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Tax Credits for the Working Poor: A Call for Reform **by Michelle Lyon Drumbl**

by

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I. Introduction

We are in a historic moment as a country as the economic fallout from the COVID-19 pandemic continues. Historically marginalized communities (women, people of color, low-income workers) are suffering a disproportionate share of the burden of this crisis, with unemployment concentrated among these workers.[1] As in prior recessions, the current economic crisis is exposing structural weaknesses in our work-based safety net, including two refundable (or partially refundable) tax credits: the earned income tax credit (EITC) and child tax credit (CTC).[2] The work requirement, timing, and mode of delivery of these tax subsidies

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1. *See* Gene Falk, Cong. Rsch. Serv. R41823, Low-Income Assistance Programs: Trends in Federal Spending (2012).

2. *See, e.g.*, Marianne Bitler et al., *Do In-Work Tax Credits Serve as a Safety Net?*, 52 J. Hum. Resources 319 (2017); Kerry A. Ryan, *EITC as Income (In)Stability?*, 15 Fla. Tax Rev. 583 (2014).

make them particularly unattractive as vehicles to deliver emergency economic aid to these vulnerable subpopulations. Job or income loss may reduce or eliminate eligibility for these benefits, and a tax refund containing these benefits may arrive too late to provide much-needed relief.

Of course, the global pandemic merely exacerbated the economic insecurity of the working poor. Many of these families experience spells of intra-annual income loss due to changes in household composition, employment, and/or disability status.[3] The lumpiness of the EITC and CTC payments prevent them from smoothing income and consumption for low-income families, who experience boom and bust cycles over the course of a year. Instead, families accumulate debt during the year in anticipation of receiving their annual windfall in the form of a large tax refund.

The question thus becomes: can we modify these tax subsidies to allow them to better serve their target populations? Michelle Drumbl answers that question affirmatively in her book, *Tax Credits for the Working Poor* (*Tax Credits*).[4] *Tax Credits* describes the history and importance of the EITC, examines the shortcomings of its implementation, and proposes modifications to the tax credit's design and administration to increase its effectiveness as an antipoverty supplement for low-income working families. In crafting her recommendations, Drumbl draws on her extensive advocacy experience representing low-income taxpayers before the Internal Revenue Service (IRS), existing EITC scholarship (including her own), and the experience of other countries with similar tax-based social benefit programs.

While Drumbl convinces me of the need for, benefits of, and feasibility of implementing her administrative reforms, I raise concerns about cost, complexity, and framing. I juxtapose her reimagined EITC against the family benefit schemes of her benchmark countries and proposals put forth by other tax credit reformists. This analysis suggests that Drumbl can enhance the policy coherence and antipoverty effectiveness of her design proposals by targeting them at a non-work contingent family tax credit.

3. Sarah Sternberg Greene, *The Broken Safety Net: A Study of Earned Income Tax Credit Recipients and a Proposal for Repair*, 88 N.Y.U. L. Rev. 515, 544 (2013).

4. Michelle Lyon Drumbl, Tax Credits for the Working Poor: A Call for Reform (2019).

A recent proposal by President Biden embodies this approach. Biden's plan incorporates most of Drumbl's design modifications but applies them to a fully refundable CTC rather than to the EITC.[5] This is an emphatic endorsement of *Tax Credits* from the highest levels of government, making this book a must-read for anyone interested in using the I.R.C. to improve the lives of vulnerable Americans during this current COVID crisis and beyond.

After this Introduction, Part II surveys the substance of *Tax Credits*. It describes Drumbl's main proposals, and her arguments in support of each. Part III evaluates whether Drumbl's EITC restructuring achieves its claimed benefits. In doing so, it raises the possibility that her reforms might be more effective when applied to the modified CTC rather than to the EITC. Part IV concludes this Review.

II. Proposals & Arguments

Tax Credits first traces the historical evolution of the EITC from a work incentive to an antipoverty program.[6] Drumbl then synthesizes existing research (her own and that of others) to detail the modern challenges faced by the IRS in administering the EITC program.[7] While there are advantages in delivering the EITC through the tax system (lower administrative costs, recipient preference, and high participation rates), she describes the trade-offs as "the stubbornly high improper payment rate, [taxpayer] noncompliance, predatory lending practices [by tax return preparers], and identity theft."[8] Government responses to these problems include delaying the EITC until eligibility is confirmed or recouping improperly distributed credit amounts through the examination process. By channeling her clients' experiences, Drumbl effectively conveys the devastating negative financial consequences to low-income families of EITC delay, denial, or recoupment.

