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Testimony regarding H.B. 5626 – An Act Concerning the Earned Income Tax Credit

Roger Senserrich- Policy Director, Connecticut Association for Human Services – 3/17/2016

Good morning Senator Fonfara, Representative Berger and members of the Finance, Revenue and Bonding Committee. My name is Roger Senserrich, and I am the Policy Director at the Connecticut Association for Human Services (CAHS). CAHS is a statewide nonprofit agency that works to reduce poverty and promote economic success through both policy and program work.

I am here to express our support to H.B. 5626, a bill concerning improvements to the Earned Income Tax Credit (EITC). This proposal will direct the Department of Revenue Services (DRS) to study two areas for possible program improvement.

Monthly Distribution of refunds

Currently EITC payments are distributed as a single lump sum when the recipient files for income taxes. This bill would direct DRS to study the feasibility of distributing the credit in monthly payments throughout the whole year.

This concept was tested in 2014 as an extensive pilot program in Chicago conducted by the Center for Economic Progress¹. Two hundred and twenty nine families received their EITC refunds in four quarterly payments over the year, with a control group receiving the traditional one-time payment. The results were striking: periodic payment recipients were 45% less likely to use payday loans, and borrowed from family and friends at half the rate of the control group. Pilot participants were also half as likely to have incurred late fees at the end of the period.

In addition, the periodic payments provided a buffer against financial stress. Control group members were twice as likely to report high levels of stress regarding their ability to make ends meet, and over twice as likely to show depressive symptoms. Ninety percent of pilot participants preferred periodic payments to a lump sum at the end of the program. Simply put, spreading their refund over the year (\$80 to \$500 every three months, in this case) was enough to strengthen the financial security of the participating families, make them feel safer and reduce their reliance on debt financing.

We consider this a proposal worth exploring, as it has the potential to considerably improve the financial well-being of EITC recipients at little to no cost for the state.

Graduate payment schedule

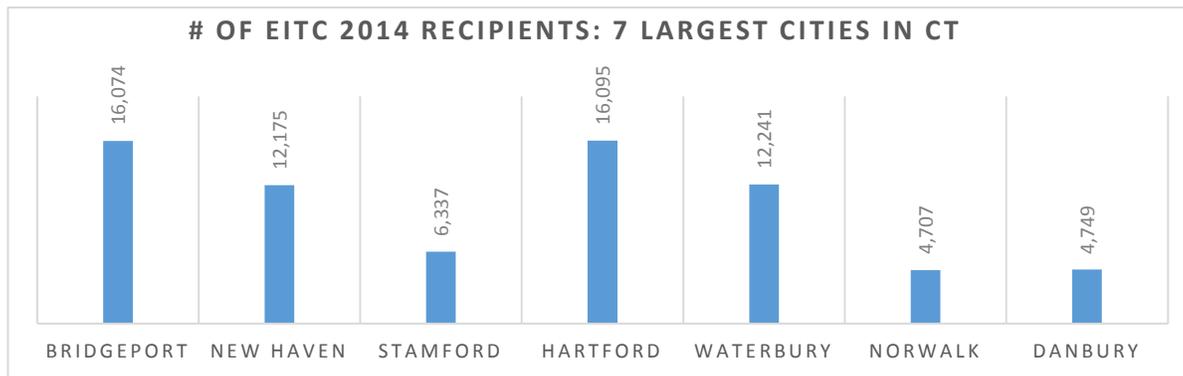
The bill also directs DRS to consider a graduated schedule that phases out benefits to families as their benefits increase. As currently structured, the EITC is reduced quickly as households move closer to the maximum

¹ http://www.economicprogress.org/sites/economicprogress.org/files/restructuring_the_eitc_a_credit_for_the_modern_worker_0.pdf

allowable income, producing high marginal tax rates for families that are still not making much money. Although the benefit cliff for EITC is less pronounced than in other social programs, we believe that DRS should seek ways to make it less pronounced.

The EITC is an effective program

Above all, CAHS believes that the Connecticut EITC is the most effective tool available to the state to reduce poverty and support low-income families. In 2014, more than 190,000 working families claimed the state EITC². The average income of the recipients was \$17,732 a year, receiving an average \$472 credit. In 2013 the Federal and state EITC lifted more than 70,000 people out of poverty in Connecticut alone, including more than 35,000 children³. The majority of recipients had less than the equivalent of a high school education; 52% were white, 26% Hispanic and 18% African American.



There is extensive research on the effectiveness of the EITC not only to reduce poverty, but also to encourage work, improve infant and maternal health, raise school achievement and college attendance and increase social mobility.

Studies focused on the EITC expansion during the 1990s suggest that the EITC had a clear and sustained effect in boosting labor participation and employment, especially for single mothers⁴. The EITC is also strongly correlated with improved health indicators. Research has shown reduced mental stress among EITC recipient mothers⁵, lower probability of smoking or drinking alcohol amongst pregnant women⁶, fewer low-weight births and premature births⁷, and even increased use of prenatal care⁸. Children in families that receive the EITC receive better grades and are more likely to attend college⁹, and as a result, are more likely to have higher wages in adulthood¹⁰.

