the taxpayer has two or more qualifying children. *Id.*

117. Rev. Proc. 2009-21, 2009-16 I.R.B. 862.

118. American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, § 1002, 123 Stat. 115, 312.

119. See I.R.C. § 32(d). A taxpayer is entitled to file as “head of household” and claim the EITC because the taxpayer is considered to be “unmarried.” To qualify, the taxpayer must be legally separated from the taxpayer’s spouse or if the spouse is not a member of the taxpayer’s household during the last six months of the year, the taxpayer paid more than one-half the cost of maintaining a home and the home is a child’s principal place of abode. See I.R.C. § 7703 (2006).

120. Rev. Proc. 2009-21, 2009-16 I.R.B. 862.

A married couple may be precluded from claiming the credit because of the so-called marriage penalty.¹²¹ A marriage penalty is imposed because the statute does not adequately adjust for dual income. An unmarried couple with dual income and children will be entitled to a greater EITC than a similarly situated married couple. For example, for an unmarried couple with two children, where each parent earns \$14,000 in wages and each parent claims a child as an exemption and for EITC purposes for taxable year 2009, each parent will receive the maximum EITC of \$3043¹²² for a combined EITC of \$6086. In contrast, due to the marriage penalty, a married couple with two children receives a smaller EITC. Numerous scholars have argued that Congress should amend the credit to alleviate the marriage tax penalty,¹²³ and ARRTA finally lessened the severity of the marriage tax penalty by increasing the phase-out amounts by \$5000.¹²⁴ Even after the amendment, however, the married couple's EITC is only \$3642,¹²⁵ substantially less than the combined EITC of \$6086 for the unmarried couple. As a result, there remains a substantial marriage penalty under the EITC.

121. Many scholars have discussed the EITC's marriage penalty. *See, e.g.*, Dorothy A. Brown, *The Tax Treatment of Children: Separate but Unequal*, 54 EMORY L.J. 755, 769, 806–07 (2005); Danshera Cords, *Paid Tax Preparers, Used Car Dealers, Refund Anticipation Loans, and the Earned Income Tax Credit: The Need to Regulate Tax Return Preparers and Provide More Free Alternatives*, 59 CASE W. RES. L. REV. 351, 357–59 (2009); George K. Yin, *Accommodating the "Low-Income" in a Cash-Flow or Consumed Income Tax World*, 2 FLA. TAX REV. 445, 477 (1995).

122. The EITC is computed by multiplying the earned income limitation amount by a credit percentage, which is 7.65% for eligible taxpayers with no qualifying children, 34% for taxpayers with one qualifying child, 40% for taxpayers with two qualifying children, and beginning in 2009, 45% for taxpayers with three or more qualifying children. I.R.C. § 32(b)(1)(A) (West Supp. 2010). For the unmarried couple, the credit for each filer is determined by multiplying the earned income amount of \$8950 by 34%. That figure equals the credit amount of \$3043.

123. *See, e.g.*, Peter B. Edelman, *Changing the Subject: From Welfare to a Living Income*, 4 NW. J.L. & SOC. POL'Y 14, 22 (2009) (stating that the credit needed further improvement by easing the marriage penalty); Forman, *supra* note 103, at 93–95 (exploring several options which would reduce the marriage penalty); Wendy Richards, Comment, *An Analysis of Recent Tax Reforms from a Marital-Bias Perspective: It Is Time to Oust Marriage from the Tax Code*, 2008 WIS. L. REV. 611, 627–28 (stating marriage penalty discourages taxpayers from working full time and counters the EITC goals).

124. Rev. Proc. 2009-21, 2009-16 I.R.B. 862.

125. I.R.C. § 32(b)(1)(A). The computation of the EITC for the married couple is more complicated because their earned income exceeds the threshold earned income phaseout. The earned income amount of \$12,570 is multiplied by 40% for a maximum EITC before the phaseout of \$5028. The threshold earned income phaseout is \$21,420. Hence, the married couple's \$28,000 earned income exceeds the threshold earned income amount by \$6580. Pursuant to I.R.C. § 32(b)(1)(A), the EITC before phaseout must be reduced by \$1386 (\$6580 times the phaseout percentage of 21.06). Consequently, the EITC for the married couple is \$3642.

Currently, 24 states have also enacted the EITC at the state level.¹²⁶ The state EITC provisions vary among states. The states that have enacted an EITC determine its amount based on a percentage of the federal EITC, ranging from 3.5% to 50%.¹²⁷ While most of the states that have enacted the EITC allow for a refundable credit,¹²⁸ or a partially refundable credit,¹²⁹ a few states do not permit an EITC where the taxpayer does not have a tax liability.¹³⁰ In addition, most states are consistent with the federal EITC and allow an EITC for childless workers, Wisconsin being the sole state that

126. See Jason Levitis & Jeremy Koulisch, *State Earned Income Tax Credits: 2008 Legislative Update*, CTR. ON BUDGET & POLICY PRIORITIES, 1 (Oct. 8, 2008), <http://www.cbpp.org/files/6-6-08sfp1.pdf>.

127. See, e.g., DEL. CODE ANN. tit. 30, § 1117(a) (2009) (providing a credit of 20% of the federal EITC); D.C. CODE § 47-1806.04(f)(1) (2009) (providing a 40% credit of the federal EITC); 35 ILL. COMP. STAT. ANN. 5/212(a) (West 2009) (granting a state EITC of 5% of the federal EITC); IND. CODE ANN. § 6-3.1-21-6(a) (West 2009) (allowing a state credit equal to 9% of the federal credit); IOWA CODE § 422.12B(1) (2008) (providing a credit of 7% of the federal EITC); KAN. STAT. ANN. § 79-32,205(a) (2008) (allowing a state credit of 17% of federal EITC); LA. REV. STAT. ANN. § 47:297.8(a) (2009) (granting a credit equal to 3.5% of the federal credit); ME. REV. STAT. ANN. tit. 36, § 5219-S(1) (2009) (granting a state credit equal to 4% of federal credit); MD. CODE ANN., TAX-GEN. § 10-704(b)(1) (West 2009) (providing a credit equal to the lesser of 50% of the federal EITC or the state tax liability); MASS. GEN. LAWS ch. 62, § 6(h) (2009) (granting a state EITC of 15% of the federal credit); MICH. COMP. LAWS ANN. § 206.272(1)(b) (West 2009) (increasing the state EITC to 20% of federal credit for taxable years beginning 2009); NEB. REV. STAT. § 77-2715.07(2)(e) (2009) (granting a credit to workers equal to 10% of the federal credit); N.J. STAT. ANN. § 54A:4-7(a)(2)(f) (West 2009) (establishing a credit equal to 25% of the federal credit beginning in taxable year 2009); N.M. STAT. ANN. § 7-2-18.15(A) (2008) (providing a working families tax credit of 10% of the federal EITC); N.Y. TAX LAW § 606 (d) (1) (vii) (McKinney 2009) (granting a state EITC equal to 30% of the federal EITC); N.C. GEN. STAT. §§ 105-151.31(a)-(c) (2009) (granting a credit equal to 5% of the federal EITC beginning in 2009 but scheduled to sunset in taxable year 2013); OKLA. STAT. tit. 68, § 2357.43 (2009) (providing a credit equal to 5% of the federal EITC); OR. REV. STAT. § 315.266(1) (2009) (allowing a credit of 6% of the federal EITC); R.I. GEN. LAWS § 44-30-2.6(N)(1) (2009) (granting a credit of 25% of the federal EITC); VT. STAT. ANN. tit. 32, § 5828b(a) (2009) (allowing of credit of 32% of the federal EITC); VA. CODE ANN. § 58.1-339.8 (B)(2) (2009) (providing a credit of 20% of the federal EITC); WASH. REV. CODE ANN. § 82.08.0206(3) (West 2009) (granting greater of ten% of the federal EITC or fifty dollars); WIS. STAT. ANN. § 71.07(9e)(af) (West 2009) (granting a credit based upon the number of qualifying children of 4%, 14%, or 43% of the federal EITC). *But see* MINN. STAT. § 290.0671(1) (2009) (basing its working family credit on a percentage of earned income).