Drumbl's next move is to link the identified administrative challenges to certain unique characteristics of the EITC—self-declaration

5. *President Biden Announces American Rescue Plan*, White House (Jan. 20, 2021), https://www.whitehouse.gov/briefing-room/legislation/2021/01/20/president-biden-announces-american-rescue-plan/ [https://perma.cc/Q6B6-FWWA].

6. Drumbl, *supra* note 4, ch. 1.

7. *Id.* ch. 3.

8. *Id.* at 75.

of eligibility on the tax return and delivery of the benefit in one large lump sum as part of the annual tax refund.[9] For Drumbl, these are the key variables that hinder effectiveness of the credit and require reform. Interestingly, EITC proponents typically cite these precise features as the ones that give the EITC a comparative advantage over traditional social welfare programs, such as Temporary Assistance to Needy Families (TANF).[10] One contribution of *Tax Credits* is to move us away from using welfare as the sole frame of reference in evaluating the EITC program. Drumbl instead draws inspiration for her restructuring from EITC-analogues in other countries. In her view, while the United States (US) may have been a first mover in enacting an in-work, tax-based, social benefit scheme, the innovative late entrants seemingly redefined the category.

The book then provides an in-depth case study of the family subsidy schemes of two countries: New Zealand (NZ) and Canada (CAN).[11] Both countries' programs were inspired by the EITC but contain improvements that Drumbl deems worthy of importation back to the US. She focused on these two countries, in part, because the revenue agency in each plays a role in administering the tax-benefit scheme. The subsidy package in each country includes a family credit and a separate, in-work tax credit, both of which are targeted at low-income families by being phased out at higher income levels. The family allowance in both countries is distributed periodically (by default or by option) and can be split in shared custody situations. In NZ, parents apply for the child-based benefit in a process that is separate and apart from a tax return filing. After Drumbl describes the objectives, mechanics, and domestic critiques of each country's suite of benefits, she identifies some takeaways that presage her proposed re-imagination of the EITC.

As a first step, Drumbl recommends splitting the EITC into two parts: a work-support credit (designed to incentivize work and mitigate the regressivity of payroll taxes) and a family-support credit (aimed at

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9. *Id*. ch. 2.

10. *See* Jennifer Sykes et al., *Dignity and Dreams: What the Earned Income Tax Credit (EITC) Means to Low-Income Families*, 80 Am. Socio. Rev. 243, 244 (2015); *see also* Anne L. Alstott, *The Earned Income Tax Credit and the Limitations of Tax-Based Welfare Reform*, 108 Harv. L. Rev. 533, 564–65, 565 nn.123–25(1995) (describing arguments by ETIC advocates regarding administrative advantages and citing those advocates).

11. Drumbl, *supra* note 4, ch. 4.

reducing poverty by providing income support to low-income working families).[12] The work-support credit would remain on the tax return, be framed as a reward for work, and look like the current childless EITC.[13] Frustratingly, she does not address whether the work-support credit would be a per-worker or a per-taxpayer benefit, whether the amount of the benefit available to workers without children would be increased as many scholars advocate,[14] nor how the low take-up rate for the existing childless EITC will be affected by such a split.[15] I don't fault Drumbl for this, however, since *Tax Credits* is focused primarily on improving the administration and delivery of the family-based EITC.

Next, Drumbl suggests decoupling the process for claiming the family-support credit from the tax return filing.[16] As in NZ, families would apply for the family EITC on a separate registration form (paper or electronic) that would be submitted after the tax return is filed. Drumbl recognizes the form must be simple enough as not to deter families from filing it, noting CAN's form is only two pages.[17] To further that goal, the family EITC application form would solicit information about household composition only. Income data would be drawn from a required previously filed tax return. The IRS, rather than claimants, would calculate the amount of any allowable family-support credit.

Drumbl argues separating the registration process for the family-support credit from the tax return offers several advantages over the current system. First, taxpayer misrepresentations, and thus noncompliance, may decrease since applicants would provide demographic information

12. *Id.* ch. 5. Drumbl notes that other scholars also propose splitting the EITC in this manner. *Id.* at 124 & nn.46–49.

13. *Id.* at 125–26.

14. *See, e.g.*, Elaine Maag et al., *Expanding the EITC for Workers Without Resident Children*, URB. INST. (May 2019), https://www.taxpolicycenter.org/sites/default/files/publication/157236/expanding_the_eitc_for_workers_without_resident_children_6.pdf [https://perma.cc/38UC-TNP3]; Chuck Marr et al., *Strengthening the EITC for Childless Workers Would Promote Work and Reduce Poverty*, CTR. ON BUDGET & POL'Y PRIORITIES (Apr. 11, 2016), https://www.cbpp.org/sites/default/files/atoms/files/4-11-16tax.pdf [https://perma.cc/H58H-4Z9P].