² <http://www.ctvoices.org/sites/default/files/bud16restoreeitc.pdf>

³ <http://apps.cbpp.org/3-5-14tax/?state=CT>

⁴ <http://www.nber.org/papers/w9472.pdf>

⁵ William N. Evans and Craig L. Garthwaite, "Giving Mom a Break: The Impact of Higher EITC Payments on Maternal Health," *American Economic Journal: Economic Policy* (6)2, 2014, pp. 258-290.

⁶ <http://www.irp.wisc.edu/newsevents/workshops/2011/participants/papers/15-Strully.pdf>

⁷ <http://poverty.ucdavis.edu/research-paper/policy-brief-linking-eitc-income-real-health-outcomes>

⁸ <http://www.nber.org/papers/w18206>

⁹ http://www.cbpp.org/research/federal-tax/eitc-and-child-tax-credit-promote-work-reduce-poverty-and-support-childrens#_ftn30

¹⁰ <https://www.irs.gov/pub/irs-soi/11rpchettyfriedmanrockoff.pdf>

Even though the EITC has proven to be a highly successful and effective program, there have been concerns regarding possible overpayments. In 2010¹¹, The IRS estimated an error rate of 22 to 26% for the federal EITC, on which the Connecticut EITC is based.

Although we share these concerns, it is important to stress that error does not necessarily mean fraud. Most overpayments are due to the complexity of the tax refund calculation, with most errors associated with residency and relationship rules. Studies have shown that most errors are not intentional¹². In addition, subsequent studies of IRS data have shown that the original figures overstated the error rate¹³, and that a significant proportion of those errors may produce underpayments, not additional spending. It is important to stress, however, that the noncompliance rate for the EITC is considerably lower than found in other parts of the tax code. For instance, 56% of business income that had to be reported in individual tax returns went unreported in 2006¹⁴.

It is also relevant to mention that EITC error rates are considerably higher for returns produced by paid tax preparers compared to Volunteer Income Tax Assistance sites (VITA)¹⁵. If they are seeking to reduce the error rate, The General Assembly and the Bureau of Revenue Services should consider strengthening the VITA sites that served more than 53,000 filers last year, .

Additional options to strengthen the EITC program

Finally, CAHS would encourage the committee to consider including two additional study areas for consideration of the Department of Revenue Services:

- **Savings incentive programs:** In New York and Tulsa¹⁶, pilot programs as well as some national initiatives^{17 18}, have experimented with splitting EITC refunds in two payments, one immediate payment in cash and a second one, a period of time later, in the form of savings plus interest or a match. The studies showed promising results in asset building and savings for EITC recipients. Our own experience as coordinators in more than 40 VITA sites suggest that there is a strong demand for savings vehicles for low-income working families. Close to 8% of the more than 11,000 households that filed tax returns at our VITA sites this year claimed the saver's credit¹⁹. The percentage is even higher for families with one (14%) or two (11%) dependents.
- **Extending the EITC to households with no dependents:** currently the EITC offers no significant benefits to working adults with no dependents. As a result, many needy low-income households are being penalized, and some of the beneficial aspects of the EITC (increased participation in labor force) are not reaching their full potential.

To sum up, we strongly believe that the Connecticut EITC is one of the most effective programs to reduce poverty and create opportunity in the state. We support H.B. 5626 as a way to further improve what it is already

¹¹ http://www.cbpp.org/research/federal-tax/reducing-overpayments-in-the-earned-income-tax-credit#_ftn10

¹² See Janet Holtzblatt and Janet McCubbin, "Issues Affecting Low-Income Filers," in Henry Aaron and Joel Slemrod, *The Crisis in Tax Administration*, Brookings Institution Press, November 2002; and Jeffrey Liebman, "Noncompliance and the EITC: Taxpayer Error or Taxpayer Fraud," Harvard University, November 1995.

¹³ <http://www.cbpp.org/research/federal-tax/reducing-overpayments-in-the-earned-income-tax-credit>

¹⁴ http://www.irs.gov/pub/newsroom/overview_tax_gap_2006.pdf

¹⁵ <https://www.irs.gov/pub/irs-utl/2015%20QSS%20Review%20Results%20Report.pdf>

¹⁶ http://www.nyc.gov/html/ceo/downloads/pdf/saveusa_finalreport_2015_fr.pdf

¹⁷ http://cfed.org/blog/inclusiveeconomy/refund_to_savings_r2s_initiative/

¹⁸ <https://cdn.americanprogress.org/wp-content/uploads/2013/02/ValentiWealth-1.pdf>

¹⁹ The Saver's Credit is a refundable credit for low-income tax payers that contributing to a saving vehicle for retirement.

a very effective program, and make it an even better tool for increasing the financial security of families in Connecticut. Thanks for your time.