128. D.C. CODE § 47-1806.04(f)(3); 35 ILL. COMP. STAT. ANN. 5/212(b); IND. CODE ANN. § 6-3.1-21-6(b); IOWA CODE § 422.12B(1); KAN. STAT. ANN. § 79-32,205(b); LA. REV. STAT. ANN. § 47:297.8(b); MASS. GEN. LAWS ch. 62, § 6(h); MICH. COMP. LAWS ANN. § 206.272(2); MINN. STAT. § 290.0671(4); NEB. REV. STAT. § 77-2715.07; N.J. STAT. ANN. § 54A:4-7(c); N.M. STAT. ANN. § 7-2-18.15(B); N.Y. TAX LAW § 606 (d) (2); N.C. GEN. STAT. § 105-151.31(b); OKLA. STAT. tit. 68, § 2357.43; OR. REV. STAT. § 315.266(5) (2007); VT. STAT. ANN. tit. 32 § 5828b(b); WIS. STAT. ANN. § 71.07(9e)(f).

129. MD. CODE ANN., TAX-GEN. § 10-704(b) (granting either a refundable credit of 50% or a nonrefundable credit equal to 25% of the federal credit); R.I. GEN. LAWS § 44-30-2.6(N)(1) (providing for a refundable credit of 15% of its 25% credit).

130. See DEL. CODE ANN. tit. 30, § 1117(a); ME. REV. STAT. ANN. tit. 36, § 5219-S(4); VA. CODE ANN. § 58.1-339.8(C).

requires recipients to have at least one dependent child.¹³¹ Interestingly, the state of Washington, which has no state income tax, still provides a state refundable EITC equal to the greater of 5% of the federal EITC, or \$25 in taxable years 2009 and 2010, and the greater of 10% of the federal EITC, or \$50 for 2011 and subsequent years.¹³²

B. Problems with the Tax Credit

One large problem with the EITC is that eligible taxpayers neglect to claim it. The IRS estimates that approximately 25% of eligible taxpayers fail to claim the EITC because they are unaware that they qualify to receive the credit.¹³³ Another frequent problem with the administration of the EITC is the high level of erroneous claims. During taxable year 1999, 27% to 31.7% of the \$8.4 billion to \$9.9 billion of EITC claims were erroneous.¹³⁴ The erroneous claims result from several common mistakes. The IRS has disallowed the EITC when a married couple failed to file a joint return.¹³⁵ On numerous tax returns, taxpayers attempt to claim the earned income tax credit on the basis of having a qualifying child. The courts have frequently sustained the IRS's denial of the credit where a child is not a qualifying child for purposes of the credit.¹³⁶

One possible explanation for taxpayer's reporting of an ineligible child for EITC purposes is that there have traditionally been inconsistent rules pertaining to whether a taxpayer is entitled to the dependency exemption, child tax credit, head of household

131. See WIS. STAT. ANN. § 71.07(9e).

132. See WASH. REV. CODE ANN. § 82.08.0206(3).

133. I.R.S. News Release IR-2008-13 (Jan. 31, 2008).

134. I.R.S. News Release IR-2003-78 (June 13, 2003).

135. See, e.g., *McCullough v. Comm'r*, No. 14718-04S (T.C. Feb. 21, 2006) (finding that taxpayer not allowed to amend improperly filed head of household status to married filing jointly after taxpayer filed a petition with the Tax Court); *Newsom v. Comm'r*, 78 T.C.M. (CCH) 415 (1999) (finding that EITC disallowed where husband and wife filed separate tax returns after husband originally filed as a head of household); *Mischel v. Comm'r*, 74 T.C.M. (CCH) 253 (1997) (finding that EITC disallowed because the married taxpayer did not file a joint income tax return).

136. See, e.g., *Willoughby v. Comm'r*, 97 T.C.M. (CCH) 1302 (2009) (denying credit where the taxpayer attempted to claim his live-in girlfriend's daughters as qualifying children); *Redmond v. Comm'r*, 96 T.C.M. (CCH) 414 (2008) (denying credit because taxpayer did not meet her burden that two children were her niece and nephew); *Linton v. Comm'r*, 85 T.C.M. (CCH) 1436 (2003) (finding taxpayer ineligible to claim children for purposes of the EITC because they did not reside with the taxpayer for more than one-half of the taxable year).

filing status, and EITC.¹³⁷ The Working Families Tax Relief Act of 2004¹³⁸ alleviated some of this inconsistency by creating a uniform definition of the term “qualifying child,” but did not completely eliminate the problem of confusion over inconsistent rules. For example, a taxpayer is entitled to utilize the head of household filing status and claim a dependency exemption for a “qualifying relative,”¹³⁹ but the taxpayer is not entitled to claim such person for purposes of the EITC and child tax credit. Consequently, a taxpayer can claim an eligible non-relative who resided with the taxpayer for the entire taxable year for purposes of the dependency exemption, but that taxpayer is unable to claim that non-relative for purposes of the EITC.¹⁴⁰ In addition, the child tax credit is inapplicable for a child who turned 17 by the end of the tax year,¹⁴¹ but for purposes of the EITC, dependency exemption, and head of household filing status, the maximum age is generally under the age of nineteen.¹⁴² For purposes of the EITC, dependency exemption, and head of household filing status, the maximum age is under twenty-four if the taxpayer’s qualifying child is a full-time student.¹⁴³ There is no maximum age where the child is permanently or totally disabled.¹⁴⁴

While there are several reasons for erroneous EITC claims,¹⁴⁵ Professor Dorothy Brown has argued that one of the core explanations is that the IRS and politicians have unfairly targeted the low-income recipients because they are considered to be pseudo welfare recipients.¹⁴⁶ Professor Brown states that “[t]he belief that EITC errors are the result of fraud and not complexity is a function of the mental

137. In *Olivio v. Commissioner*, No. 311-07S (T.C. Sept. 8, 2008), the 22-year old taxpayer properly claimed the dependency exemption for a cousin whose parents lived in the Dominican Republic, but the taxpayer was not entitled to the EITC because the cousin was not a qualifying child. Similarly, in *Hartfield v. Commissioner*, No. 7439-05S (T.C. May 11, 2006), the Tax Court concluded that although the taxpayer was entitled to claim the dependency exemption for his girlfriend’s child because he met the residency and support tests, he was not able to claim the child for purposes of the EITC.

