

FOIA MARKER

This is not a textual record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

Collection/Record Group: Clinton Presidential Records

Subgroup/Office of Origin: National Economic Council

Series/Staff Member: Carl Haacke

Subseries:

OA/ID Number: 15352

FolderID:

Folder Title:

[Potential Tax Credits - Homeownership, Education, Low Income Housing] [loose] [3]

Stack:

S

Row:

15

Section:

2

Shelf:

10

Position:

1

Clinton Presidential Records Digital Records Marker

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

This marker identifies the place of a publication.

Publications have not been scanned in their entirety for the purpose of digitization. To see the full publication please search online or visit the Clinton Presidential Library's Research Room.

Reemployment Services: A Review of Their Effectiveness



U.S. Department of Labor

April 1994

Clinton Presidential Records Digital Records Marker

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

This marker identifies the place of a publication.

Publications have not been scanned in their entirety for the purpose of digitization. To see the full publication please search online or visit the Clinton Presidential Library's Research Room.



I Bonds

Everyone Needs a Safe Place to Grow

*H*onoring
Great Americans

Helen Keller

Dr. Hector P. Garcia

Dr. Martin Luther King, Jr.

Chief Joseph

General George C. Marshall

Albert Einstein

Marian Anderson

Spark M. Matsunaga



Clinton Presidential Records Digital Records Marker

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

This marker identifies the place of a publication.

Publications have not been scanned in their entirety for the purpose of digitization. To see the full publication please search online or visit the Clinton Presidential Library's Research Room.

IBonds Investor's
Guide [2 pgs]

Looking for a safe investment
that protects your savings
from inflation for up to 30
years? Get a hold of the new
I Bond from the U.S.
Treasury. Its unique benefits
make it an ideal way to build
up savings you simply don't
want to risk.*
What can be more comforting
than knowing that you own
an investment that
guarantees you returns over
and above the rate of
inflation for up to 30 years.



SH-2234

Everyone Needs a Safe Place to Grow.

Department of the Treasury
Bureau of the Public Debt

I Bonds

*H*onoring
Great Americans

Helen Keller

Dr. Hector P. Garcia

Dr. Martin Luther King, Jr.

Chief Joseph

General George C. Marshall

Albert Einstein

Marian Anderson

Spark M. Matsunaga

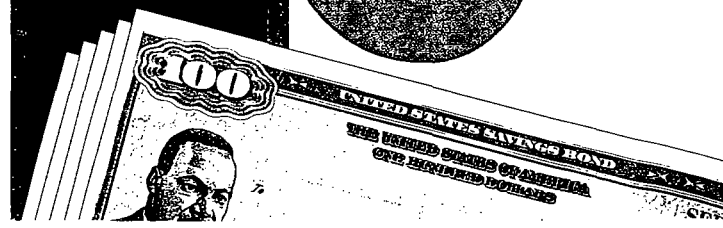
I Bonds

Everyone Needs a Safe Place to Grow.

INFLATION PROTECTION

**Investor's
Guide**

Value
COMPETITIVE RATES



* For a complete description of the I Bond and its terms and conditions investors are urged to read the regulations governing the offering of these bonds found in 31 CFR Part 359, particularly, 31 CFR 359.2, that sets forth the investment considerations with respect to I Bonds.

U.S. TREASURY SECURITIES

**Come to the Bureau of the ~~the~~ Public Debt, we're the
source for info on:**

- T-Bills, Notes and Bonds
- Treasury Direct
- Savings Bonds



Call or e-mail:

Pete Hollenbach, 202-219-3302

e-mail: Phollenbach@bpd.treas.gov

Lori DeRose, 202-219-3305

e-mail: Lderose@bpd.treas.gov

Check out: www.publicdebt.treas.gov for info on all Treasury Securities

Clinton Presidential Records Digital Records Marker

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

This marker identifies the place of a publication.

Publications have not been scanned in their entirety for the purpose of digitization. To see the full publication please search online or visit the Clinton Presidential Library's Research Room.

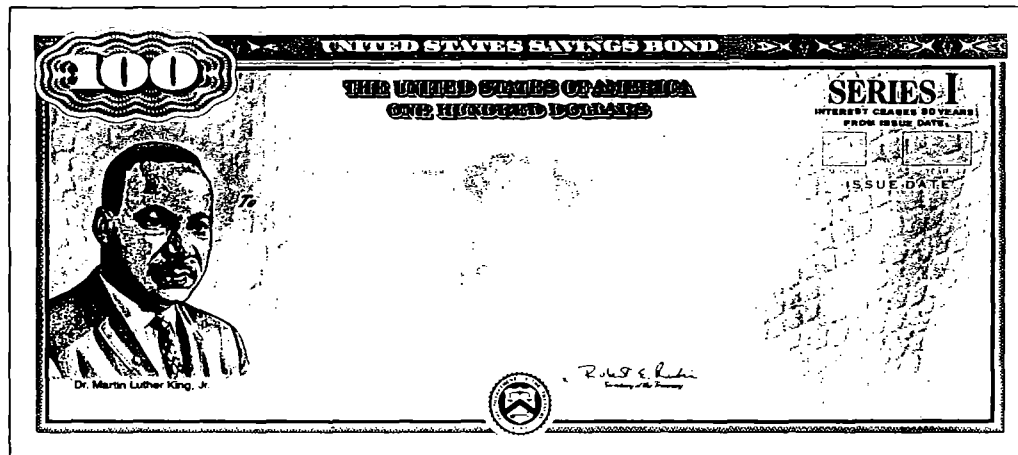
1pg

NOTICE

The laws governing reproduction of U.S. Savings Bonds appear under Title 31, Code of Federal Regulations, Part 405, and Title 18, United States Code, Section 504.

All illustrations must be in black and white, and more than one and one-half times as large (150%) or less than three-fourths (75%) the size of an actual Savings Bond. Horizontal measurements must be less than 5 1/2" (14cm) or more than 11 11/16" (29.7 cm).

The Reproduction Below is 74 % of Actual Size.



Take
Stock
in America  **U.S. SAVINGS
BONDS**

50

(1880-1968)

Author, Advocate for People
with Disabilities

Helen Keller



*H*elen Keller lost her sight and hearing as a young child from illness but overcame these challenges and went on to become the twentieth century's best known advocate for people with disabilities. Through her writing, lectures, and work with various organizations, Keller focused public attention on issues affecting the handicapped. She was also successful in making Braille the standard for printed communication with the blind. She had a lifelong relationship with the American Foundation for the Blind, and was instrumental in the Lions Club International's devotion to the blind and blindness prevention.



I Bonds

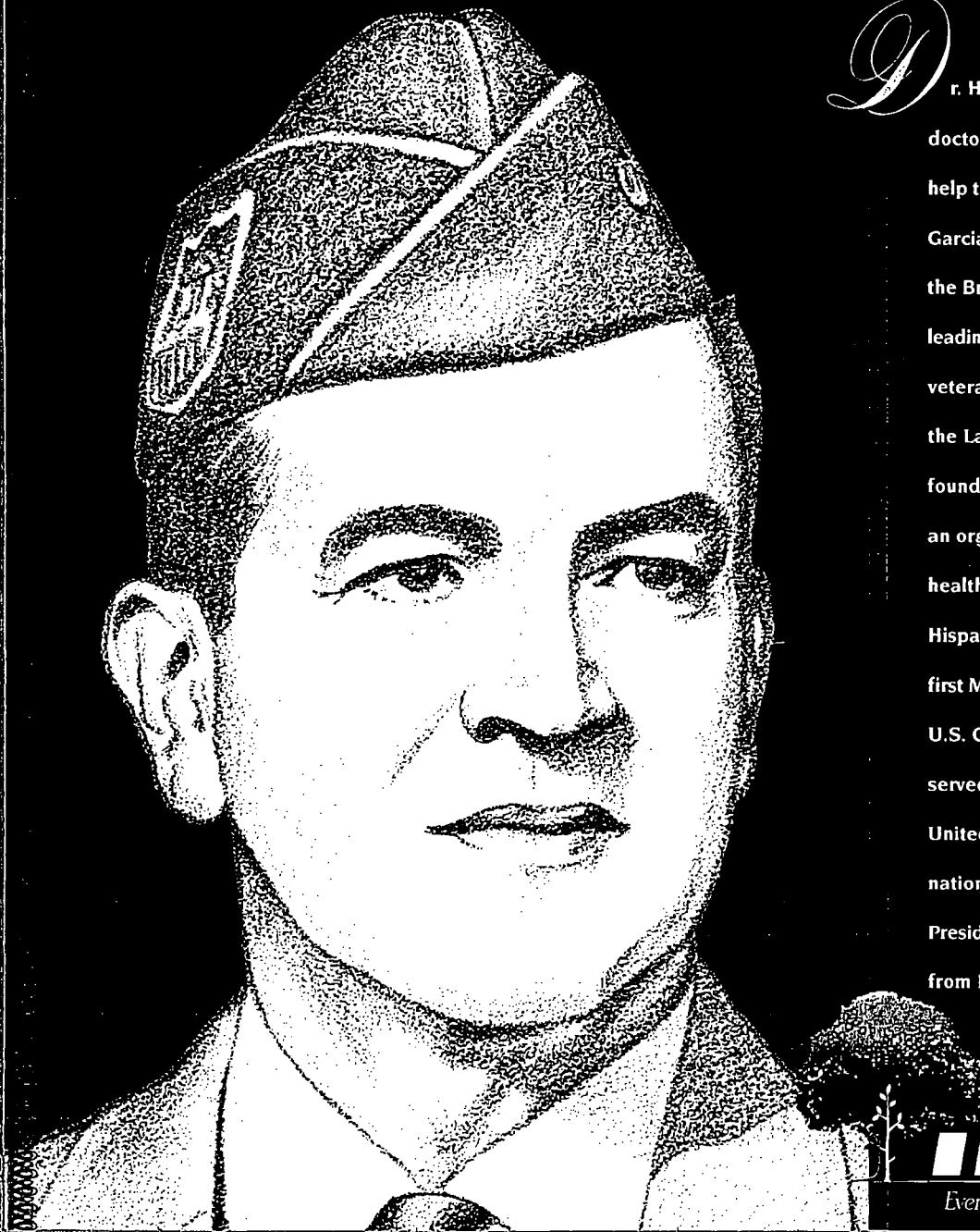
Everyone Needs a Safe Place to Grow.



(1914-1996)

Physician, Humanitarian,
World War II Veteran

Dr. Hector P. Garcia



*D*r. Hector Garcia was a medical doctor who spent his life working to help the poor, sick, and neglected. Dr. Garcia served in World War II, received the Bronze Star Medal, and became a leading advocate for Mexican-American veterans' rights. He was an activist in the Latino civil rights movement and founder of the American G.I. Forum, an organization that addresses the health, education, and civil rights of Hispanic veterans. Dr. Garcia was the first Mexican-American to serve on the U.S. Commission on Civil Rights and served as U.S. Ambassador to the United Nations. He received our nation's highest civil honor, the Presidential Medal of Freedom, in 1984 from President Ronald Reagan.

I Bonds

Everyone Needs a Safe Place to Grow.

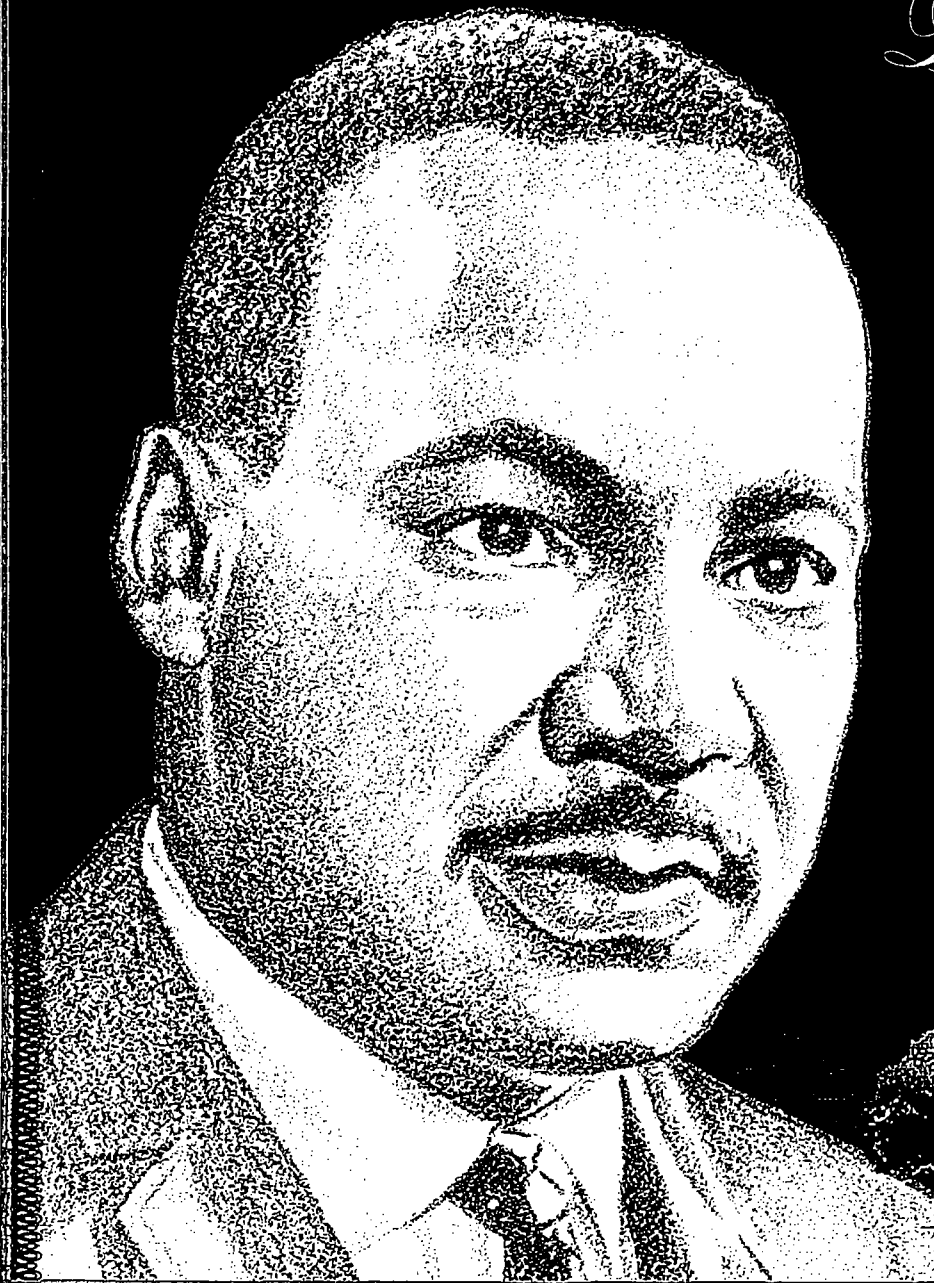
100

(1929-1968)

Civil Rights Leader, Minister,

Nobel Peace Prize Recipient

Dr. Martin Luther King, Jr.