15. *See* Jacob Goldin, *Tax Benefit Complexity and Take-up: Lessons from the Earned Income Tax Credit*, 72 TAX L. REV. 59, 71 & n.64 (2018).

16. DRUMBL, *supra* note 4, at 127–29.

17. *Id.* at 171.

"affirmatively in written words—instead . . . check[ing] a box."[18] Second, the later timing for the family benefit application and allocation would give the IRS more time to verify income. Finally, moving the complicated EITC calculations off the tax return may reduce the need for paid return preparers. I am less sanguine about this last claim since a tax return still needs to be filed prior to applying for the family benefit, and low-income taxpayers are simply used to paying preparers to carry out this task. Furthermore, while preparation of a tax return without an IRS Schedule EIC costs less, it is "easy to imagine return preparers promoting [family-support credit claims] as an add-on service."[19]

Under Drumbl's scheme, the EITC's family-based benefit would be distributed periodically in smaller amounts rather than as one large annual lump sum.[20] This is the norm in NZ and CAN. She cites three advantages to periodic delivery: (1) reducing the need for EITC claimants to access high-cost credit vehicles; (2) reducing the incentive for third-party misbehavior; and (3) lowering the stakes for overpayments and frozen refunds. Drumbl acknowledges her proposal may seem paternalistic considering existing evidence that EITC recipients overwhelming prefer lump sum delivery as part of the tax refund since it reduces stigma and fosters feelings of social inclusion. In response, Drumbl notes that 90% of taxpayers in those studies accumulated debt during the year prior to EITC receipt. Her second rejoinder is much stronger: a more recent pilot project in Chicago suggests taxpayers who experimented with periodic delivery of the EITC came to prefer it to the existing single payment EITC.[21] I would also note participants in the older studies preferred the EITC timing and delivery mechanism to those of traditional welfare, while the subjects of the later studies were comparing a lump sum EITC with one distributed on a quarterly basis. It is this latter comparison which seems most germane to Drumbl's arguments.

Drumbl then answers what she deems the two crucial questions in designing a periodic payment scheme: frequency and base.[22] After rejecting monthly distributions as too small in amount to be

18. *Id.* at 172.
19. *Id.* at 149.
20. *Id.* ch. 6.
21. *See id.* at 44–45 (describing the details of the Chicago pilot project).
22. *Id.* ch. 6.

meaningful to families, she settles on quarterly distributions. Quarterly payments balance recipient need for more frequent distributions against expressed recipient preference for large lump sums. Her ideal proposal would be quarterly distribution of the family-support credit based on the recipient's most recent three months of work, without regard to total annual income. As she notes, this would necessitate real-time payroll reporting, a system not currently in place, nor realistically implementable in the near future. This leads her to propose an alternative, more viable path forward based on NZ's system: quarterly benefits based on current estimated income. After filing a tax return for the prior year, a taxpayer would provide a good faith estimate of earnings for the current year. The IRS would then use that figure to determine the periodic benefit amount for the current year.

One can question how accurate even a good-faith estimate would be, given the tremendous income volatility of this population.[23] This raises the specter of a required year-end reconciliation to account for the difference between EITC based on actual versus estimated income. This was the approach of the underutilized, now-repealed Advance EITC.[24] As Drumbl notes, empirical work suggests aversion to the risk of owing money to the IRS at year's end contributed to the extremely low take up rate of that program. She avoids this pitfall by adopting a no clawback rule with regard to overpayments.[25] Drumbl acknowledges a no clawback approach requires "us, as a society, to accept some level of individuated overpayment from year to year as an acceptable cost of the program."[26] Recognizing we might not be there yet, she suggests a cap on total advance payments in the current year set at the prior-year EITC amount (or some percentage thereof) to make the no clawback rule less costly and more politically viable. Of course, this would reduce the proposal's effectiveness and increase its complexity.

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23. Elaine Maag et al., *Income Volatility: New Research Results with Implications for Income Tax Filing and Liabilities*, Urb. Inst. & Brookings Tax Pol'y Ctr. (May 25, 2017), https://www.taxpolicycenter.org/sites/default/files/publication/141711/2001284-income-volatility-new-research-results-with-implications-for-income-tax-filing-and-liabilities_1.pdf [https://perma.cc/6QTJ-8EVD].

24. Drumbl, *supra* note 4, at 36–42.

25. *Id.* at 164.

26. *Id.* at 165.