138. Working Families Tax Relief Act of 2004, Pub. L. No. 108-311, § 201, 118 Stat. 1166, 1169–71.

139. See I.R.C. § 152(d).

140. A non-relative is not a qualifying child for purposes of the child tax credit. See *id.* § 24(c).

141. *Id.* § 24(c)(1).

142. See *id.* §§ 32(c)(3), 152(c)(3)(A)(i).

143. See *id.* § 152(c)(3)(A)(ii).

144. See *id.* § 152(c)(3)(B).

145. Professor Leslie Book analyzed several factors contributing to EITC noncompliance based on categories of taxpayer behavior and argued that the IRS must focus on these categories rather than the error rate. Leslie Book, *The Poor and Tax Compliance: One Size Does Not Fit All*, 51 U. KAN. L. REV. 1145, 1177–78 (2003).

146. Brown, *supra* note 22, at 800-01.

connection between EITC recipients and welfare recipients.”¹⁴⁷ These errors are uncovered because approximately 50% of all individual tax return audits are those in which the taxpayer claimed the EITC rather than higher income taxpayers.¹⁴⁸ According to Professor Brown, the premise that errors are attributable to fraud is based on critical race issues and the faulty perception that African Americans and Hispanics are the primary EITC claimants.¹⁴⁹

Professor Forman has identified additional problems with the EITC. He argues that the EITC should be converted from an earned income credit to a wage subsidy credit because the current tax incentive not only provides benefits to high-wage individuals, but also because these benefits exceed those provided to low-wage earners.¹⁵⁰ One problem he identifies is that there is not necessarily horizontal equity¹⁵¹ between two workers where one of the workers works half of the hours that the other worker works but earns double the hourly rate, particularly where the worker with the higher

147. *Id.* at 806-07.

148. *Id.* at 808. Professor Brown also discusses the precertification requirement for 25,000 EITC claimants implemented by the IRS beginning in 2004 that required these claimants to provide eligibility documentation in order to receive the EITC. *Id.* at 809-10; see also Stephen D. Holt, *Keeping It in Context: Earned Income Tax Credit Compliance and Treatment of the Working Poor*, 6 CONN. PUB. INT. L.J. 183, 190 (2007) (finding that the audit rate for high income taxpayers has increased but audits of EITC claimants remains substantially higher); James L. Rockney, Note, *Prove It or Lose It: The Certification Program for Select Individuals Claiming the Earned Income Tax Credit*, 2 PITT. TAX REV. 49, 60 (2004) (discussing the precertification requirement resulting in audits of a random sample of taxpayers claiming the EITC and noting that “in all fairness . . . [the IRS] should also tailor a certification program for those other taxpayers in higher brackets who have historically abused the tax system and amassed fortunes with tax avoidance schemes”). *But see* Dennis J. Ventry, Jr., *Welfare by Any Other Name: Tax Transfers and the EITC*, 56 AM. U. L. REV. 1261, 1275 (2007) (“To the extent a small number of EITC claimants are required to precertify their eligibility for benefits, or that otherwise EITC eligibles shown to have made erroneous claims in previous years are prevented from claiming the EITC for as many as ten years (for fraud), is, to my mind, a realistic price to pay.” (footnote omitted)). A recent New York Times article supports the conclusion that the government could benefit by auditing the tax returns of wealthy taxpayers. In the article, it was reported that a former chief executive of an accounting firm was indicted for selling bogus tax shelters to wealthy taxpayers costing the government billions of dollars in tax losses between 1994 and 2004 and \$3.9 billion from 1998 to 2000. Lynnley Browning, *7 Indicted on Charges of Selling Tax Shelters*, N.Y. TIMES, June 10, 2009, at B1.

149. Brown, *supra* note 22, at 824. *But see* Bekah Mandell, *Race and State-Level Earned Income Tax Credits: Another Case of Welfare Racism?*, 10 RUTGERS RACE & L. REV. 1, 19-23 (2008) (outlining several factors to establish that people of color disproportionately receive the EITC including low-wage jobs, larger family sizes, higher single parent families, and high concentration in the south where there are lower wages).

150. Forman, *supra* note 103, at 81.

151. One of the goals of the income tax is horizontal equity. Under horizontal equity principles, similarly situated taxpayers should be taxed similarly. See, e.g., Joseph M. Dodge, *Theories of Tax Justice: Ruminations on the Benefit, Partnership, and Ability-to-Pay Principles*, 58 TAX L. REV. 399, 401 (2005).

rate works fewer hours because of “labor-leisure choices.”¹⁵² He posits that “a net worth or resources test” for determining the EITC phase-out may provide a better solution because it prevents an individual with little earned income but a high net worth from claiming the credit consistent with “typical welfare programs” such as the Aid for Dependent Children program.¹⁵³

An additional problem indirectly impacting the EITC tax incentive is the substantial transfer of benefits to tax preparers and rapid loan providers. Many low-income workers fall prey to the allure of rapid refunds offered by some paid preparers for hefty fees. Evidence establishes that approximately \$2 billion of EITC claims are paid to paid preparers and loan providers, resulting in a 6.7% loss of EITC benefits to the low-income claimant.¹⁵⁴ Because of limited financial services, low-income individuals are easy targets for refund-anticipation loans and other services such as rent-to-own transactions, pawn shops, and check cashing outlets.¹⁵⁵ Additional regulation of return preparation is necessary to reduce the substantial EITC benefits paid to preparers and loan providers.¹⁵⁶ With free electronic filing and return preparation available through the IRS’s VITA program, it is troubling that many low-income workers unnecessarily relinquish a portion of their EITC to paid preparers for high-interest rapid refunds.

152. Forman, *supra* note 103, at 81.

153. *Id.* at 88.

154. Rockney, *supra* note 148, at 58. Another concluded that “loans with triple-digit interest rates are now attached to nearly half of all EITC refund dollars. Overall, roughly \$1.75 billion intended to benefit low-income families flows instead to commercial tax preparers and affiliated national banks.” Silverman, *supra* note 82, at 490 (internal quotation marks omitted).