*D*r. Martin Luther King, Jr., a Baptist minister from Atlanta, was one of the most prominent figures in the civil rights movement which succeeded in achieving legal equality for African-Americans. He co-founded and served as the first president of the Southern Christian Leadership Conference, organized to promote the advancement of integration and legal and social equality. Dr. King was the recipient of numerous awards which recognized his outstanding work for non-violent social change, including the Nobel Peace Prize in 1964. In 1986, Dr. King's birthday became a national holiday in recognition of his enormous contributions to American history.

I Bonds

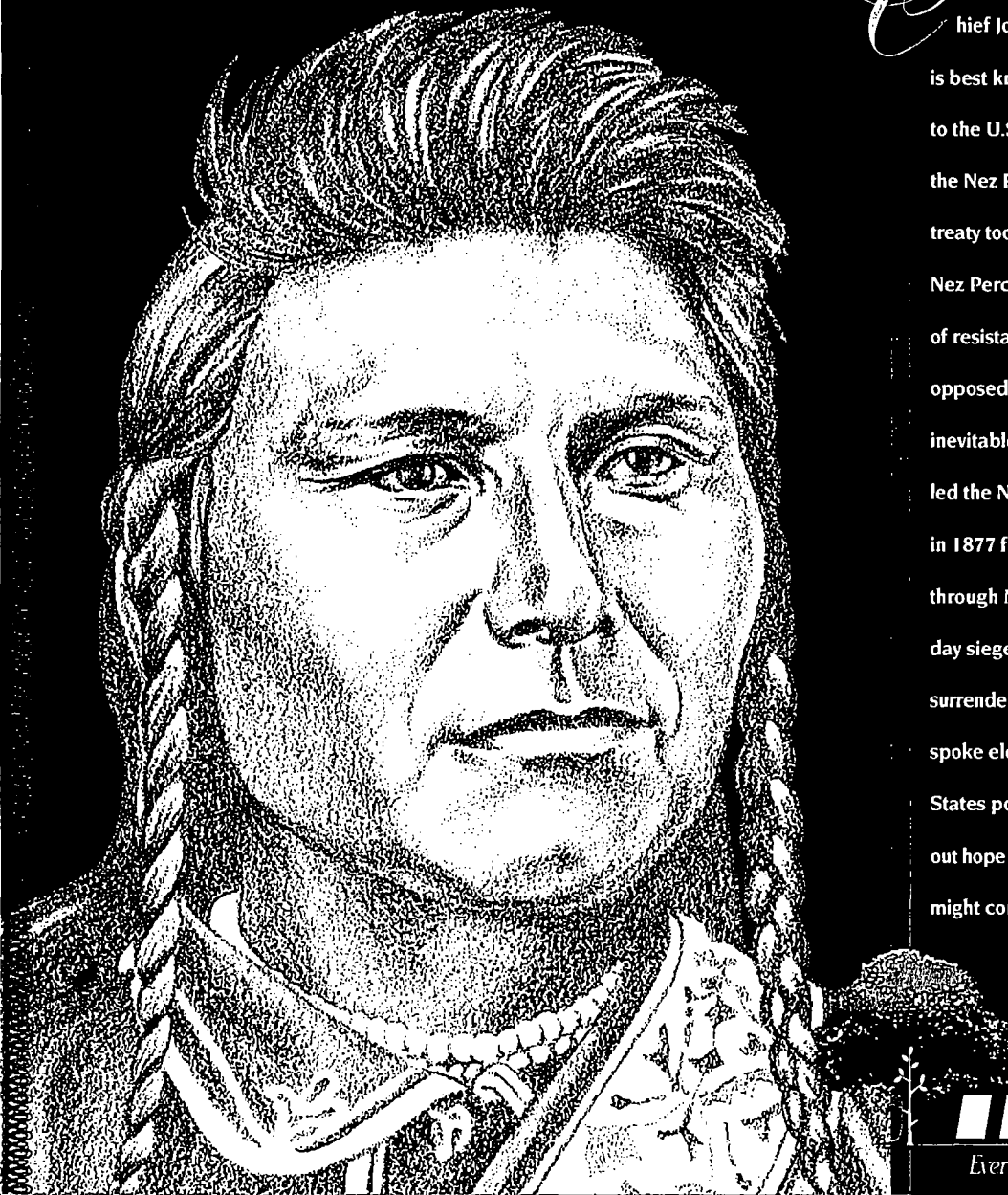
Everyone Needs a Safe Place to Grow.

200

(1840-1904)

Nez Perce Chief

Chief Joseph



Chief Joseph, a Native American leader, is best known for his principled resistance to the U.S. government's attempts to force the Nez Perce onto a reservation. An 1863 treaty took away their lands and forced the Nez Perce and their leader into a position of resistance. Though he consistently opposed war, when conflict became inevitable Chief Joseph and other leaders led the Nez Perce on a courageous retreat in 1877 for more than a thousand miles through Montana and Idaho. After a five day siege only 30 miles from safety, he surrendered. In his final years, Chief Joseph spoke eloquently of the injustice of United States policy toward his people and held out hope that one day freedom and equality might come for Native Americans.

I Bonds

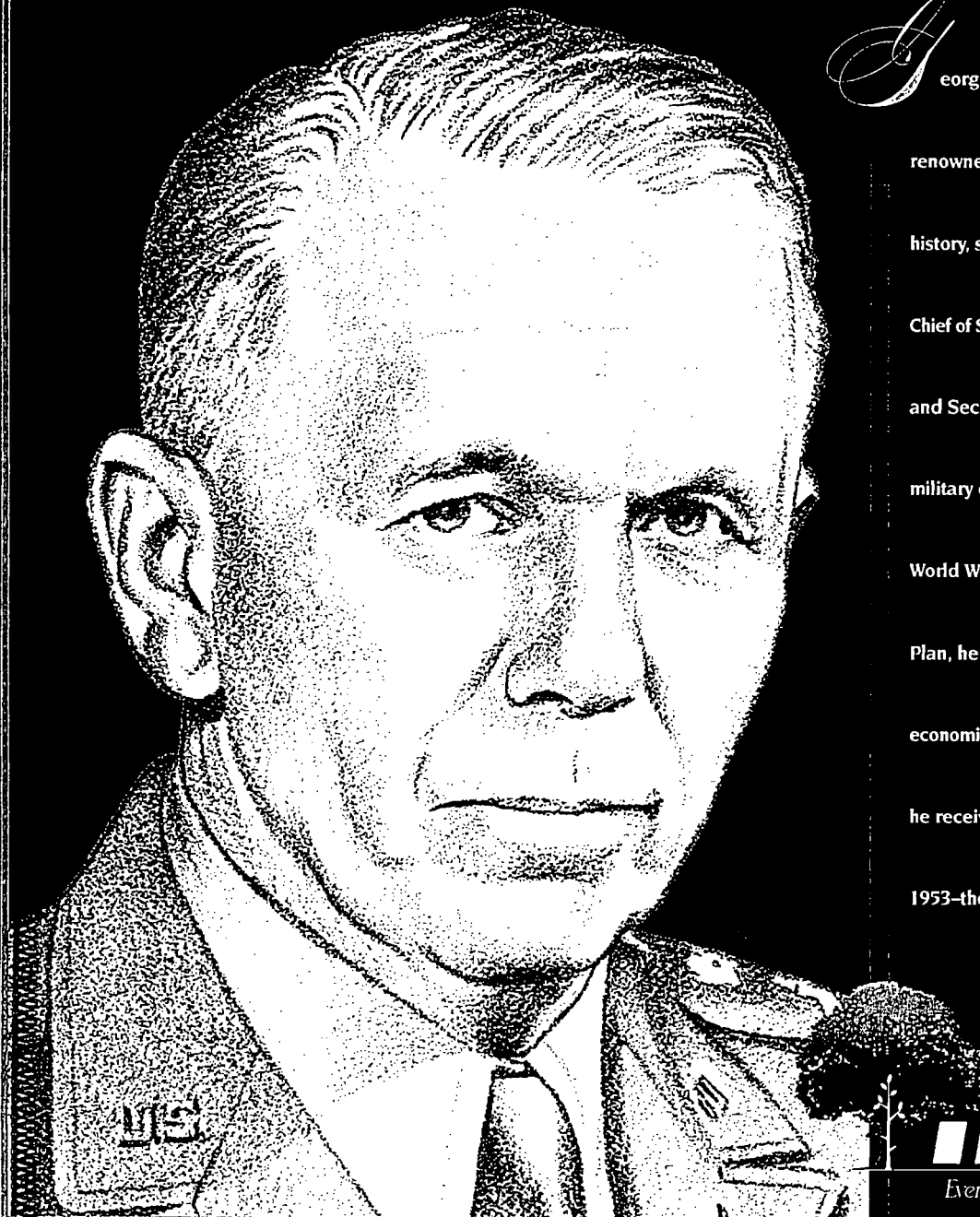
Everyone Needs a Safe Place to Grow.

500

(1880-1959)

Military General, Statesman,
Nobel Peace Prize Recipient

General George C. Marshall



*G*eorge C. Marshall was one of the most

renowned military figures in United States

history, serving as a General of the Army,

Chief of Staff of the Army, Secretary of State,

and Secretary of Defense. He led U.S.

military efforts to victory in the Second

World War. Later, through the Marshall

Plan, he built the foundation for the

economic rehabilitation of Europe for which

he received the Nobel Peace Prize in

1953—the first soldier to receive this honor.

I Bonds

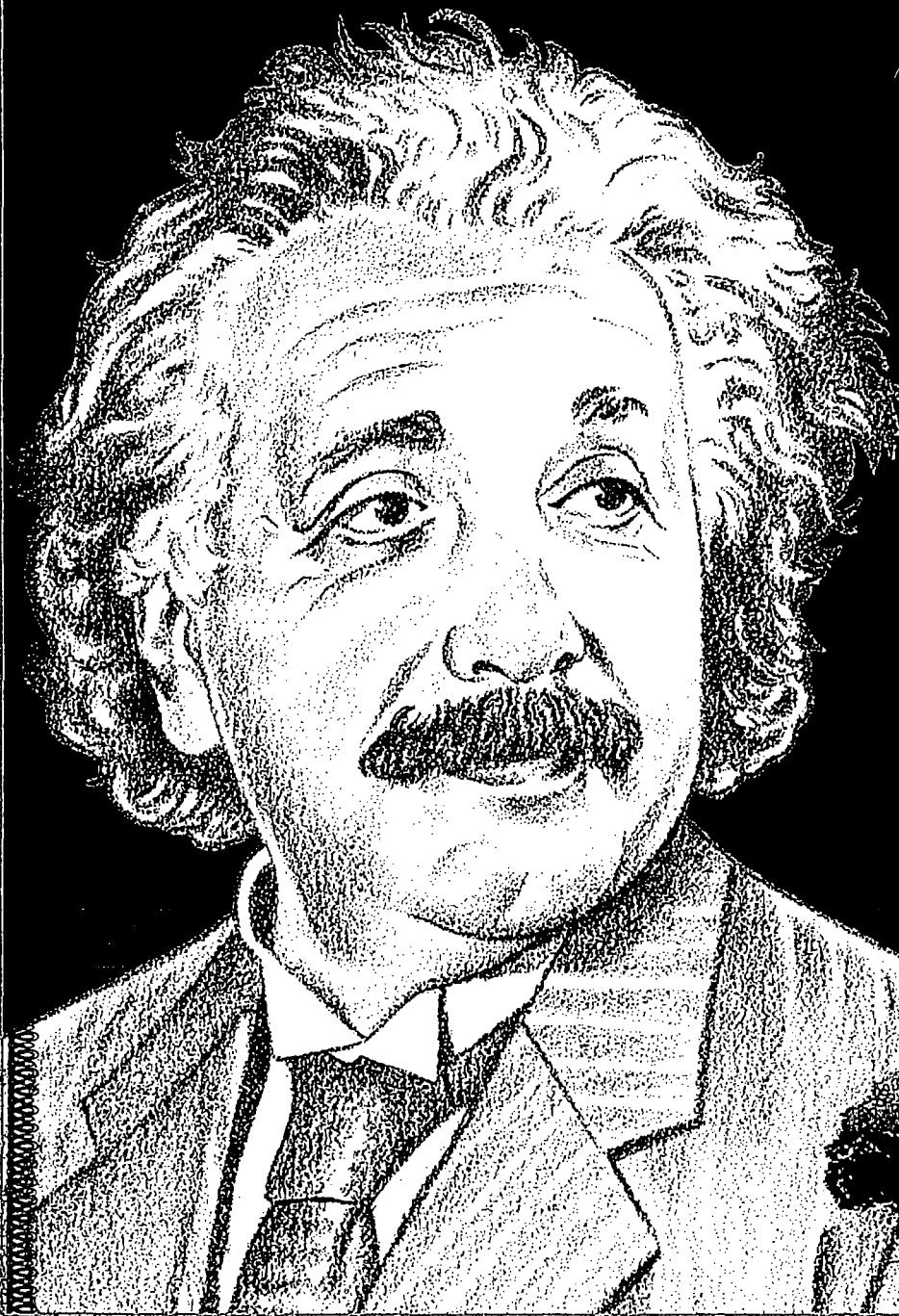
Everyone Needs a Safe Place to Grow.