Additional proposals include calculating income eligibility for the EITC based on either marital status or parental cohabitation, adjusting benefit amounts regionally for cost of living, and allowing parents who share custody of a child to share the credit.[27] I am agnostic on the very incremental change to the income calculation and not convinced of the wisdom of regional adjustments at this moment in our political history. Given the current political climate, I cannot imagine advocating for a change that directs more federal dollars to blue states than to red states. And, as Drumbl points out, the state-level EITCs can accomplish some of what she seeks to achieve with regional adjustments. I am most persuaded about the necessity and feasibility of splitting the EITC in shared custody situations, as is currently authorized in NZ and CAN.

I completely support Drumbl's stand-alone proposal to protect the family-support tax credit from being applied to satisfy certain outstanding governmental obligations.[28] Given its antipoverty goal, Drumbl argues the family component "deserves protection from offset (whether in whole or in part) to better serve its purposes."[29] As she notes, other means-tested social benefit programs are safeguarded in this manner. Recent precedent provides support for increased tax refund protection. In the coronavirus stimulus packages passed in 2020, Congress prohibited Treasury from invoking its offset authorities to reduce the amount of direct relief payments (economic impact payments).[30] As noted below, the Biden administration also proposes extending offset protection to the CTC.[31]

III. Evaluating Claimed Advantages of Reforms

Drumbl claims several benefits of her restructuring including: (1) reduced incidence of existing EITC challenges, (2) enhancement of antipoverty effectiveness through periodic benefit delivery, (3) simplicity, and (4) furthering policy coherence.[32] While I agree her proposed reforms may

27. *Id.* at 130–41.

28. *Id.* ch. 7.

29. *Id.* at 177.

30. *See* Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136, § 2201, 134 Stat. 281, 335–40 (2020); Consolidated Appropriations Act, 2021, Pub. L. No. 116-260, §§ 272–73 (2020).

31. *See infra* text accompanying note 42.

32. Drumbl, *supra* note 4, at 4.

achieve the first two listed claimed benefits, I doubt that her restructuring will "simplify the current structure of the EITC and related family benefits."[33] I also suggest she could achieve greater policy coherence by targeting her reforms beyond the EITC.

I suspect Drumbl's modifications, if implemented, will increase, rather than decrease, EITC complexity and cost. Drumbl's plan effectively introduces a new tax credit with a unique two-step application process involving a new form that requires claimants to answer, in narrative form, a series of open-ended questions and estimate expected annual income. I also anticipate the cost of administering the EITC will increase because: (1) the non-standard nature of the responses on the family-support credit application may prevent electronic processing, and (2) periodic delivery tax benefit delivery may require IRS infrastructure upgrades. After reading *Tax Credits*, I am persuaded the benefits to low-income families of periodic delivery outweigh these costs; I simply cannot subscribe to the notion that one benefit in this calculus is simplicity.

There is a danger in disentangling the current potpourri of EITC objectives and dividing them between the in-work and family-support credits. While I tend to view current EITC policy incoherence as a feature not a bug, I am not opposed to clarity of purpose if it furthers the cause of those arguing in its favor. However, given the fraught politics of welfare out of which the EITC emerged,[34] her explicit framing of the new family-support EITC in terms associated with means-tested social benefit programs ("safety net," "income support," "benefit for children")[35] gives me pause—particularly since her reforms will cause some erosion in the tax-system-based advantages of the EITC vis-à-vis welfare. While I applaud Drumbl for benchmarking the EITC against its foreign progeny, I urge mindfulness of the program's political history in pitching her imported proposals to a domestic audience.

Drumbl is not unaware of this risk, and I suspect that is one reason she retained the work requirement for the family-support portion of the EITC. An earnings prerequisite is the essential feature that differentiates the EITC from means-tested welfare programs in the

33. *Id.*

34. *See generally* Dennis J. Ventry, Jr., *The Collision of Tax and Welfare Politics: The Political History of the Earned Income Tax Credit, 1969–99*, 53 Nat'l Tax J. 983, 1004 (2000).