155. See Jim Hawkins, *Renting the Good Life*, 49 WM. & MARY L. REV. 2041, 2076–77 (2009) (stating “that most rent-to-own customers have low incomes” and that the “APR is frequently above 200 percent”); Silverman, *supra* note 82, at 486–89 (stating that the working poor rely on a second-tier financial system that includes pawnshops, check cashing outlets, rent-to-own stores, and tax refund anticipation lenders); see also Lois R. Lupica, *The Consumer Debt Crisis and the Reinforcement of Class Position*, 40 LOY. U. CHI. L.J. 557, 593–94 (2009) (“Borrowers who are driven by need, however, know that payday lenders are exploiting them, that credit cards are a trap, and that rent-to-own stores are a rip-off, but in the face of such dire need, the price of credit and the effects of indebtedness become irrelevant. In the absence of alternatives, these borrowers do not have the luxury to meaningfully consider the long-term consequences of incurring high priced debt.” (emphasis in original) (footnotes omitted)); Todd J. Zywicki, *The Economics of Credit Cards*, 3 CHAP. L. REV. 79, 83 (2000) (stating that the regulation of the credit card industry could have negative consequences on low-income individuals because they might be driven back to pawnbrokers, rent-to-own establishments, and loan sharks).

156. See Cords, *supra* note 121, at 355 (advocating that increased regulation of tax preparers and oversight of loan providers are necessary). See generally Michele Estrin Gilman, *Poverty and Communitarianism: Toward a Community-Based Welfare System*, 66 U. PITT. L. REV. 721, 813 (2005) (stating the flaw that “the low-wage population is preyed upon by tax preparers who take a hefty share of the tax credit” needs to be corrected).

Finally, the current EITC provisions do not encourage recipients to save a portion of their EITC benefits. Unlike other government transfer programs, “families who receive the EITC experience a greater freedom and increased potential to invest in long-term purchases and equities, enabling them to reduce their vulnerability.”¹⁵⁷ While the legislative history indicates that one purpose of the tax incentive is to “funnel[] funds to persons likely to spend the money immediately,” it also states that the credit is intended to provide relief for individuals hurt by inflationary food and energy costs.¹⁵⁸ The EITC needs to incorporate a savings component to ensure recipients can sustain payment for such necessities upon retirement. As already discussed in this Article, the government promotes low-income individuals to save in other ways, but there are several limitations on those efforts.

VI. ADDING A SAVING COMPONENT TO THE EITC

A. In General

This section will outline a proposal to amend the Internal Revenue Code to increase the incentive for the working poor and other low-income workers to save for retirement. President Barack Obama’s budget includes proposals to increase the savings rate of low-income and middle income workers. His budget includes an expansion of the saver’s credit by making it refundable, mandating that employers automatically enroll employees in their retirement plans, and requiring employers who do not offer retirement plans to enroll employees in direct-deposit IRAs.¹⁵⁹ The President’s proposal also suggests converting the saver’s credit to a refundable one with a 50% match on \$1000 of savings for families earning less than \$65,000.¹⁶⁰ The Obama administration estimates that implementation of the proposal will increase the participation rate of these workers to 80%.¹⁶¹ Even if Congress enacts President Obama’s proposal, Congress should still add a savings component to the EITC

157. Mandell, *supra* note 149, at 19.

158. Sorenson v. Sec’y of the Treasury, 475 U.S. 851, 864 (1986).

159. OFFICE OF MGMT. & BUDGET, A NEW ERA OF RESPONSIBILITY: RENEWING AMERICA’S PROMISE 84–85 (2009), available at http://www.whitehouse.gov/omb/assets/fy2010_new_era/A_New_Era_of_Responsibility2.pdf. Senator Jeff Bingaman recently introduced a bill into the Senate to require employers without qualified plans to automatically enroll their employees into IRAs subject to employee opt out. See Automatic IRA Act of 2010, S. 3760, 111th Cong. § 2(a) (2010).

160. OFFICE OF MGMT. & BUDGET, *supra* note 159, at 85.

161. *Id.*

because it does not address many of the challenges that low-income individuals have in saving for retirement.

B. Proposed Expansion of the EITC

1. In General

The EITC has gained nonpartisan support and represents an integral component of tax policy. Empirical data indicates that the majority of EITC benefits is used to pay bills, but that 49% of recipients save a portion of the credit to purchase a car or home or save for education.¹⁶² However, as already noted, the EITC has its share of shortcomings. In light of these shortcomings, scholars have proposed modifications to the EITC. One interesting proposal is to expand the EITC to reach more low-income workers who do not have qualifying children because they frequently financially support noncustodial children and pay a large percentage of their income in payroll, sales, and excise taxes.¹⁶³ That proposal also argues that the EITC should be expanded to these low-income workers to promote saving for education and retirement.¹⁶⁴ The rationale for this proposal is as follows:

With the national savings rate at zero, innovative approaches that promote savings and asset building for all low-income workers deserve support. The current tax structure favors asset building among middle and upper income families, but has too little to offer those with low incomes and low tax liabilities. . . . An expanded EITC linked to opportunities for single low-wage workers to save and build assets could achieve a number of worthwhile social policy goals, including financing primary and secondary educations for the children of non-custodial parents as well as reducing the number of people facing poverty in retirement.¹⁶⁵

I agree that the scope of the EITC should be expanded to implement the objective of saving for retirement.¹⁶⁶ However, the expansion should not be limited to low-income workers who lack

162. Mandell, *supra* note 149, at 18 (citing Timothy M. Smeeding et al., *The EITC: Expectation, Knowledge, Use, and Economic and Social Mobility*, 53 NAT'L TAX J. 1187, 1203 (2000)).

163. Gitterman et al., *supra* note 29, at 249-50.

164. *Id.* at 248.

165. *Id.* at 249.

166. *Cf.* Smeeding, *supra* note 14, at 18 ("Clearly there is potential for the EITC to be linked to asset-building policy.").

qualifying children. A portion of a taxpayer's EITC should be contributed to a retirement savings vehicle. The fact that many taxpayers lack access to retirement accounts should not prevent implementation of this proposal. President Obama's proposal to require employers to enroll employees in a direct-deposit IRA if the employer lacks a retirement plan is worth consideration. In addition, the federal government already has a template in place to solve the problem of lack of access to retirement accounts: the Thrift Savings Plan (TSP). The TSP was created under the Federal Employees' Retirement System Act of 1986.¹⁶⁷ As originally enacted, the TSP was a program for Federal civilian employees only; however, beginning with fiscal year 2001, it was extended to members of the military.¹⁶⁸ The Thrift Savings Plan Enhancement Act of 2009 made several additional changes to the TSP, including: 1) ending the one year waiting period for Agency contributions in order to enable employees to immediately receive a one percent automatic Agency contribution and potentially an Agency match; 2) creating automatic enrollment for civilian employees, but not for military personnel; 3) allowing a deceased participant's spouse to leave savings in the TSP account instead of requiring mandatory withdrawal; 4) allowing participants to contribute after-tax dollars to the TSP and avoid tax on earnings consistent with Roth IRAs; and 5) allowing (but not requiring) participants the opportunity to invest in a variety of mutual funds selected by the Agency.¹⁶⁹ While the current TSP only covers federal government employees and members of the military, Congress could either extend the TSP to EITC recipients or establish a similar vehicle for the program. Because of the barriers to savings for low-income workers, including lack of access to retirement plans and lack of investment savvy, the creation of a program similar to the TSP or the requirement that employers enroll employees in a direct-deposit IRA where the employer lacks a retirement plan is critical to the success of the expansion of the EITC.