1000

(1879-1955)

Physicist, Author of the Theory of Relativity,
Nobel Prize Recipient

Albert Einstein



With the special and general theories of relativity, Einstein replaced Newton's view of absolute time and absolute space with a new physics in which time slows down and gravity changes the shape of the universe. Albert Einstein is a symbol of the pursuit of truth through science that knows no national boundaries. As an immigrant to the United States, Einstein fled pre-war Germany and became a United States citizen. As a prize-winning physicist, Einstein replaced centuries of physics with a new and more complete view of the universe. As an international figure, Einstein fought for the cause of peace. He received the Nobel Prize for physics for his work on the photoelectric effect.

I Bonds
Everyone Needs a Safe Place to Grow

5,000

(1897-1993)

World-Renowned Vocalist (Contralto)

Marian Anderson



arian Anderson was a world-renowned contralto with a vocal mastery from Bach and Schubert to Verdi and spirituals. In 1939, barred from singing at a concert hall in Washington, D.C., because of her race, Anderson was invited to sing on the steps of the Lincoln Memorial to a record crowd. Her long career began with singing in church as a young girl and took her to the pinnacle of the profession. In 1955, she became the first African-American to sing with the Metropolitan Opera. Marian Anderson was loved and admired throughout the world as a great artist whose dignity in the face of discrimination opened doors for the many African-American artists now performing in concert halls and opera houses worldwide.



I Bonds

Everyone Needs a Safe Place to Grow.

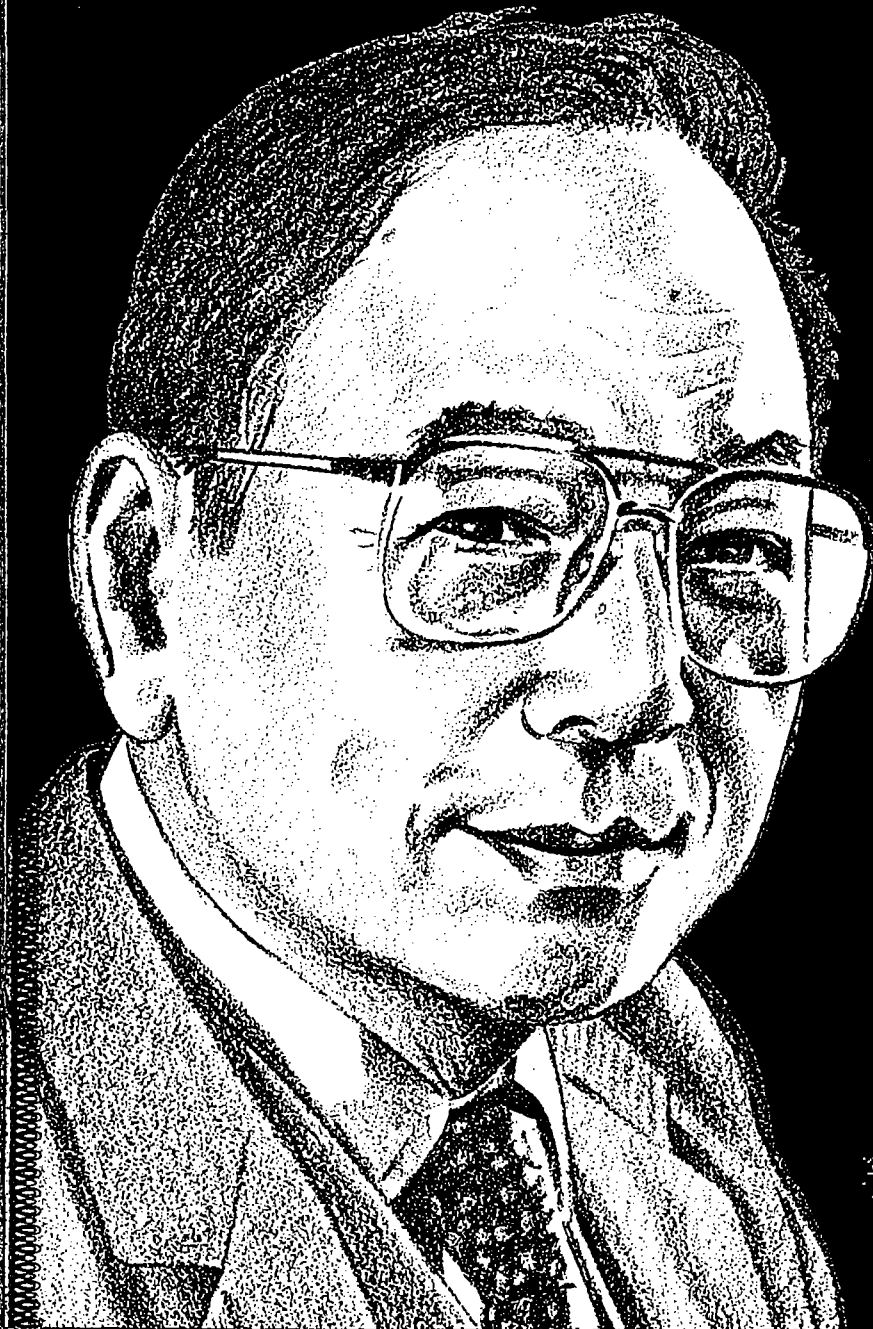
10,000

(1916-1990)

U.S. Senator and Congressman,

World War II Hero

Spark M. Matsunaga



Spark Matsunaga, a war hero who

became a United States Senator from Hawaii, dedicated his career to promoting peace and achieving justice. A Japanese-American, Matsunaga served with distinction in the 100th Infantry Battalion, the first Japanese-American unit formed during World War II, for which he received the Bronze Star and two Purple Hearts. As a political leader, he was a champion of civil rights for all Americans regardless of race. As a member of the United States Senate, he worked to promote the peaceful resolution of conflicts, and he fought for redress for survivors of the World War II internment camps.



I Bonds

Everyone Needs a Safe Place to Grow.

**Helen Keller
(1880-1968)
Author, Advocate for People with Disabilities**

Helen Keller lost her sight and hearing as a young child from illness but overcame these challenges and went on to become the twentieth century's best known advocate for people with disabilities. Through her writing, lectures, and work with various organizations, Keller focused public attention on issues affecting the handicapped. She was also successful in making Braille the standard for printed communication with the blind. She had a lifelong relationship with the American Foundation for the Blind, and was instrumental in the Lions Club International's devotion to the blind and blindness prevention.

Helen Keller was born on June 27, 1880, in Tuscumbia, Alabama. She was less than two years old when she lost her sight and hearing due to a childhood illness. In March 1887 her parents arranged for Helen to be tutored by an extraordinary young teacher, Anne Sullivan. The results over the next several years were nothing short of miraculous. Using only the sense of touch, Sullivan was able to teach Keller to communicate by the manual alphabet, to read Braille, to use a special typewriter, and eventually to speak and read lips. An award winning play and movie, "The Miracle Worker," chronicled the success Sullivan had in getting Keller to make the connection between a word and the object it represented. Keller went on to enroll at Radcliffe and graduated with honors in 1904. Keller had a great facility with language and went on to learn Latin, Greek, French, Spanish, and Italian, in addition to English.

Shortly after college, Keller published her popular biography, "The Story of My Life," and went on to write other books, including: "My Religion" and "Midstream." She became active in the women's suffrage movement, and through her writings and personal appearances, began to raise public awareness about the challenges faced by people with physical disabilities. In 1924, Keller began a lifelong association with the American Foundation for the Blind, for which she was a tireless fund-raiser. One year later, in 1925, she made her famous challenge to the Lions Clubs International to become "knights of the blind in the crusade against darkness." Since then, services for the blind and the prevention of blindness have been the organization's primary causes. Keller advocated the United States entry into World War II, and she often visited wounded soldiers in military hospitals.

Helen Keller remained with her mentor, Anne Sullivan, until her death in 1936. Following Sullivan's death, Keller kept an active life as an advocate and writer. Helen Keller died in 1968 and her ashes are in the National Cathedral in Washington, D.C.

50

(1880-1968)

Author, Advocate for People
with Disabilities

Helen Keller

*H*elen Keller lost her sight and hearing as a young child from illness but overcame these challenges and went on to become the twentieth century's best known advocate for people with disabilities. Through her writing, lectures, and work with various organizations, Keller focused public attention on issues affecting the handicapped. She was also successful in making Braille the standard for printed communication with the blind. She had a lifelong relationship with the American Foundation for the Blind, and was instrumental in the Lions Club International's devotion to the blind and blindness prevention.



I Bonds

Everyone Needs a Safe Place to Grow.

**Dr. Hector P. Garcia
(1914-1996)
Physician, World War II Veteran, Humanitarian**

Dr. Hector Garcia was a medical doctor who spent his life working to help the poor, sick, and neglected. Dr. Garcia served in World War II, received the Bronze Star Medal, and became a leading advocate for Mexican-American veterans' rights. He was an activist in the Latino civil rights movement and founder of the American G.I. Forum, an organization that addresses the health, education, and civil rights of Hispanic veterans. Dr. Garcia was the first Mexican-American to serve on the U.S. Commission on Civil Rights and served as U.S. Ambassador to the United Nations. He received our nation's highest civil honor, the Presidential Medal of Freedom, in 1984 from President Ronald Reagan.

Dr. Hector P. Garcia was born in Mexico on January 17, 1914. His family left Mexico because of the revolution and moved to Mercedes, Texas, where they opened a drugstore. Dr. Garcia's father, author of several books, insisted that his children concentrate on their education. As a result, six of the seven Garcia children completed medical school and became doctors, including Dr. Hector Garcia who earned his medical degree from the University of Texas in 1940.

During World War II, Dr. Garcia served in the Army as an infantry officer, a combat officer and, when the Army finally allowed him to practice medicine, a medical corps officer before being discharged as a Major. Dr. Garcia was awarded the Bronze Star for his service in North Africa and Italy.

Following the war, Dr. Garcia returned to South Texas, marrying Wanda Fusillo, whom he met in Italy. He opened his first medical practice in Corpus Christi, Texas, located next to the U.S. Veterans Administration. Many of his patients were Mexican-American veterans who had fought in the Pacific for the United States but when they returned experienced inferior treatment and segregation.

Dr. Garcia, refusing to overlook the mistreatment of the Mexican-American veterans, founded the American G.I. Forum, designed initially to improve veteran benefits and medical attention. The Forum soon expanded to address a broad range of issues, including education and vocational training, housing, public education, poll taxation, voter registration, hospitalization, and employment. Other veterans advocacy groups existed at the time, but few admitted Mexican-Americans and none pursued their needs, even though 500,000 had served with distinction in World War II.

In 1949, a Funeral Home refused burial rights to a South Texas World War II veteran, Felix Longoria. The Longoria case brought Dr. Garcia and the American G.I. Forum to the national forefront and gave him the first of many humanitarian victories. As a result of Dr. Garcia's efforts, Felix Longoria was buried in Arlington National Cemetery through the sponsorship of then U.S. Senator Lyndon B. Johnson.

Dr. Garcia became the first nationally known Latino civil rights leader.