35. Drumbl, *supra* note 4, at 117 ("safety net"), 114 ("income support"), 118 ("benefit for children").

US.[36] But, if Drumbl's reforms were implemented, the US would have three tax credits for working low-income families (work-support EITC, family-support EITC, and CTC) and no tax benefits for non-working poor families. This result stands in stark contrast to the family benefit packages in NZ/CAN, which contain both a generous per-child subsidy not contingent on work and a separate, significantly less generous, in-work tax credit with an earnings prerequisite.[37] Similarly, as Drumbl describes, the National Taxpayer Advocate, in several reports, urged Congress to consolidate the various family status provisions in the I.R.C. (including the EITC and CTC) by creating two new tax credits: a Family Credit available regardless of income (that would reflect the costs of maintaining a household and raising a family) and a per-individual Worker Credit (that would provide a work incentive and subsidy to low-income workers).[38]

To be clear, Drumbl is not opposed to expanding benefits for the nonworking poor. She just doesn't think the EITC is the right vehicle through which to do it because of (1) path dependence, (2) scope limitation, and (3) political pragmatism. First, the EITC always contained an earned income requirement.[39] As I discussed above, she can use the work requirement as a shield against accusations that the redesigned family-support tax credit is actually "welfare in disguise." Second, her reforms only target EITC delivery and administration, deliberately leaving the remaining EITC parameters unchanged. Drumbl also "assumes, somewhat pessimistically, that neither Congress nor the White House would support an increase in public benefits for nonworking individuals through the [I.R.C.]."[40]

Recent events suggest she might be wrong on this last point, at least with regard to the CTC. As part of his coronavirus relief plan, President Biden proposed a one-year expansion and redesign of the CTC.[41] This provision would increase the amount of the CTC per child benefit and make it fully refundable thereby allowing all low- and middle- income families to realize on the full value of the credit regardless of the existence or level of earnings (or tax liability). Biden's proposal also

36. *Id.* ch.1.
37. *Id.* ch. 4.
38. *Id.* at 124 & nn.46–47.
39. *Id.* at 112.
40. *Id.* at 112 n.1.
41. *See supra* note 5 and accompanying text.

incorporates virtually all of *Tax Credits*'s recommended administrative improvements: periodic delivery, protection from offset, online portal to report changes in family demographics, and a modified no clawback rule.[42] *Tax Credits,* published in 2019, appears positively prophetic in its prescriptions.

It is worthwhile exploring why the CTC, rather than the EITC, might be a better target for both eligibility and design reforms. The CTC's political history is not weighed down by the same welfare baggage as that of the EITC. As told by Drumbl, the CTC emerged not as a part of a debate on social welfare legislation but rather as one of several proposals proffered by the bipartisan National Commission on Children geared towards improving all children's lives.[43] Its architects originally envisioned the CTC as a universal fully refundable per child tax credit. Of course, political expediency left its implementation less than ideal and an earnings phase-in became part of its initial structure. But Congress seems poised to repeal that aspect of the CTC (at least temporarily), and doing so makes the CTC a much closer analogue than the EITC to the child benefits in NZ and CAN.

While Drumbl introduces the CTC in the first chapter and mentions it periodically throughout, it is clearly not her primary focus. She views the existence of the CTC as compounding the incoherence of the EITC, with its different eligibility rules and target audience but similar existing delivery mechanism.[44] I doubt, however, that Drumbl would object to Biden's CTC proposal since it responds to her "call to reimagine how a largely successful social program . . . can be improved upon as part of a broader effort to address poverty in the United States."[45] Furthermore, applying her design and delivery modifications to a non-work conditioned CTC will enhance the antipoverty effectiveness of her

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42. *See* H. Comm. on Ways & Means, 117th Cong., Budget Reconciliation Legislative Recommendations Relating to Promoting Economic Security: Subtitle G (Comm. Print 2021), https://waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/7.%20Tax.pdf [https://perma.cc/U39S-8DQR].

43. Drumbl, *supra* note 4, at 18–19.

44. *Id.* at 114.

45. *Id.* at 3.

proposals and bring the US closer to the policy coherence she so admires in CAN and NZ.[46]

IV. Conclusion

Drumbl successfully invokes the existing EITC challenges as a call for change and applies a comparative perspective to imagine alternative possibilities for delivering the credit to its target population. *Tax Credits* breathes new life into the conversation surrounding ideal tax credit design by focusing on procedure and administration rather than on substantive eligibility rules. Drumbl's goal remains steadfast throughout: how to increase the antipoverty effectiveness of the EITC for her clients and all low-income families. *Tax Credits* is an important contribution to the literature on how to implement social policy through the tax system in a way that advances economic justice.

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46. The Center on Budget and Policy Priorities estimates that Biden's CTC proposal "would lift 4.1 million children above the poverty line—cutting the number of children in poverty by more than 40 percent." Chuck Marr et al., *House COVID Relief Bill Includes Critical Expansions of Child Tax Credit and EITC*, Ctr. on Budget & Pol'y Priorities 2 (Mar. 2, 2021), https://www.cbpp.org/sites/default/files/2-9-21tax.pdf [https://perma.cc/RV67-MTWS].