167. Federal Employees' Retirement System Act of 1986, Pub. L. No. 99-335, § 206, 100 Stat. 514, 593-94.

168. Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001, Pub. L. No. 106-398, § 661, 114 Stat. 1654, 1654A-167 (2000).

169. See *Legislative Changes to the Thrift Savings Plan*, THRIFT SAVINGS PLAN, 1-2 (Aug. 2009), <https://www.tsp.gov/PDF/formspubs/oc09-16.pdf>.

2. Basic Structure of a Revamped EITC

a. Investment Income Restriction

The EITC statutory scheme prohibits a recipient from claiming the credit where investment income exceeds \$3100 for the taxable year.¹⁷⁰ Investment income includes taxable and tax-exempt interest, dividends, net rents, net royalties, net capital gains, and passive activity income to the extent that it exceeds passive activity losses.¹⁷¹ According to the Joint Committee on Taxation, individuals with meaningful assets can dispose of them to purchase consumable products.¹⁷² In addition, Medicaid, Supplemental Nutrition Assistance Program, and other government programs have asset tests to determine eligibility and rely on caseworkers to determine eligibility.¹⁷³

Because interest, dividends, rents, and royalties are derived from assets, they serve as “a proxy for an asset-based test” for determining EITC eligibility.¹⁷⁴ Consequently, a low-income individual whose assets generate substantial income is unable to receive the EITC tax subsidy. However, the legislative history is devoid of any indication that this proxy applies to assets held in retirement savings accounts. The expansion of the EITC program to encourage retirement savings is not inconsistent with the reasons underlying the excess investment income prohibition. The investment income restriction therefore should remain in force but should not apply to any retirement savings or any accrued earnings from such savings.

b. Necessity of Automatic Contributions

Neoclassical economists support individual choice rather than a policy of paternalism that is typical in many employer benefit plans because they allow for the least amount of individual choice.¹⁷⁵ The greatest range of choices is superior to more limited choices because an individual has a greater opportunity to select the optimal

170. See Rev. Proc. 2008-66, 2008-45 I.R.B. 1111.

171. I.R.C. § 32(i)(2).

172. STAFF OF JOINT COMM. ON TAXATION, 104TH CONGRESS, GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN THE 104TH CONGRESS 390 (Comm. Print 1996), available at <http://www.jct.gov/s-12-96.pdf>.

173. *Id.*

174. *Id.*

175. See Weiss, *supra* note 46, at 1289.

choice.¹⁷⁶ According to this approach, the decision to save or consume is an example of rational human behavior.¹⁷⁷ Neoclassical economists also consider extremely low levels of saving to be rational.¹⁷⁸ However, neoclassical economists recognize that some restriction on individual choice may be necessary because “savings affects the welfare of future generations.”¹⁷⁹

In contrast to the neoclassical economic theory, the proposal to modify the EITC is based on the choice architecture theory advanced by Professors Richard H. Thaler and Cass R. Sunstein. Under this theory, a choice architect influences behavior by designing the available options for a decision maker.¹⁸⁰ The choice architect attempts to persuade, or “nudge,” people to make certain choices that the architect perceives to be beneficial for those people.¹⁸¹ The decision to contribute to a retirement savings plan presents an individual with a choice and a consequence that are separated in time. According to choice architecture theory, individuals need “nudges” for these types of decisions because they do not get “prompt feedback.”¹⁸²

Offering a “nudge” can have a profound impact in encouraging the working poor and other low-income workers to invest in retirement savings. The employer match has not succeeded in increasing the participation rate of the working poor and other low-income workers.¹⁸³ Therefore, an additional nudge may be required to increase their retirement savings.

The creation of automatic enrollment programs may provide the nudge for some workers to save for retirement.¹⁸⁴ The Pension Protection Act of 2006¹⁸⁵ (PPA) created a safe harbor for employers who wanted to establish automatic enrollment programs for their employees. Prior to 2006, automatic enrollment was possible, but many employers did not utilize it because of perceived “potential

176. See Matthew Venhorst, Note, *Helping Individual Investors Do What They Know Is Right: The Save More for Retirement Act of 2005*, 13 CONN. INS. L.J. 113, 127 (2006–2007).

177. See Weiss, *supra* note 46, at 1286.

178. *Id.* at 1298.

179. *Id.* at 1291.

180. THALER & SUNSTEIN, *supra* note 5, at 3.

181. *Id.* at 6. Professors Thaler and Sunstein define a nudge as “any aspect of the choice architecture that alters people’s behavior in a predictable way without forbidding any options or significantly changing their economic incentives.” *Id.*

182. *Id.* at 74.

183. See *id.* at 109.

184. See *id.* at 110.

185. Pension Protection Act of 2006, Pub. L. No. 109-280, § 902, 120 Stat. 780, 1033–40.

legal liability.¹⁸⁶ The PPA details how employers can automatically enroll their employees in a retirement plan while meeting ERISA's nondiscrimination rules.¹⁸⁷ The PPA does not mandate automatic enrollment, but it provides an incentive for its use by giving employers the ability to automatically enroll their employees in retirement plans without fear of violations of ERISA. Under the PPA, the retirement plan administrator must provide notice of the employee's rights to eligible employees within a reasonable time period before each plan year.¹⁸⁸ The plan must have an opt-out feature, and the notice must clearly explain that feature. It must also include a description of investment options to the extent that the plan contains such options.

In addition, the IRS facilitates automatic enrollment by providing sample amendments that can assist employers, plan sponsors, and practitioners in establishing an automatic enrollment feature to retirement plans.¹⁸⁹ The sample amendments are designed to aid in the drafting of an automatic enrollment plan and are intended to allow for modifications to comport with the plan's terms and procedures.¹⁹⁰ They provide employers with sample language that outlines the specifics of automatic enrollment into an employer plan, including the default percentage, annual increases to the default percentage up to a cap, and mandatory notice requirements that allow for an employee to opt out of the automatic enrollment or to elect a different percentage to be invested in the plan.¹⁹¹

Participation in automatic enrollment plans has been increasing since the enactment of the PPA. According to a survey conducted by the Profit Sharing/401K Council of America, participation in automatic enrollment plans increased from 23.6% in 2006 to 35.6% in 2007.¹⁹² However, in the case of low-income workers, the automatic enrollment feature alone will not sufficiently increase their retirement savings because of the lack of access to employer retirement plans.