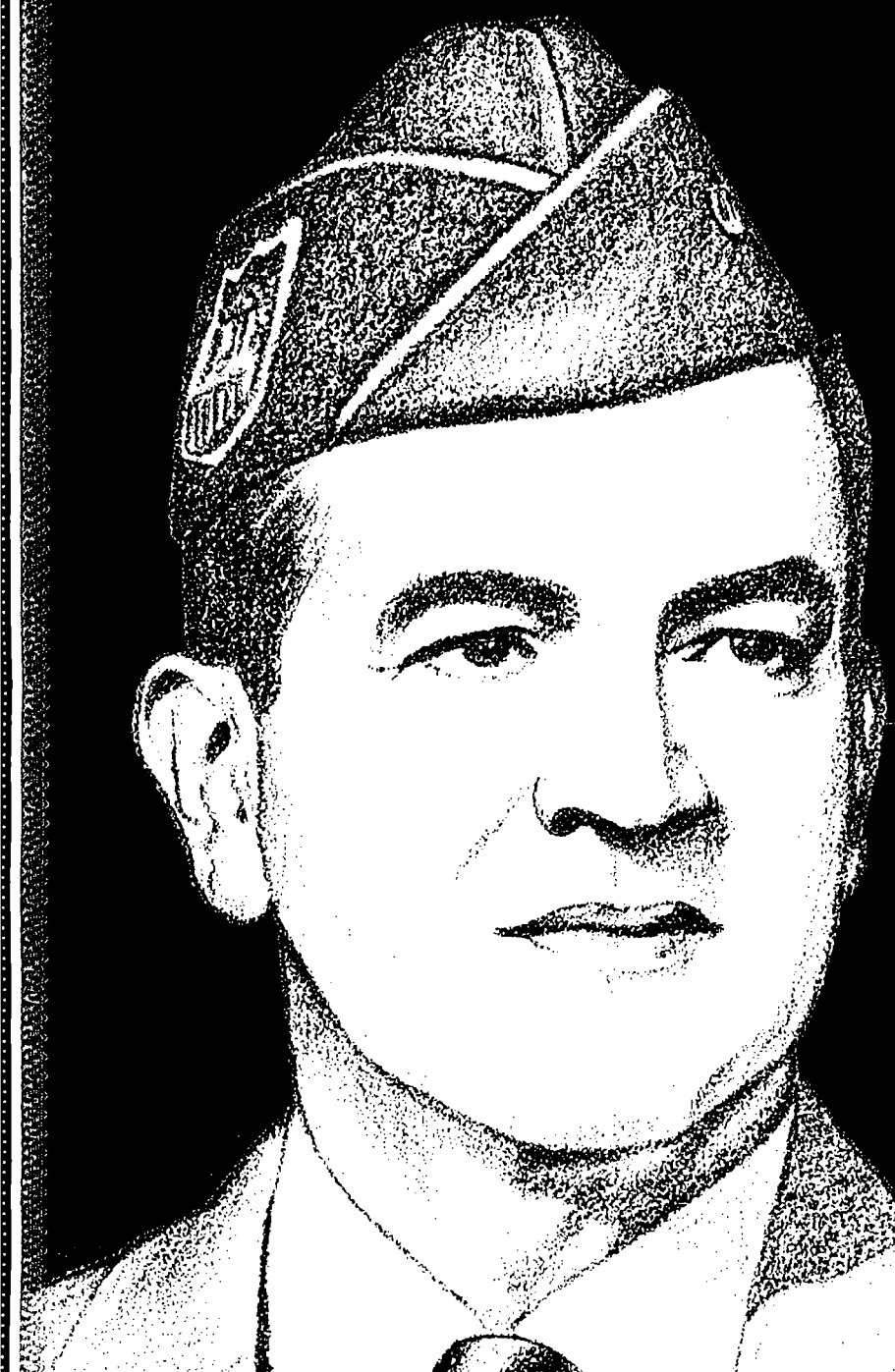
During the Vietnam War, Dr. Garcia would rise early in the morning to greet the coffins coming back almost daily from Southeast Asia, a gesture of respect from one soldier to another. In memory of his remarkable life, the citizens and business community of Corpus Christi honored him with a statue and named a plaza after him at Texas A&M University.



(1914-1996)

Physician, Humanitarian,
World War II Veteran

Dr. Hector P. Garcia



*D*r. Hector Garcia was a medical doctor who spent his life working to help the poor, sick, and neglected. Dr. Garcia served in World War II, received the Bronze Star Medal, and became a leading advocate for Mexican-American veterans' rights. He was an activist in the Latino civil rights movement and founder of the American G.I. Forum, an organization that addresses the health, education, and civil rights of Hispanic veterans. Dr. Garcia was the first Mexican-American to serve on the U.S. Commission on Civil Rights and served as U.S. Ambassador to the United Nations. He received our nation's highest civil honor, the Presidential Medal of Freedom, in 1984 from President Ronald Reagan.



I Bonds

Everyone Needs a Safe Place to Grow.

Dr. Martin Luther King, Jr.
(1929-1968)
Civil Rights Leader, Minister, Nobel Peace Prize Recipient

Dr. Martin Luther King, Jr., a Baptist minister from Atlanta, was one of the most prominent figures in the civil rights movement which succeeded in achieving legal equality for African-Americans. He co-founded and served as the first president of the Southern Christian Leadership Conference, organized to promote the advancement of integration and legal and social equality. Dr. King was the recipient of numerous awards which recognized his outstanding work for non-violent social change, including the Nobel Peace Prize in 1964. In 1986, Dr. King's birthday became a national holiday in recognition of his enormous contributions to American history.

Martin Luther King, Jr., was born on January 15, 1929, in Atlanta, Georgia. At the age of 15, he entered Morehouse College. At the age of 18, he was ordained a Baptist minister at the Ebenezer Baptist Church, the church led by his father and previously by his grandfather. After completing his studies at Morehouse, he entered Crozer Theological Seminary, graduating as valedictorian in 1951, and went on to earn a doctorate in theology from Boston University. During his theological studies he was exposed to writing of Mohandas Gandhi, whose teachings formed the basis of Dr. King's philosophy of non-violence. In 1953, he married Coretta Scott with whom he had two sons and two daughters.

In 1953, Dr. King became pastor of the Dexter Avenue Baptist Church in Montgomery, Alabama. In 1955, the arrest of Rosa Parks for refusal to give up her seat on a Montgomery city bus sparked the Montgomery Bus Boycott. Dr. King was called upon to lead the year-long boycott, during which he endured the first of many arrests for fighting unjust laws. Dr. King's stand against segregation and his commitment to working for non-violent social change catapulted him to national prominence.

In 1959, Dr. King returned to Atlanta to serve as president of the Southern Christian Leadership Conference and to serve as co-pastor with his father at Ebenezer Baptist Church. Dr. King continued to work for non-violent change, pushing for voting rights, desegregation, economic and educational advancement, and peace. In 1963, Dr. King participated in the March on Washington where he delivered his now famous "I Have A Dream" speech. He led a series of protests in 1963-64, culminating in the passage of the Civil Rights Act of 1964. In 1965, Dr. King organized the Selma to Montgomery March which led to the passage of the Voting Rights Act of 1965. In 1967, Dr. King organized the Poor People's Campaign to address the economic problems of poor people of all races. The Poor People's Campaign included a multi-racial march on Washington to highlight poverty in America.

In April of 1968, Dr. King was assassinated by a sniper in Memphis, Tennessee.

100

(1929-1968)

Civil Rights Leader, Minister,
Nobel Peace Prize Recipient

Dr. Martin Luther King, Jr.

*D*r. Martin Luther King, Jr., a Baptist minister from Atlanta, was one of the most prominent figures in the civil rights movement which succeeded in achieving legal equality for African-Americans. He co-founded and served as the first president of the Southern Christian Leadership Conference, organized to promote the advancement of integration and legal and social equality. Dr. King was the recipient of numerous awards which recognized his outstanding work for non-violent social change, including the Nobel Peace Prize in 1964. In 1986, Dr. King's birthday became a national holiday in recognition of his enormous contributions to American history.



I Bonds

Everyone Needs a Safe Place to Grow.

**Chief Joseph
(1840-1904)
Nez Perce Chief**

Chief Joseph, a Native American leader, is best known for his principled resistance to the U.S. government's attempts to force the Nez Perce onto a reservation. An 1863 treaty took away their lands and forced the Nez Perce and their leader into a position of resistance. Though he consistently opposed war, when conflict became inevitable Chief Joseph and other leaders led the Nez Perce on a courageous retreat in 1877 for more than a thousand miles through Montana and Idaho. After a five-day siege only 30 miles from safety, he surrendered. In his final years, Chief Joseph spoke eloquently of the injustice of United States policy toward his people and held out hope that one day freedom and equality might come for Native Americans.

Chief Joseph was born in Oregon in 1840. He was given the name Hinmaton-Yalaktit (Hin-mah-too-yah-lat-kekt) or Thunder Rolling Down the Mountain but was known as Joseph, or Joseph the Younger, because his father had been baptized Joseph by a Christian missionary in 1838.

In 1871, Chief Joseph succeeded his father as Chief of the Wallowa band of Nez Perce. He inherited a volatile situation because some Nez Perce resisted the federal government's efforts to force them into a small Idaho reservation one tenth the size of their native lands. In 1877, after the cavalry threatened to attack, Chief Joseph and other leaders began the journey to the reservation. On a night that Chief Joseph was away from camp, a young Nez Perce man and his friends, avenging the killing of his father, attacked and killed a white settler. Immediately, the cavalry began to pursue Chief Joseph and other Nez Perce, and although he opposed war, he sided with the war leaders.

In a valiant series of battles which took place over three months, the Indian tribe of 700 with fewer than 200 warriors fought 2,000 U.S. soldiers in four major battles and several smaller ones. General Howard, leading the opposing cavalry, was impressed with the skill with which they fought using advance and rear guard, skirmish lines and field fortifications. Finally, after a devastating five-day battle during freezing weather conditions with no food or blankets, Chief Joseph formally surrendered on October 5, 1877.

After surrendering, Chief Joseph and his people were taken to Kansas and present-day Oklahoma. It was not until 1885 that they were returned to the Pacific Northwest, and even then Chief Joseph and others were taken to non-Nez Perce territory. Chief Joseph died in 1904, still in exile, on the Colville Reservation in Washington.

200

(1840-1904)

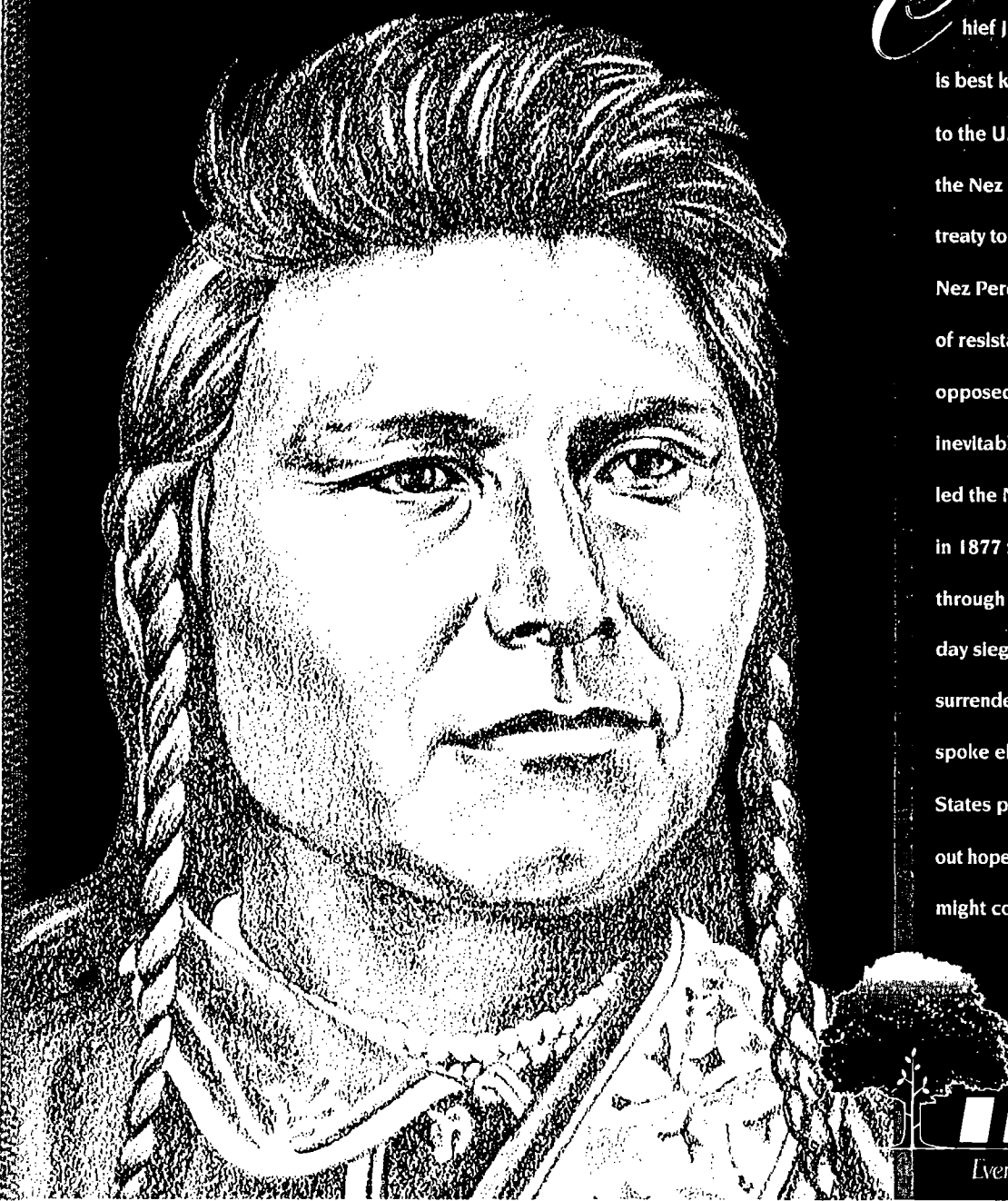
Nez Perce Chief

Chief Joseph

C

Chief Joseph, a Native American leader,

is best known for his principled resistance to the U.S. government's attempts to force the Nez Perce onto a reservation. An 1863 treaty took away their lands and forced the Nez Perce and their leader into a position of resistance. Though he consistently opposed war, when conflict became inevitable Chief Joseph and other leaders led the Nez Perce on a courageous retreat in 1877 for more than a thousand miles through Montana and Idaho. After a five day siege only 30 miles from safety, he surrendered. In his final years, Chief Joseph spoke eloquently of the injustice of United States policy toward his people and held out hope that one day freedom and equality might come for Native Americans.