186. *EBRI Policy Forum: Defined Contribution Plans in a Post-PPA Environment*, EBRI NOTES (Emp. Benefit Res. Inst., Washington, D.C.), July 2008, at 2, 2, available at http://ebri.org/pdf/notespdf/EBRI_Notes_07-2008.pdf.

187. Under ERISA, there are standards and percentages for determining whether there is discrimination between the "highly compensated employees" and all other employees. See I.R.C. § 401(k)(3)(A)(ii).

188. Pension Protection Act of 2006 § 501.

189. See I.R.S. Notice 2009-65, 2009-39 I.R.B. 413-18.

190. See *id.*

191. *Id.*

192. David Wray & Hattie Greenan, *Survey Finds Growing 401(k) Success*, DEFINED CONTRIBUTIONS INSIGHT MAGAZINE, Nov./Dec. 2008, <http://www.psc.org/DCIMagazineMembers/tabid/133/ctl/Detail/mid/490/Id/1024/Archive/Default.aspx>.

Where a low-income employee lacks access, I propose that the automatic enrollment feature should be tied to an investment vehicle similar to the TSP or to an IRA in order to increase retirement savings for the low-income worker. In order to implement the automatic enrollment feature, 10% of the recipient's EITC subsidy should be allocated to the retirement savings account. Based on the maximum EITC benefits for taxable year 2009, the amount of the benefits to be refunded to the recipient and automatically contributed to a retirement savings account are as follows:¹⁹³

	No Children	One Child	Two Children	Three or More Children
Maximum EITC	\$457.00	\$3,034.00	\$5,028.00	\$5,657.00
EITC to be refunded to employee	\$411.30	\$2,730.60	\$4,525.20	\$5,091.30
EITC to retirement account	\$ 45.70	\$303.40	\$502.80	\$565.70

These figures show that the primary objective of the EITC will not be frustrated by the automatic allocation of 10% of the EITC to a retirement savings account. The amount of the EITC benefits to be refunded to the recipient will continue to represent a substantial increase in the recipient's after-tax income. Moreover, the EITC benefits will be supplemented by other refundable credits, such as the additional child tax credit.¹⁹⁴

c. Matching Component

Under my proposal, the maximum amount that can be allocated to a retirement savings account under the EITC is \$1000 for single taxpayers and \$2000 for married taxpayers filing a joint return. These figures are identical to the maximum allowable saver's credit. This amount is only available where the EITC recipient contributes an amount in excess of the automatic contribution from the EITC benefits. To the extent that an EITC recipient contributes money to an existing IRA or 401(k) retirement plan or elects to contribute an additional portion of the EITC benefits in excess of the automatic contribution during the current taxable year, the recipient should be entitled to a match from the government. The match should be dollar for dollar. The purpose of the

193. Rev. Proc. 2009-21, 2009-16 I.R.B. 862.

194. See I.R.C. § 24(d).

match is to provide an additional incentive for the EITC recipient to contribute additional money to a retirement account.

The match is illustrated in the following example. If a single taxpayer with one child is entitled to the maximum EITC of \$3034, declines to opt out of the automatic 10% contribution, and contributes an additional \$300 under an established 401(k) account or IRA, that taxpayer will receive a total government subsidy of \$603.40 (\$303.40 from the automatic contribution plus a match of \$300). Consequently, the taxpayer will have a total amount of \$903.40 contributed to a retirement account but only \$300 is contributed from the taxpayer's wages. Alternatively, if the same taxpayer does not opt out of the automatic contribution and elects to have an additional 10% of the EITC benefits contributed to a retirement account or IRA but does not make an additional contribution to the retirement account, the total amount contributed on behalf of the taxpayer is \$910.20 (\$303.40 from the automatic contribution, \$303.40 additional contribution from the EITC, and \$303.40 from the match).

d. Role of Vesting

As noted above, with a qualified employer plan, employer contributions cannot be forfeited once the employee meets the vesting requirements.¹⁹⁵ The question arises as to whether vesting should be applicable to the portion of EITC benefits that are contributed to a retirement savings account. In the context of the EITC match, the question is based on the length of time in which the contribution was held in a retirement account rather than length of service. In other words, should an EITC recipient who has received a match from the government forfeit it or a portion thereof if he or she withdraws funds from the retirement savings account within a certain period of time prior to reaching retirement age? I propose that the EITC recipient should be fully vested in any automatic contribution of EITC benefits to a retirement plan or IRA; if the EITC recipient is not fully vested in these contributions, it will severely limit the participation level in the proposed program. However, to protect the purpose of the proposed plan, the vesting rules must apply to any match contributed by the government. Under the vesting rules, the EITC recipient must forfeit the match to the extent that automatic contributions or additional contributions are withdrawn prior to the end of the vesting period.

195. See *supra* notes 50–51 and the accompanying text.

Because the expanded EITC is more consistent with a defined contribution plan, one of its vesting schedules should be applied. The vesting schedule requiring 20% vesting two years after the contribution and 20% increases each year for six years after the contribution is more consistent with the purpose of encouraging long-term saving. In order to implement this exception, a system of “first in, first out” (also known as the accounting principle “FIFO”) should be adopted. For example, assume that \$500 is contributed to a retirement savings account each year from an automatic contribution of \$250 and an additional contribution of \$250 by the EITC recipient. The government provides a dollar for dollar match of \$250 each year. Excluding gains, the participant will have \$1500 in the retirement account after the recipient’s contributions and the government match. If the participant withdraws \$700 after making the contributions in the second year, \$500 is taken from the contribution made in year one first, and the full \$250 match from the first year of participation is forfeited. The \$200 balance of the withdrawal is taken from the EITC recipient’s contribution made during the second year, and \$200 of the match from the second year is also lost. Because the EITC recipient has withdrawn 80% of the remaining automatic or additional contribution, the recipient also forfeits 80% of the match. The EITC recipient still has \$350 in the retirement account, and the recipient will be 20% vested in the remaining match of \$50 two years after the contribution. The following table outlines these principles:

	Year One Contributions and Match	Year Two Contributions and Match
Automatic Contribution	\$250	\$250
Additional Contribution	\$250	\$250
Government Match for Additional Contribution	\$250	\$250
Total	\$750	\$750
Total in Retirement Account after \$700 Withdrawal	\$0	\$350 (\$300 Recipient Contributions and \$50 Match)

e. Early Withdrawal Penalty

Generally, the Internal Revenue Code imposes a 10% additional tax where a taxpayer withdraws money from a qualified retirement plan prior to reaching the age of 59 ½.¹⁹⁶ Equity considerations require that the penalty should continue to apply to any early

196. I.R.C. § 72(t).

withdrawal made by a recipient of the EITC. However, the penalty should only apply to amounts received from the governmental match, not from the participant's contributions. This is distinguishable from traditional retirement accounts. The rationale for this exception stems from the fundamental purpose of the EITC. As already noted, two of the most important objectives of the EITC are to offset the regressive nature of Social Security taxes and to provide relief from inflationary food and energy prices for low-income workers. These objectives may conflict with the goal of increased saving. The purpose of modifying the EITC is to reduce the likelihood that low-income workers will need to rely completely on Social Security benefits in retirement. It is of paramount importance that an EITC recipient not be dissuaded from participating in the program for fear that if money is needed for basic necessities of life, the EITC recipient must sacrifice a portion of the EITC resulting from the 10% penalty.¹⁹⁷ In other words, it is unlikely that an EITC recipient will participate in a program that may result in a forfeiture resulting from the 10% penalty when that EITC recipient can receive the money upfront without any tax exposure. These considerations are not relevant when the match is at issue. To the extent that an EITC participant is vested in the government match and makes an early withdrawal, the participant will be subject to the 10% penalty on the withdrawal of the match. For example, if a forty-year old EITC participant satisfies the vesting requirements and withdraws the government match totaling \$2000, the participant will be subject to a \$200 penalty. Conversely, a sixty-year old participant will not be subject to the \$200 penalty.

It is important to note that the exceptions from the early withdrawal penalty, including withdrawals for qualified higher education expenses¹⁹⁸ and qualified first-time homebuyer distributions,¹⁹⁹ should apply to EITC retirement savings. With respect to

197. The 10% penalty does not apply to amounts forfeited where the participant is not fully vested in the government contributions. As a result, a participant may forfeit a portion of the government contribution under the vesting schedule and be subject to the 10% penalty for early withdrawal for the nonforfeited amount.

198. *See id.* § 72(t)(7). According to I.R.C. § 72(t), there is a 10% additional tax on early distributions of qualified retirement plans, but the additional tax does not apply to qualified higher education expenses if they are furnished to the taxpayer, the taxpayer's spouse, or any child or grandchild of the taxpayer or the taxpayer's spouse if it is paid to an eligible educational institution. *See id.* § 72(t)(7)(A)(i)-(iii).

199. *See id.* § 72(t)(8). The additional tax does not apply to "qualified first-time homebuyer distributions" if within 120 days of the distribution, the distribution is used to purchase the principal residence of a first-time homebuyer and the purchaser is the taxpayer, the spouse of taxpayer, or any child, grandchild, or ancestor of the taxpayer or taxpayer's spouse. *Id.* § 72(t)(8)(A). In addition, the lifetime ceiling for "qualified first-time homebuyer distributions" cannot exceed \$10,000. *Id.* § 72(t)(8)(B). Qualified acquisition costs

qualified higher education expenses, the EITC rules already promote education by entitling the taxpayer to claim a full-time student under the age of twenty-four as a qualifying child. While the primary objective of an EITC sponsored retirement account is to build retirement savings, the withdrawal of funds for educational purposes should not result in a penalty because it is consistent with the purpose of reducing poverty of the elderly. The purchase of a principal residence is similarly consistent with the desired goal of asset accumulation.

C. Viability of Proposal

The proposal to add a savings component to the EITC should be “fair, easy to comply with and administer, conducive to economic growth, produce adequate revenue and provide little interference with private economic decisions.”²⁰⁰ It meets the standard for viability. First, it is a fair proposal. It comports with vertical equity in that it is targeted solely at the lowest income taxpayers, unlike the saver’s credit. It also satisfies the horizontal equity principle in that similarly situated taxpayers should be taxed similarly. Historical data establishes that because certain categories of workers lack access to employer retirement plans, they are not provided with the opportunity to contribute wages to a tax-deferred retirement plan and therefore are not being taxed similarly to a taxpayer who earns the same wages. My proposed expansion of the EITC corrects this horizontal equity problem by enabling many low-income workers to contribute a small portion of their EITC to a retirement vehicle.

Second, the proposal is easy to comply with and to administer. While complexity is difficult to avoid in any tax provision, the structure of the expanded EITC meets the criteria: it is already a part of an established statutory provision; the computation of the credit will not change; and the implementation of the EITC proposal should not create too great of an administrative burden. Obviously, the Department of the Treasury will need to amend a few tax forms and related publications to implement the proposed expansion of the EITC. To the extent that a low-income worker

include “acquiring, constructing, or reconstructing a residence” and “settlement, financing, or other closing costs.” *Id.* § 72(t)(8)(C). An individual qualifies as a first-time homebuyer if the individual had no ownership of a home two years prior to the date of acquisition. *Id.* § 72(t)(8)(D).

200. Vada Waters Lindsey, *The Widening Gap Under the Internal Revenue Code: The Need for Renewed Progressivity*, 5 FLA. TAX REV. 1, 43 (2001) (citing MICHAEL J. GRAETZ, *THE DECLINE (AND FALL?) OF THE INCOME TAX 10* (1997)).

already contributes to an established 401(k) plan or IRA, the government match can be done electronically through the same direct deposit method that is already in place. The proposal establishing an automatic contribution and match minimizes complexity. The EITC is automatically reduced by 10% of the credit. If a recipient wants to opt out of the automatic contribution, the recipient should only be required to check a newly created box on the tax return. To the extent that an EITC recipient has made a contribution to an IRA or 401(k) plan during the taxable year entitling the recipient to the match, it is reflected on the tax return consistently with the manner in which it is currently reported. There is no added complexity because this information is already reported for purposes of the saver's credit. With respect to compliance, the government needs to continue to reduce the error rate of EITC returns; however, the establishment of a savings component to the EITC should not create additional compliance concerns.

Third, the proposal is conducive to economic growth. In the short-term, it may appear otherwise. However, only a small percentage of the EITC will be automatically contributed to a retirement plan or IRA. The vast majority of the EITC will continue to stimulate the economy by providing much-needed funds to recipients to purchase basic necessities. It will also improve long-term economic growth by helping to reduce the number of retirees who are living below the poverty level.

Fourth, the cost of the proposal must be considered. According to the staff of the Joint Committee on Taxation, tax incentives cost the federal government \$500 billion per year or over 4% of the gross domestic product.²⁰¹ During taxable year 2006, the total EITC claimed by all taxpayers was approximately \$44.4 billion.²⁰² The cost of my proposal will likely increase this amount. However, the cost of the proposal is offset by the fact that the recipient is already entitled to the amount automatically contributed to a retirement

201. Lily L. Batchelder et al., *Efficiency and Tax Incentives: The Case for Refundable Tax Credits*, 59 STAN. L. REV. 23, 43 (2006) (citing STAFF OF JOINT COMM. ON TAXATION, 109TH CONGRESS, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2006–2010 (Comm. Print 2006) [hereinafter ESTIMATES], available at <http://www.jct.gov/s-2-06.pdf>).