I Bonds

Everyone Needs a Safe Place to Grow.

General George C. Marshall
(1880-1959)
Military General, Statesman, Nobel Peace Prize Recipient

George C. Marshall was one of the most renowned military figures in United States history, serving as a General of the Army, Chief of Staff of the Army, Secretary of State and Secretary of Defense. He led U.S. military efforts to victory in the Second World War. Later, through the Marshall Plan, he built the foundation for the economic rehabilitation of Europe for which he received the Nobel Peace Prize in 1953—the first soldier to receive this honor.

Marshall was born in Uniontown, Pennsylvania, on December 31, 1880. He was educated at the Virginia Military Institute, serving as First Captain of the Corps of Cadets, the highest ranking position in the Corps, in his final year. Commissioned as an infantry officer in the army, Marshall began a distinguished career that included service in the Philippines, as an aide to General Pershing during World War I, directing instruction at the Infantry School at Fort Benning, and serving as the Army's Deputy Chief of Staff.

Nearing what he thought was the end of his military career, Marshall's unique talents as a Commander were called upon at an important moment in history. He was appointed Army Chief of Staff on September 1, 1939, the day that World War II began with Germany's invasion of Poland. Marshall, a brilliant strategist and organizer, directed U. S. preparations for war, leading our Nation to military victory and eliminating the threat of fascism. He retired as Chief of Staff in November 1945.

In 1947, Marshall was appointed Secretary of State. He recognized that having won the war, the United States was in danger of losing the peace because of the collapse of Europe's economy. In a commencement address at Harvard on June 5, 1947, Marshall proposed a program for European economic recovery which became known as The Marshall Plan. Marshall worked at the United Nations and in other forums for treaties with the defeated powers that would restore them to places of respect and equality. Marshall worked tirelessly to end starvation and suffering in Europe as Secretary of State and resigned in 1949 to lead the American Red Cross.

After the outbreak of the Korean War in 1950, President Truman asked Marshall to return to government as the head of the Department of Defense. In the year that he served, Marshall increased the size of the Army, promoted a plan for universal military training, and helped to develop the North Atlantic Treaty Organization.

Marshall enjoyed the respect of world leaders, military commanders, and the American people. Dedicated to building a strong defense, Marshall also labored to find peaceful solutions to world conflicts. In December 1953, he became the first soldier to be awarded the Nobel Prize for Peace in recognition of his contributions to the economic rehabilitation of Europe. He died in Washington, D.C., on October 16, 1959.

500

(1880-1959)

Military General, Statesman,

Nobel Peace Prize Recipient

General George C. Marshall



George C. Marshall was one of the most

renowned military figures in United States

history, serving as a General of the Army,

Chief of Staff of the Army, Secretary of State,

and Secretary of Defense. He led U.S.

military efforts to victory in the Second

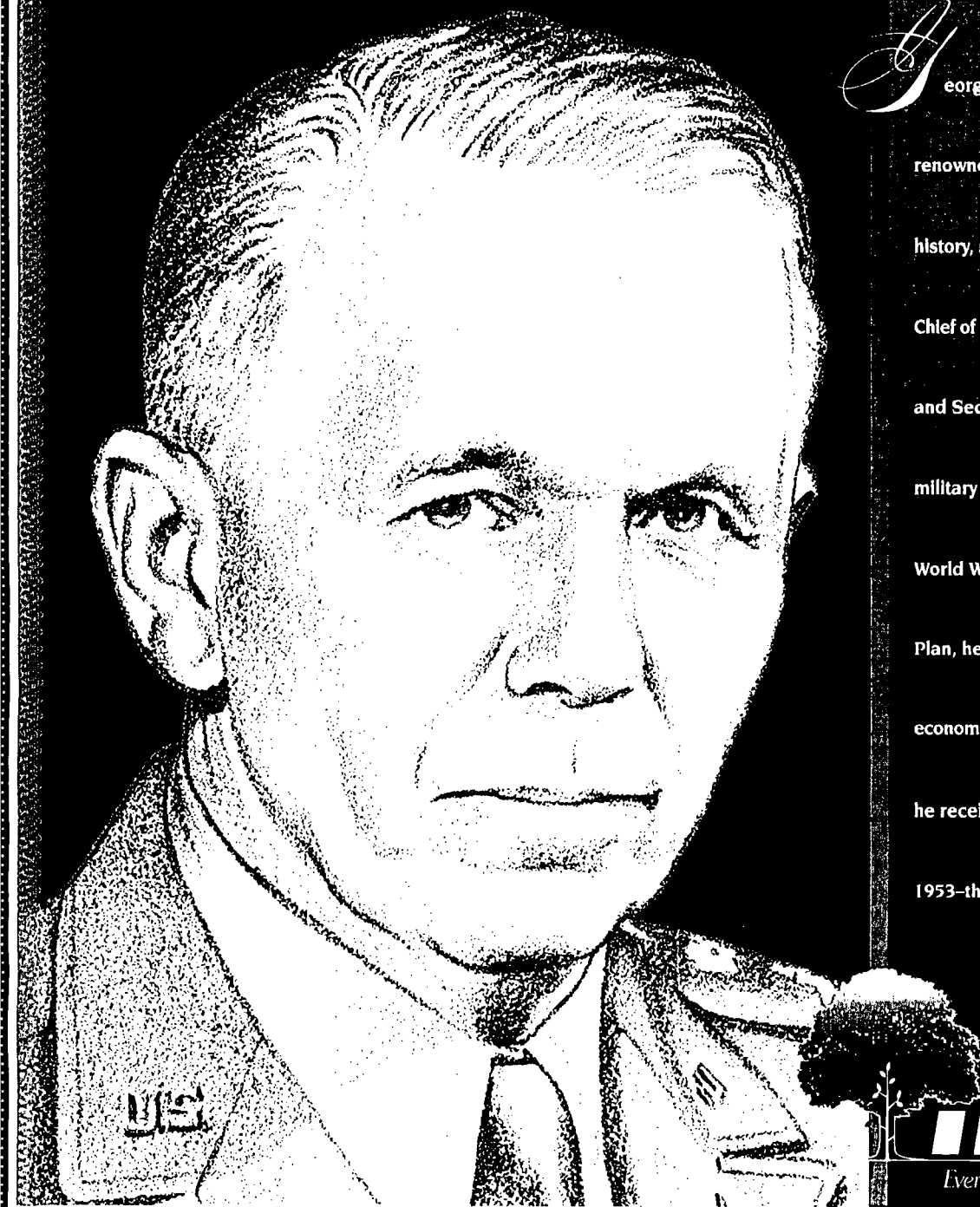
World War. Later, through the Marshall

Plan, he built the foundation for the

economic rehabilitation of Europe for which

he received the Nobel Peace Prize in

1953—the first soldier to receive this honor.



I Bonds

Everyone Needs a Safe Place to Grow.

\$1000

**Albert Einstein
(1879-1955)**

Physicist, Author of the Theory of Relativity, Nobel Prize Recipient

With the special and general theories of relativity, Einstein replaced Newton's view of absolute time and absolute space with a new physics in which time slows down and gravity changes the shape of the universe. Albert Einstein is a symbol of the pursuit of truth through science that knows no national boundaries. As an immigrant to the United States, Einstein fled pre-war Germany and became a United States citizen. As a prize-winning physicist, Einstein replaced centuries of physics with a new and more complete view of the universe. As an international figure, Einstein fought for the cause of peace. He received the Nobel Prize for physics for his work on the photoelectric effect.

Einstein was born in Ulm, Germany on March 14, 1879. In 1900 he graduated from the Swiss Federal Institute of Technology and became a secondary teacher of mathematics and physics. After two years he obtained a position at the Swiss patent office in Bern, and while there in his spare time, he completed several publications on theoretical physics. In 1905 his Special Theory of Relativity was born, and he submitted his paper on "On the Electrodynamics of Moving Bodies" to the leading German physics journal. At age 26, he applied his theory to mass and energy and formulated the equation $E=mc^2$. He submitted one of these papers to the University of Zurich to obtain a doctorate in 1905 and in 1909 became an associate professor of physics at the University of Zurich. In 1921 a solar eclipse proved Einstein's General Theory of Relativity works, and he was awarded the Nobel Prize in physics.

With the rise of fascism in Germany, Einstein moved to the United States in 1933 accepting a research fellowship at the Institute for Advanced Studies in Princeton, New Jersey, and becoming an American citizen in 1940. There he worked on a proposed unified field theory, a single mathematical system that places electromagnetism and gravitation in one universal law. This challenge occupied him for the remainder of his life.

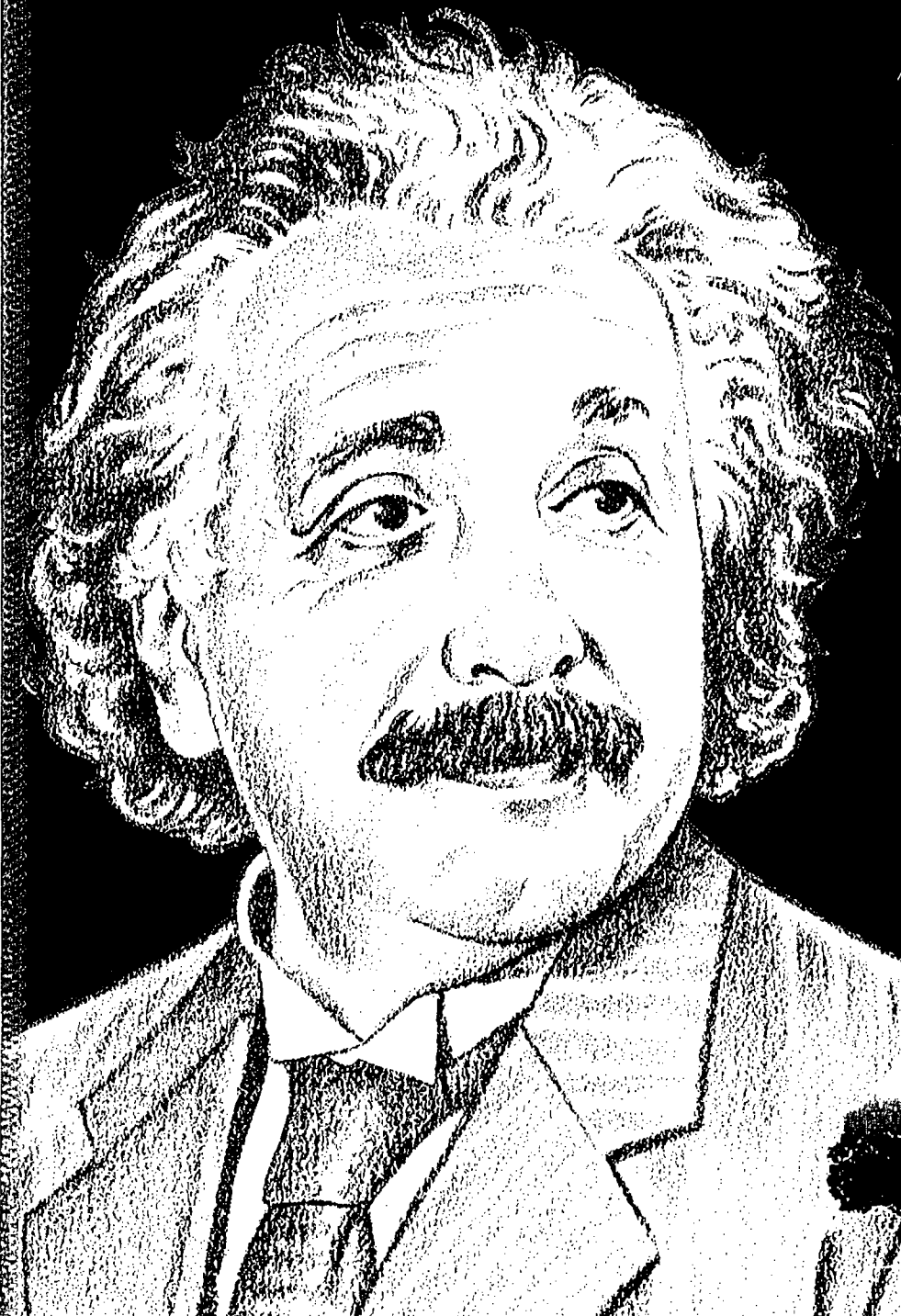
Following the war, Einstein wrote a series of influential articles seeking to limit the spread of nuclear weapons. Einstein died of a heart attack in 1955.

1000

(1879-1955)

Physicist, Author of the Theory of Relativity,
Nobel Prize Recipient

Albert Einstein



With the special and general theories of relativity, Einstein replaced Newton's view of absolute time and absolute space with a new physics in which time slows down and gravity changes the shape of the universe. Albert Einstein is a symbol of the pursuit of truth through science that knows no national boundaries. As an immigrant to the United States, Einstein fled pre-war Germany and became a United States citizen. As a prize-winning physicist, Einstein replaced centuries of physics with a new and more complete view of the universe. As an international figure, Einstein fought for the cause of peace. He received the Nobel Prize for physics for his work on the photoelectric effect.

Bonds
Everyone Needs a Safe Place to Grow.

\$5000

Marian Anderson
(1897-1993)—World-Renowned Vocalist (Contralto)

Marian Anderson was a world-renowned contralto with a vocal mastery from Bach and Schubert to Verdi and spirituals. In 1939, barred from singing at a concert hall in Washington, D.C., because of her race, Anderson was invited to sing on the steps of the Lincoln Memorial to a record crowd. Her long career began with singing in church as a young girl and took her to the pinnacle of the profession. In 1955, she became the first African-American to sing with the Metropolitan Opera. Marian Anderson was loved and admired throughout the world as a great artist whose dignity in the face of discrimination opened doors for the many African-American artists now performing in concert halls and opera houses worldwide.

Marian Anderson was born and raised in Philadelphia. She sang in the choir of the Union Baptist Church. The church, impressed with her extraordinary voice, helped raise money for her to take lessons. After winning two singing contests, her career was launched.

In 1935, after filling concert halls throughout Europe, Anderson returned to the United States to perform concerts around the country while enduring the reality of segregation on trains and in hotels. In 1939 Marian Anderson was denied the use of Washington DC's Constitution Hall for a recital. The Daughters of the American Revolution (DAR), owners of the Hall, in all contracts forbade its use by persons of color. First Lady Eleanor Roosevelt publicly resigned from the organization. Secretary of the Interior Harold Ickes invited Anderson to perform instead at the Lincoln Memorial on Easter Sunday. More than 75,000 people heard the concert live, a record audience at the time, and her performance was also broadcast by radio to millions. The DAR later changed its policy and Anderson performed many times at Constitution Hall.

In 1955, Anderson accepted the role of Ulrica in Verdi's *Un Ballo in Maschera*, and became the first African-American to sing with the Metropolitan Opera. She was a sensation throughout the world, receiving numerous honors and awards throughout her lifetime, including the Presidential Medal of Freedom and the National Arts Medal. Anderson sang at the presidential inaugurations of Dwight D. Eisenhower and John F. Kennedy.

Anderson gave a farewell recital in Carnegie Hall on April 19, 1965. She died in 1993 of a heart attack.

5000

(1897-1993)

World-Renowned Vocalist (Contralto)

Marian Anderson

*M*arian Anderson was a world-renowned contralto with a vocal mastery from Bach and Schubert to Verdi and spirituals. In 1939, barred from singing at a concert hall in Washington, D.C., because of her race, Anderson was invited to sing on the steps of the Lincoln Memorial to a record crowd. Her long career began with singing in church as a young girl and took her to the pinnacle of the profession. In 1955, she became the first African-American to sing with the Metropolitan Opera. Marian Anderson was loved and admired throughout the world as a great artist whose dignity in the face of discrimination opened doors for the many African-American artists now performing in concert halls and opera houses worldwide.



I Bonds
Everyone Needs a Safe Place to Grow.

\$10,000

Spark M. Matsunaga
(1916-1990)
U.S. Senator and Congressman, World War II Hero

Spark Matsunaga, a war hero who became a United States Senator from Hawaii, dedicated his career to promoting peace and achieving justice. A Japanese-American, Matsunaga served with distinction in the 100th Infantry Battalion, the first Japanese American unit formed during World War II, for which he received the Bronze Star and two Purple Hearts. As a political leader, he was a champion of civil rights for all Americans regardless of race. As a member of the United States Senate, he worked to promote the peaceful resolution of conflicts, and he fought for redress for survivors of the World War II internment camps.

Masayuki Matsunaga was born on the Island of Kauai, Hawaii, on October 8, 1916. His childhood friends nicknamed him Spark; he later legally adopted the name. Matsunaga attended the Kauai public schools before entering the University of Hawaii in 1937, majoring in education and serving in the Reserve Officer Training Corps. Upon graduation in June 1941, Matsunaga was commissioned in the Army and was serving on active duty on the island of Molokai when Japan attacked Pearl Harbor on December 7, 1941. Shortly afterward, he and other Japanese-Americans were relieved of their duties and shipped to a military facility, Camp McCoy, in Wisconsin, while the War Department in Washington decided whether they could fight for America. Matsunaga, along with the other soldiers, petitioned President Roosevelt for a chance to prove their loyalty.

In the Spring of 1942, President Roosevelt and other Washington leaders determined that Japanese-Americans in the Army would be loyal to the country; Matsunaga and 1,500 other Japanese-Americans formed the 100th Infantry Battalion and trained for combat duty. In September 1943, the battalion was sent to Italy; Matsunaga was wounded twice in the same night while moving through a minefield. After recuperating, Matsunaga could not go back to combat but received two Purple Hearts and the Bronze Star for his heroic acts, and was assigned to a replacement battalion. Late in the war, he returned to the U.S. where he gave 800 speeches to help Japanese-Americans become integrated into the mainstream of American life after being released from the detention camps where they were kept during the war. The 100th Infantry Battalion eventually became a part of the 442nd Regimental Combat Team of Japanese-American soldiers, the most decorated unit in U.S. military history.

Matsunaga returned to Hawaii in 1946, worked in veterans affairs briefly, married, and then entered Harvard Law School in 1948. After graduation, he practiced law in Hawaii and began his political career, being elected to the Territorial Legislature in what was known as the "Democratic Revolution" of 1954 engineered by veterans of the 100th and 442nd to take control of the legislature for the first time. Matsunaga and other Japanese-Americans were among the leaders in Hawaii's bid for statehood, which passed in 1959.

In 1962, Matsunaga won a seat in the U.S. House of Representatives, making the rights of immigrants, the welfare of veterans, and the defense of Japanese-Americans and other minorities his hallmarks. In 1976, he was elected to the U.S. Senate, supporting legislation to establish a research organization called the United States Peace Institute and to authorize the post of Poet Laureate. As a Senator, he was also a major proponent of the use of renewable energy sources and Soviet-American cooperation in space exploration. Perhaps Matsunaga's greatest achievement in the Senate was obtaining redress for Japanese-Americans who had been unjustly interned during World War II. The survivors of the camps received "token monetary compensation" and an apology from President Ronald Reagan. Another signature legislative achievement was the Spark Matsunaga Hydrogen Research and Development Act, which was passed in 1990 and provides funding for research into alternative energy sources. His last official act was to cast a vote in favor of continuing the Clean Air Act.

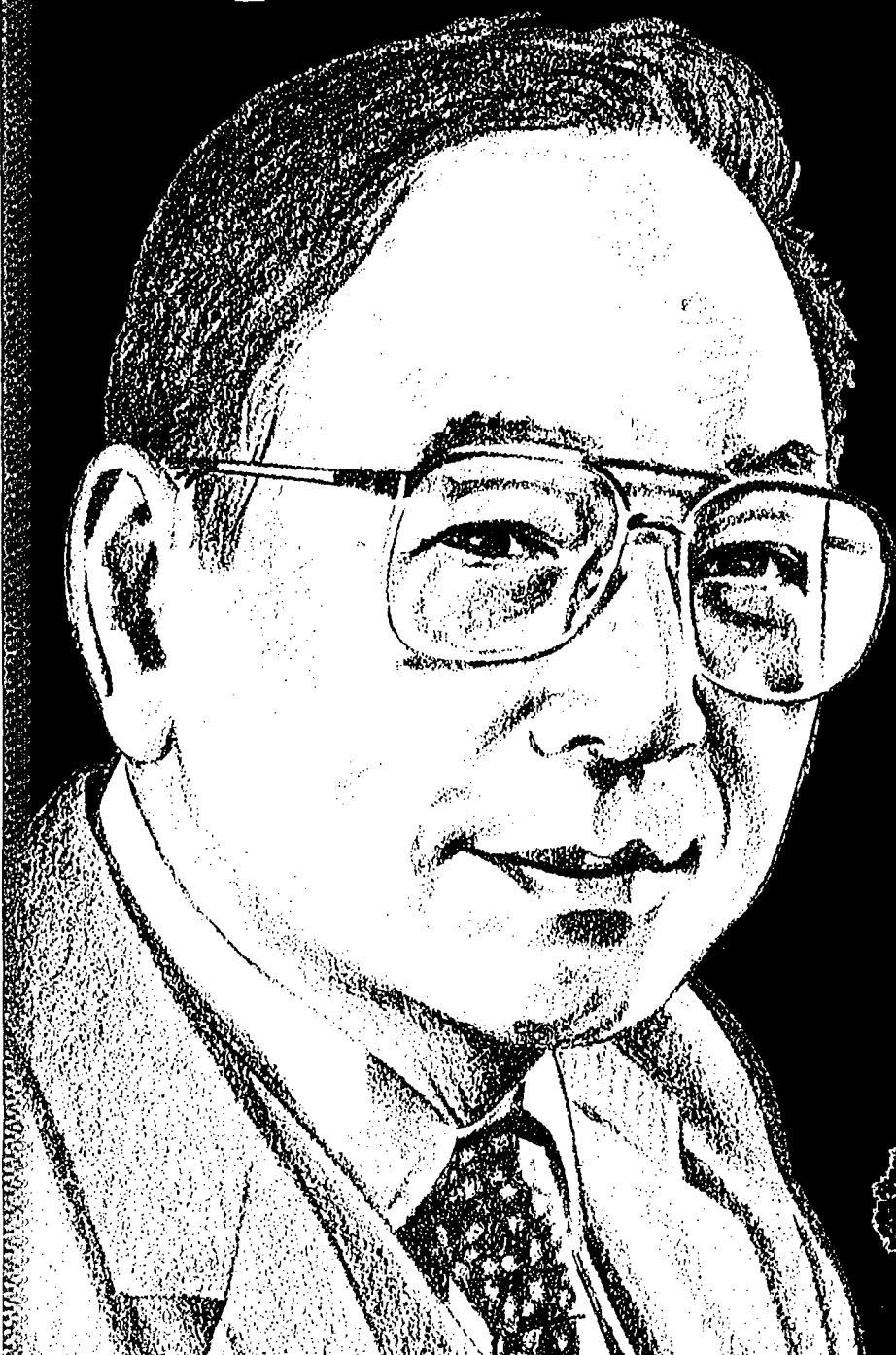
In 1990, Senator Matsunaga died while serving in the U.S. Senate. In his honor, the University of Hawaii established the Matsunaga Institute for Peace in which scholars explore ways to resolve differences without resorting to violence. This is a fitting tribute to a man who, having known the suffering of war, sought to bring the joy of peace to the human race.

10,000

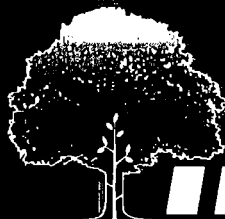
(1916-1990)

U.S. Senator and Congressman
World War II Hero

Spark M. Matsunaga



*S*park Matsunaga, a war hero who became a United States Senator from Hawaii, dedicated his career to promoting peace and achieving justice. A Japanese-American, Matsunaga served with distinction in the 100th Infantry Battalion, the first Japanese-American unit formed during World War II, for which he received the Bronze Star and two Purple Hearts. As a political leader, he was a champion of civil rights for all Americans regardless of race. As a member of the United States Senate, he worked to promote the peaceful resolution of conflicts, and he fought for redress for survivors of the World War II internment camps.



I Bonds

Everyone Needs a Safe Place to Grow.

QUESTIONS AND ANSWERS ABOUT NEW I BONDS

Features

1. What are I Bonds?

I bonds are a new type of bond designed for investors seeking to protect the purchasing power of their investment along with a guaranteed real rate of return. I Bonds are an accrual-type security—meaning interest is added to the bond monthly and paid when the bond is cashed. I bonds are sold at face value—you pay \$50 for a \$50 bond—and they grow in value with inflation-indexed earnings for up to 30 years.

2. Why is the Treasury offering the I Bond and will it replace Series EE bonds?

The Treasury is offering the I bond to provide more Americans with the opportunity to protect the purchasing power of their savings from inflation. Investors are being offered a bond with a fixed rate combined with semiannual inflation adjustments that will help protect purchasing power. No, the I Bond will not replace Series EE bonds; both will be on sale to give investors a choice.

3. How are the earnings rates of I Bonds determined?

The earnings rates of I Bonds are a combination of two separate rates: a *fixed rate of return* and a variable *semiannual inflation rate*. The fixed rate remains the same throughout the life of the I Bond, while the semiannual inflation rate can vary every six months.

The *fixed rate of return* is announced by the Treasury Department each May 1 and

November 1. The fixed rate of return announced on May 1 of a given year is the same over the entire life of the I Bonds you purchase between May 1 and October 31 of that year. Likewise, the *fixed rate of return* announced on November 1 of a given year, applies to the entire life of an I bond purchased between November 1 and April 30 of that year.

The *semiannual inflation rate* is also announced each May 1 and November 1 by the Treasury Department. The semiannual inflation rate is based on changes in the Consumer Price Index for all Urban consumers (CPI-U), which is reported by the Bureau of Labor Statistics. The semiannual inflation rate announced in May is a measure of inflation over the preceeding October through March; the inflation rate announced in November is a measure of inflation over the preceeding April through September.

The semiannual inflation rate is combined with the fixed rate of an I Bond to determine the I Bond's earning rate for the next six months.

4. When are earnings added to the I Bond?

I bond earnings are added each month, and interest is compounded semiannually. I Bonds increase in value on the first day of the month. An I Bond's issue date is the month and year when full payment is received by an I Bond issuing agent.