202. See Justin Bryan, *Individual Income Tax Returns, 2006*, SOI BULL., Fall 2008, at 5, 12 fig.H, available at <http://www.irs.gov/pub/irs-soi/08fallbul.pdf>. The \$44.4 billion was significantly lower than other tax incentives that primarily benefited wealthy taxpayers. During the same taxable year, over 90% of net capital gains and qualified dividends were claimed by taxpayers with income of at least \$100,000. See *id.* at 11 fig.F. The staff of the Joint Committee on Taxation estimated that the reduced rate on capital gains and dividends cost the federal government approximately \$92 billion in lost revenue. See ESTIMATES, *supra* note 201, at 34 tbl.1. In addition, the staff estimated that the exclusion of capital gains at death resulting from the “stepped-up” adjusted basis rules under I.R.C. § 1014 cost the government an additional \$51 billion in lost revenues. See *id.*

account and that the recipient will forfeit the government match if the minimum vesting requirements are not met. In addition, taxpayers who receive an additional EITC allocated to retirement savings are not entitled to claim the saver's credit during the same taxable year.²⁰³ As already noted, the maximum amount that a single taxpayer can receive under the proposed expansion of the EITC is \$1000 for single taxpayers and \$2000 for married taxpayers filing a joint return. These maximum amounts are consistent with the current saver's credit in order to minimize potential federal revenue shortfall, although it is not a complete wash because the saver's credit is nonrefundable. Moreover, the enhancement of current tax incentives for the working poor and other low-income workers will lower the possibility that they will be dependent on direct expenditures during their retirement years.

Finally, because the percentage that is automatically allocable to a retirement savings vehicle is relatively nominal, implementation of the proposal does not significantly interfere with private economic decisions, since EITC recipients are entitled to opt out of the automatic contributions based on their own financial needs.

VII. CONCLUSION

In recent years, Congress enacted tax incentives to benefit low-income workers by placing more tax dollars in their wallets. The recently-enacted Making Work Pay,²⁰⁴ First-Time Homebuyer,²⁰⁵ and

203. This approach is used for other tax incentives. For example, there are several tax incentives that are intended to encourage education. Taxpayers can claim the nonrefundable Hope or Lifetime Learning Credit. *See* I.R.C. § 25A. The Code also allows for an above the line deduction for tuition and fees. *See id.* § 222. However, both sections deny any possibility of a double benefit by stating that the taxpayer must elect either the deduction or credit but not both. *See id.* §§ 25A(g)(5), 222(c).

204. American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, § 1001, 123 Stat. 115, 309-12. For taxable years 2009 and 2010, low and middle-income workers generally will receive the credit in the form of lower withholdings, but some workers will receive their benefits in the form of a refundable credit on their tax returns. *Id.* § 1001, 123 Stat. at 310; *see* I.R.S. News Release IR-2009-13 (Feb. 21, 2009). The maximum credit is \$400 (\$800 for a married couple filing a joint return). American Recovery and Reinvestment Act § 1001, 123 Stat. at 310.

205. In 2008, in order to reinvigorate the housing market, Congress enacted a maximum refundable credit of \$7500 or 10% of the purchase price of a principal residence purchased on or after April 9, 2008 and before July 1, 2009. Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, § 3011, 122 Stat. 2654, 2888-91. Congress extended the refundable credit to December 1, 2009, increased the credit to \$8000, and eliminated the obligation to repay under the American Recovery and Reinvestment Act of 2009. American Recovery and Reinvestment Act § 1006. There are currently several proposals that have been introduced in the House and Senate to expand the current \$8000 tax credit. *See* Stephanie Armour, *Tax Credit for Home Purchase Could Rise; Proposals Call for Expanding Benefits*, U.S.A.

American Opportunities refundable credits²⁰⁶ supplement the longstanding refundable credits that include the EITC and the Additional Child Tax Credit. These established programs provide much-needed cash for low-income workers and help them acquire an education and purchase consumable products. With the exception of the First-Time Homebuyer Credit, however, these credits do little to encourage asset accumulation. Therefore, additional tax incentives are required to encourage wealth accumulation in the form of retirement savings because the incentives to save that are targeted at the working poor and other low-income workers are ineffective. The saver's credit has proven to be ineffective as a tax incentive for the working poor. Many low-income workers lack access to employer qualified 401(k) plans. This is particularly true for part-time employees, employees working in a service occupation, and employees working for small businesses.

All individuals, including low-income workers, need to rely on the "three-legged stool" of Social Security, pension plans, and personal savings to finance their retirement years. In order to provide an additional incentive for low-income workers to save for retirement, the EITC should be expanded to add a savings component. This expansion must include an automatic enrollment option. The ability of an employer to establish an automatic enrollment option has been strengthened by the PPA. In order to counter the lack of access by low-income workers, part-time employees, and non-white employees, a savings vehicle similar to the TSP should be utilized. Ten percent of the EITC benefits should automatically be added to a retirement savings vehicle. To the extent that the recipient of EITC benefits contributes a greater percentage to a retirement savings vehicle, the government should match the contribution dollar for dollar, with a maximum contribution of \$1000. That figure equals the maximum credit allowable under the saver's credit for single taxpayers. Married taxpayers filing a joint return are entitled

TODAY, June 22, 2009, at 1A. Economists believe that expansion of the credit is critical to the housing market recovery. *Id.*

206. American Recovery and Reinvestment Act § 1004. The Act expands the eligible expenses to include books and computer equipment not purchased from the educational institution, provides a maximum credit of \$2500, allows for a portion of the education credits to be refundable, and applies to expenses related to the first four years of postsecondary education. *Id.* Congress enacted the American Opportunity Tax Credit because of representations by some that the cost of post-secondary education has grown faster than the inflationary rate and that the expansion of the credit will help people with financial difficulties obtain a post-secondary education. STAFF OF JOINT COMM. ON TAXATION, 111TH CONGRESS, DESCRIPTION OF REVENUE PROVISIONS CONTAINED IN THE PRESIDENT'S FISCAL YEAR 2010 BUDGET PROPOSAL—PART ONE: INDIVIDUAL INCOME TAX AND ESTATE AND GIFT TAX PROVISIONS 107 (Comm. Print 2009), available at <http://www.jct.gov/publications.html?func=startdown&id=3573>.

to the same \$2000 maximum government contribution that is allowed under the saver's credit. The taxpayer would not be permitted to receive both the EITC retirement benefits and claim the saver's credit in the same taxable year. Finally, the match that an EITC recipient receives will be forfeited to the extent that the recipient is not vested in it. To the extent that the recipient is vested in the benefits but withdraws the amounts contributed to a retirement account prior to reaching age 59 ½, the recipient will be subject to the early distribution penalty of 10%, unless the withdrawal or distribution meets one of the allowable exceptions.

As noted, the EITC has received nonpartisan support. While the EITC's error rate has historically been high, it remains an important tax incentive. The modifications to the credit suggested in my proposal satisfy the equity principle of fairness. If properly structured, it should not be too complicated to administer. In addition, consistent with many other tax incentives, its implementation will impact federal revenue. However, because of the numerous barriers to saving experienced by low-income workers and the importance of ensuring that low-income individuals have accumulated sufficient retirement assets, my proposal will create an effective vehicle for encouraging recipients of the EITC to save. Finally, implementation of the proposal will not significantly impact the primary goals of the EITC.