5. Can I ever lose money in I Bonds?

No. I Bonds are U.S. Treasury securities backed by the U.S. Government. I Bonds even protect you from the effects of deflation. In the rare event that the CPI-U is negative during a period of deflation and the amount of the decline in the CPI-U is greater than the fixed rate, the redemption value of your I Bonds will remain the same until the period of deflation ends.

6. How long will my bond earn interest?

I Bonds earn interest for up to 30 years.

7. What are the tax advantages of the I Bond?

Earnings are exempt from state and local income taxes. Federal income taxes can be deferred for up to thirty years, or until redemption or other taxable disposition, whichever comes first.

8. Is there a tax advantage for I Bonds used for college tuition?

Yes. If you qualify, you can exclude all or part of the interest on I Bonds from income as long as the proceeds are used to pay for tuition and fees at eligible post-secondary educational institutions. This tax advantage is the same one available for Series EE bonds. Details are available in IRS Publication 550, "Investment Income and Expenses." Contact your nearest Internal Revenue Service District Office to get this publication.

Investing and Redeeming

9. When will the I Bond be available?

On September 1, 1998 six denominations (\$50, \$75, \$100, \$500, \$1,000, \$5,000) will be available for purchase through financial institutions across the country.

Two additional denominations (\$200 and \$10,000) will be available in May 1999.

10. How much do I Bonds cost?

I Bonds fit all budgets. They will be sold at face value in denominations of \$50, \$75, \$100, \$200, \$500, \$1,000, \$5,000, and \$10,000. This makes it easy to keep track of the growth of your bond's value.

11. Is there a limit on how much can be invested each year in I Bonds?

Yes. You can buy up to \$30,000 worth of I bonds each calendar year. The purchase limitation for Series I Bonds is not affected by purchases of Series EE bonds.

12. Where can I buy I Bonds?

You can order I Bonds at most local financial institutions. You just fill out a simple purchase order, pay for the bond, and your I Bond will be mailed to you within three weeks. I bonds will also be available through employer-sponsored payroll savings plans. Check with your employer to see if I Bonds will be available where you work. If not, let them know you are interested.

13. Can I Bonds be purchased as gifts?

I Bonds are great gifts for all occasions. An I Bond can be sent to you so that you can present it personally or it can be sent directly to the person receiving the gift. When you buy the I bond, ask for a free gift certificate. The word "gift" will not appear on the I Bond.

14. Who can buy I Bonds?

U.S. citizens and residents of any age with a social security number can buy I Bonds.

15. How can I Bonds be registered?

There are three primary ways to register I Bonds:

- *Single ownership:* Only the registered owner can cash the I Bond.

Coownership: Two individuals' names appear on the I Bond; either person may cash the I Bond without the knowledge or approval of the other. Upon the death of one coowner, the other becomes the sole owner of the I Bond.

Beneficiary: Only the owner may cash the I Bond during his or her lifetime. The beneficiary automatically becomes the sole owner of the I Bond when the original owner dies.

The registration on an I bond can be changed but there are some restrictions. Check with your bank. This information will also be on our web site (www.savingsbonds.gov).

16. Where can I Bonds be redeemed?

Most financial institutions serve as paying agents for I bonds *and* Series EE bonds. If they redeem Series EE bonds, they redeem I Bonds.

17. When can an I Bond be cashed in (redeemed) if I need the money?

An I Bond can be cashed in (redeemed) six months after the issue date to get the original investment plus the earnings. However, I Bonds are meant to be longer term investments. So, if you redeem an I Bond within the first five years, there is a 3-month earnings penalty. For example, if you redeem an I Bond after 18-months you will get 15 months of earnings.

18. How are lost, stolen, or destroyed I Bonds replaced?

The Bureau of the Public Debt is authorized

to replace lost, stolen, or destroyed I Bonds. You can file a claim by writing to: Bureau of the Public Debt, Parkersburg, West Virginia 26106-1328. You will need to complete Form PD F 1048. This form is available at most financial institutions, or you can download it from our web site: www.savingsbonds.gov.

Keep records of your I Bond serial numbers, issue dates, and the social security or taxpayer identification numbers in a safe place. This information will help speed up the replacement process. The Savings Bond Wizard (free software available on our web site) is a great way to keep track of your savings bond inventory (see question 22).

Honoring Great Americans

19. What is new about the appearance of the I Bond?

The I Bond's physical dimensions and the placement of the information will be the same as for the Series EE bonds. However, each I Bond denomination will feature a prominent American who has contributed to the history of this country; also the background and colors will be new and different from the Series EE bonds.

20. Which Americans will appear on the I Bonds?

Eight Americans are honored on the I Bonds, representing the diversity that built this country, made it what it is today, and will take it into the future. Portraits of the following prominent Americans will appear on the eight I Bond denominations.

- \$50 - *Helen Keller* - Noted author and advocate for people with disabilities; responsible for Braille becoming the standard for printed communications with the blind.
- \$75 - *Dr. Hector P. Garcia* - Physician;

leading advocate for Mexican-American veterans' rights; activist in Latino civil rights movement and founder of the American G.I. Forum.

\$100 - Dr. Martin Luther King, Jr. -

Prominent Civil Rights Leader; Minister; Nobel Peace Prize Recipient.

\$200 - Chief Joseph - Nez Perce Chief; a great Native American leader.*

\$500 - General George C. Marshall - U.S. Army Chief of Staff during World War II; Secretary of State; Secretary of Defense; Nobel Peace Prize Recipient.

• *\$1,000 - Albert Einstein -* Physicist; Author of the Theory of Relativity; Nobel Prize Recipient for Physics.

\$5,000 - Marian Anderson - World-Renowned Vocalist (Contralto); first African-American to sing with the Metropolitan Opera.

\$10,000 - Spark Matsunaga - U.S. Senator and Congressman; World War II Hero; obtained redress for survivors of World War II internment camps.*

** The \$200 and \$10,000 denominations will not be available prior to May 1999.*

For More Information

21. Is there information on the Internet about I Bonds?

Yes. Visit our web site on the Internet at: www.savingsbonds.gov. It has information on the new I Bond, as well as general

information about savings bonds, and other Treasury securities. You can request order forms and e-mail questions and comments.

22. What is the Savings Bond Wizard?

The Savings Bond Wizard is a free computer program developed by Treasury's Bureau of the Public Debt. It lets you keep an inventory and an up-to-date record of the current value of your savings bonds (Series EE and I Bonds when available for purchase). You can download the Wizard from our web site: www.savingsbonds.gov.

23. Can I write or call for more information?

For more information write: Bureau of the Public Debt, Savings Bond Operations Office, Parkersburg, WV 26106-1328. To get current rate information on savings bonds, call: 1-800-4US-BOND (1-800-487-2663). You can also get detailed rate information by looking at the United States Savings Bonds/Notes Earnings Report. The Earnings Report is available on our web site (www.savingsbonds.gov), or you can send a post card to the above address.

The official Offering Circular (31 CFR 359) and Regulations Governing I Bonds (31 CFR 360) will be available via our web site before the first day of sale on September 1, 1998, (www.savingsbonds.gov) or you can write to the above Parkersburg, WV address.

Fact Sheet on the Process of Designing the I Bond

- The I Bond honors a diverse group of Americans whose lives and many achievements have enriched our culture and strengthened our Nation.
- The bonds also have a more contemporary look than earlier series, but continue to provide the safety and security that Americans expect from their investment in Treasury securities.
- The Ball Group, Lancaster, Pennsylvania, provided creative development services, including the theme, colors, layout and look of the security. The Ball Group team was led by Marlin Miller, Creative Director.
- Award-winning illustrator and portrait artist Gary Ciccarelli of Dearborn, Michigan, created original portraits of each of the honorees. In addition he created a background vignette reflective of an important part or event in each individual's life. The art was created from photographic reference material provided by the estates of each honoree, or from foundations and museums to which the estates directed the Treasury Department. Mr. Ciccarelli employed a photo-realistic style to create the portraits and backgrounds for each denomination.
- The Ball Group, using the illustrations created by Ciccarelli, then turned over to the Bureau of Engraving & Printing (BEP) the general design and layout. Leonard Buckley, Design Foreman, of BEP, added the border, marker, background and other details to complete the design
- The bonds are being printed by Moore Business Forms, in their Quakertown, Pennsylvania, plant. The color tones are tri-tones and quad tones, and the printing is being done using stochastic methods. The tones were reproduced using diamond screening, a high quality electronic screening process that has counterfeit deterrent qualities.

U.S. SAVINGS BOND PROGRAM HISTORY AT A GLANCE

Treasury introduced the Series A savings bond on March 1, 1935. The savings bond program was conceived to encourage Americans to save money by investing in small denomination U.S. Treasury securities.

President Franklin D. Roosevelt launched the most successful savings program in our history in 1941 by calling on Americans to join him in, "one great partnership." He bought the first Series E Defense Savings Bond on May 1, 1941 as the nation undertook a massive effort to bolster its defenses. When America entered World War II in December 1941 the Series E bond became the War Savings Bond. Americans responded to the call by buying bonds to help finance the war effort. Series E bonds sold for 3/4 their face value or \$18.75 for a \$25 bond. The savings bond campaign effort was bolstered by the support of Hollywood stars who appeared at events all across the country. For the first time Americans could buy bonds where they worked with introduction of the payroll savings plan. Americans bought some \$54 billion worth of bonds to help ensure victory.

The payroll savings plan became a popular way for people to save for their retirement, their children's education or to set money aside for unforeseen needs. Because of savings bonds popularity as a long-term investment, Treasury granted a series of extended maturity periods which let investors earn interest for as long as 40 years. In 1952, Treasury introduced the Series H bond, a current income bond, which paid interest every six months. Series H bonds were available in exchange for Series E bonds or could be purchased for cash. In 1967, Treasury introduced U.S. Savings Notes or Freedom Shares which were sold in combination with Series E bonds.

The Series EE bond replaced the venerable Series E bond in 1980. The new bond sold for half its face value and became available in denominations from \$50 through \$10,000. The Series HH, current income bond was introduced to replace the Series H bond at the same time.

Improving the savings bonds program is one part of a broad effort by the Clinton Administration to encourage Americans to save more. During the Clinton Administration, Treasury has taken steps to make savings bonds a more attractive and competitive investment for all Americans. In 1997, Treasury began to calculate the savings bond rate using a formula which raised the rate. Treasury also changed the accrual basis on Series EE bonds from a semiannual basis to a monthly basis. Currently, EE bonds pay 90 percent of the 5-year Treasury securities yields and have tax advantages. Savings bonds remain a popular way for all Americans to save. Some 55 million Americans own more than 800 million savings bonds worth \$185 billion.

In keeping with the Clinton Administration's effort to encourage greater savings, this year, Treasury is introducing the inflation-indexed savings bond (Series I) which is patterned after Treasury's successful marketable inflation-indexed securities which were introduced in 1997. The Series I bond will protect hard-earned savings from inflation and, with denominations as low as \$50, the new Series I bond will put an inflation-protected investment within reach of all Americans.

HONORED GUESTS PARTICIPATING IN THE I BOND ANNOUNCEMENT CEREMONY

<u>DENOMINATION</u>	<u>PORTRAIT</u>	<u>REPRESENTATIVE</u>
\$50	Helen Keller Noted author and advocate for individuals with disabilities. Responsible for Braille becoming the standard for printed communication with the blind.	Keller Johnson Great grand-niece of Helen Keller and is associated with the American Foundation for the Blind.
\$75	Dr. Hector P. Garcia Leading advocate for Mexican-American veterans' rights, an activist in the Latino civil rights movement and the founder of the American GI forum.	Mrs. Wanda Garcia Widow of the late Dr. Hector P. Garcia.
\$100	Dr. Martin Luther King, Jr. One of the nation's most prominent civil rights leader. Minister and Nobel Peace Prize recipient.	Mr. Walter E. Fauntroy Reverend Congressman Walter Fauntroy was Dr. King's Director of the Washington Bureau of the Southern Christian Leadership Conference, serving as liaison to the White House, the Department of Justice and Congress.
\$200	Chief Joseph Nez Perce Chief. One of the greatest Native American leaders.	Samuel N. Penney Chairman of Nez Perce Tribal Executive Committee
\$500	General George C. Marshall U.S. Army Chief of Staff during World War II, Secretary of State and Defense, author of the Marshall plan and Nobel Peace Prize recipient.	Albert J. Beveridge, III President of George C. Marshall Foundation.
\$1,000	Albert Einstein Physicist and creator of the Theory of Relativity. Nobel Prize recipient for Physics.	Mr. Yitzchak Oren Minister for Congressional Affairs, Israeli Embassy.
\$5,000	Marian Anderson World renowned vocalist and the first African American to sing with the Metropolitan Opera.	James DePreist Nephew of late Marian Anderson, and conductor of the Portland Symphony.
\$10,000	Spark Matsunaga Former Senator, Congressman, and World War II hero.	Mrs. Helene Matsunaga Widow of late Spark Matsunaga.

7 new members
in June.

Chika Amos
for Gephhardt.

Gore to Clinton:
Drop Deed.



Eli G. Attie @ OVP
07/07/98 08:49:32 PM

Record Type: Record

To: See the distribution list at the bottom of this message

cc:

Subject: VP inflation-indexed bonds announcement

Let event of
w people
is a joke.

**Draft Remarks for Vice President Gore
Inflation-Protection Savings Bonds Announcement
Wednesday, July 8, 1998**

There are several buildings in Washington with rooms that reflect the substance of the agency that house them. As we see so magnificently today, the Treasury Department has the Cash Room. The Defense Department has the Situation Room. NASA has the control room. But I want to be clear on one thing: Statuary Hall is a room in the United States Capitol, not the Office of Vice President.

It's my pleasure to stand here today with Secretary Rubin and Deputy Secretary Summers -- two key members of the President's economic team -- to announce a new way to build on today's prosperity, by helping families save and invest for the future. Five and a half years ago -- under President Clinton's leadership -- we put in place a new economic strategy, merging elements that had never before been combined: strict fiscal discipline, targeted investments in the future, and opening new markets for our products. Five and a half years later, we all see the results: over 16 million new jobs, the lowest unemployment in 28 years, the smallest national government in 35 years -- and we're about to have the first balanced budget in 29 years. No wonder consumer confidence is at a 30-year high. There's never been a better time to invest in America -- but we want to make it even safer for families to invest.

We are proud of the fact that we have the lowest inflation in three decades. But we remember well the days when inflation was high, and we know how that can deter investment. And while our national savings rate is rising, our rate of personal savings is not as high as it should be. That is why we are taking the next step to help families save and invest more for the future. Today, I am pleased to announce that for the very first time, families will be able to buy new inflation-protected savings bonds. ~~For the very first time, families will be able to save money without losing one penny to inflation.~~ These bonds will help middle-class families save for retirement and invest in their children's education without ever having to worry that their savings will be undercut by future inflation.

The message of today is clear: If you want to start saving for a home, these bonds will enable you to start now without worrying about future price increases. If you want to save for

HONORED GUESTS PARTICIPATING IN THE I BOND ANNOUNCEMENT CEREMONY

<u>DENOMINATION</u>	<u>PORTRAIT</u>	<u>REPRESENTATIVE</u>
\$50	Helen Keller Noted author and advocate for individuals with disabilities. Responsible for Braille becoming the standard for printed communication with the blind.	Keller Johnson Great grand-niece of Helen Keller and is associated with the American Foundation for the Blind.
\$75	Dr. Hector P. Garcia Leading advocate for Mexican-American veterans' rights, an activist in the Latino civil rights movement and the founder of the American GI forum.	Mrs. Wanda Garcia Widow of the late Dr. Hector P. Garcia.
\$100	Dr. Martin Luther King, Jr. One of the nation's most prominent civil rights leader. Minister and Nobel Peace Prize recipient.	Mr. Walter E. Fauntroy Reverend Congressman Walter Fauntroy was Dr. King's Director of the Washington Bureau of the Southern Christian Leadership Conference, serving as liaison to the White House, the Department of Justice and Congress.
\$200	Chief Joseph Nez Perce Chief. One of the greatest Native American leaders.	Samuel N. Penney Chairman of Nez Perce Tribal Executive Committee
\$500	General George C. Marshall U.S. Army Chief of Staff during World War II, Secretary of State and Defense, author of the Marshall plan and Nobel Peace Prize recipient.	Albert J. Beveridge, III President of George C. Marshall Foundation.
\$1,000	Albert Einstein Physicist and creator of the Theory of Relativity. Nobel Prize recipient for Physics.	Mr. Yitzchak Oren Minister for Congressional Affairs, Israeli Embassy.
\$5,000	Marian Anderson World renowned vocalist and the first African American to sing with the Metropolitan Opera.	James DePreist Nephew of late Marian Anderson, and conductor of the Portland Symphony.
\$10,000	Spark Matsunaga Former Senator, Congressman, and World War II hero.	Mrs. Helene Matsunaga Widow of late Spark Matsunaga.

FAX TRANSMISSION

CENTER ON BUDGET AND POLICY PRIORITIES

820 First Street, NE Suite 510

Washington, DC 20002

202-408-1080

Fax: 202-408-1056

wancheck@center.cbpp.org

To: John Arszag

Date: September 23, 1998

Fax #: 456-2223

Pages: 3, including this cover sheet.

From: John Wancheck

Subject: Earned Income Credit Recipient

COMMENTS: Attached is a summary, using last year's numbers, which we did in the midst of the Child Tax Credit legislative fight. Also attached is a page from the Democratic Policy Committee's July 1997 "Faces of America" piece highlighting working families who need tax relief. (There was also a family from Fairfax in this report who Jodi Grant might have a lead to.)

I told Lashawn that you would call her directly if interested and would make all arrangements with her.

Lashawn Buckmon
Washington, DC
home 202-529-3664

Ms. Buckman is an administrative assistant at NIH (previously at Georgetown Hospital for six years). She received the EITC for work in 1997. Her income in 1997 was about \$25,000. A single mother, she's raising two children, ages three and seven. Her income tax in 1997 before any credits are considered would be \$1,650. She pays \$486 per month for child care, and is eligible for a Dependent Care Tax Credit of \$1,056, which reduces her income tax liability to \$594.

Under current law, the family's tax bill equals \$1,603 (counting only an income tax liability of \$594 and \$1,591 for the employee share of payroll tax) after her EITC of \$903 is subtracted. Under the 1995 Republican budget bill, this family would have received a child tax credit of \$594. But under the proposed House plan, since the family's EITC exceeds its income tax, the family would not receive *any* child tax credit to help offset its tax bill. The family would receive a child tax credit of \$143 under the Senate plan. However, under the Clinton plan, the Buckman family would receive a credit of \$1,000, because the family's EITC is less than the employee share of payroll tax. (\$1000 = \$594 income tax liability + \$406 from the difference between the EITC and payroll tax).

How the Proposed Change Would Affect a Family of Three Earning \$25,000					
Proposal	Pre-Tax Income	Income Tax	Employee Share of Payroll Tax	EITC	Child Tax Credit
Republican Budget Reconciliation Bill (1995) and S. 2 (1997)	\$25,000	\$594	\$1,913	-\$903	-\$594
House version of child credit	\$25,000	\$594	\$1,913	-\$903	\$0

If the *employer's* share of payroll tax is also treated as taxes that the employee pays, as most economists would recommend, the family's federal tax bill rises to \$3,516.

HOUSE BILL - zero credit

SENATE BILL - \$143

WHITE HOUSE PLAN - \$1,000



Lashawn Buckman lives in Washington, DC. She works as an administrative assistant at Georgetown University Hospital. She expects to earn \$25,000 this year. Ms. Buckman has two children, ages 3 and 7. She pays \$3,241 in income and payroll taxes a year.

- Under the **House-passed** bill, Ms. Buckman would receive: **\$0**
- Under the **Senate-passed** bill, Ms. Buckman would receive: **\$143**
- ✓ Under the **President's** plan, Ms. Buckman would receive: **\$1,000**

Economic Trends

BY GENE KORETZ

A TAX CREDIT THAT DELIVERS

Efficient aid for the working poor

Ronald Reagan called it the best anti-poverty and job creation measure to come out of Congress, and Clinton Administration officials cite its expansion as one of their major achievements. Today the earned income tax credit (EITC) benefits some 19 million working families at a cost of \$28 billion.

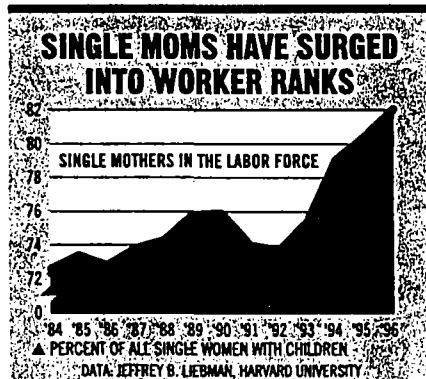
Is it worth it? Advocates claim the credit—which provides cash to low-wage earners with children—reduces poverty and income inequality without the hefty

participation by single women without children (who qualify for a negligible tax credit if they work, compared with as much as \$3,656 for single working moms) has actually declined.

One concern about the EITC is that many low-wage workers face a huge marginal tax of more than 50% as it is phased out at earnings levels over \$12,000—that is, the combined effects of losing the credit and paying payroll and income taxes mean that workers may take home less than half of each additional dollar earned. But while economic theory suggests that such workers will reduce their work effort when they reach the phaseout range, Liebman finds no evidence this actually occurs. A possible explanation: Many beneficiaries have little awareness of how the tax credit works.

What of charges that the tax credit program is plagued by fraud? Liebman estimates that rule changes and closer monitoring by the Internal Revenue Service have reduced the incidence of noncompliance to a level comparable to that found in the income-tax system in general. Moreover, most ineligible recipients have low incomes, and close to half of erroneous claims appear inadvertent rather than fraudulent.

Thus, Liebman concludes, the EITC seems a reasonably effective way to accomplish several goals: reducing earnings inequality, rewarding low-income workers, and—perhaps most important in light of welfare reform—encouraging welfare recipients to join the workforce.



administrative costs or work disincentive effects of welfare. Businesses like it because it rewards workers without raising employer costs and thus encourages both job-seeking and hiring. But fiscal critics worry about its high cost and susceptibility to fraud.

In a recent study, Harvard University economist Jeffrey B. Liebman assesses the EITC's track record. Because it is keyed to earnings, and many poor households have had little or no earnings or fail to apply, he finds that the credit has helped more near-poor families than families under the poverty line. In the process, it has mitigated the effect of rising income inequality in the economy, offsetting nearly a third of the 14% drop in income share suffered by the lowest fifth of households with children over the past two decades.

Liebman also finds that the tax credit has substantially boosted work activity by single mothers. Their labor-force participation rate has risen by about 10 percentage points since 1984 (chart), mirroring almost exactly a decline in the number of such women on welfare who do no work. Meanwhile, labor-force

higher than the levels reached in four of the past five recessions.

This has occurred, says Paulsen, because much of the current expansion has been fueled by investment in capacity, with consumption assuming a smaller role than in past upturns. As a result, domestic supply is now at a record level relative to demand—a state reached previously only when demand evaporated in the depths of recessions.

The upshot, Paulsen argues, is that a recession today would exert far more severe downward pressure on prices than in past contractions, when the emergence of excess supply acted simply to cool inflation. "What the Federal Reserve should be thinking about as it considers easing," he says, "is the unprecedented risk of escalating deflation if the economy slips into recession."

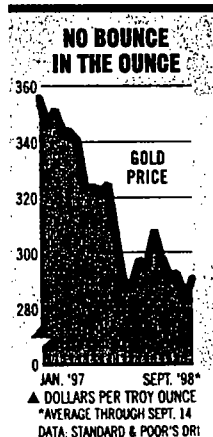
THE IFFY OUTLOOK FOR GOLD

Demand for gold jewelry is slowing

Once upon a time, investors turned to gold to hedge inflation or currency risks. No more. Rather, current turbulence in global financial markets may herald further weakness in gold prices, warns Kevin A. Crisp of J.P. Morgan Securities in London.

The reason: With central banks selling gold reserves in recent years and inflationary pressures waning, consumer demand for gold jewelry—particularly in developing Asia—had emerged as perhaps the major prop of gold prices in dollar terms. Now, however, deep recessions in Asia have inspired distress selling and undercut consumer purchases, even as the collapse of many Asian currencies has led to prohibitively high prices in local markets.

In light of growing woes in the developing world and an anticipated global slowdown, the prospects for continued rapid growth in private-sector demand for gold jewelry look iffy. Add the lack of investor interest in the metal as an inflation hedge, and the possibility that prices could test 20-year lows by yearend looks decidedly realistic.



DEFLATION: IS THE FED PREPARED?

Prices may plummet in a recession

With consumer prices up less than 2% over the past year, it's hardly news that we now live in a relatively inflation-free environment. What many people seem to be ignoring, however, is the potential for significant deflation if a recession hits, says James W. Paulsen, chief investment officer of Norwest Investment Management Inc.

Paulsen believes that prices have been held down not only by excess capacity overseas but by unusually robust capacity expansion in the U.S. To show how strongly domestic supply has grown relative to demand, he divides the manufacturing capacity index by real GDP, which is a proxy for basic demand. Whereas in previous business cycles this ratio has risen only during downturns, it has taken off in recent years and is now

January 8, 1998

NOTE FOR GENE SPERLING

From: Chuck Marr

Re: EITC Briefing Book

Here is material on the EITC. The first tab is a summary two-pager that includes key positive EITC facts, a summary of our recent compliance efforts, and talking point that puts the EITC error problem in context of overall tax gap. In addition to this summary the book includes, a Treasury walkthrough of the EITC (which Treasury will likely update soon), a Rubin letter to the Congressional leadership and a Scholz letter to GAO on our compliance efforts, and a Holtzblatt memo on tax gap.

EITC

A Clinton Principle - Americans who work hard full-time should not have to raise their families in poverty.

- In 1997, the EITC provided a tax credit to about 19 million working people and their families (making up to \$29,290). The average credit was about \$1,500.
- The Census Bureau reports that the EITC lifted 4.3 million persons out of poverty in 1996.
- Rewards work and offsets other federal taxes - about 85 percent of EITC payments offset income, social security, and other federal taxes.

The Administration has been extremely aggressive in addressing the EITC error rate. The Tax Relief Act of 1997 includes six legislative provisions we urged the Congress to adopt and that will save \$5 billion over the next decade, including:

- 1) The Treasury Department will have access to an expanded Federal Case Registry of Child Support Orders -- to help the IRS identify erroneous EITC claims by parents who do not live with their children. This is important because 39 percent of EITC 1994 overclaims were from parents who did live with children for requisite amount of time.
- 2) The Social Security Administration will be required to obtain SSNs of parents of minor children when applications for SSNs are made for these children. The IRS will have access to this data.
- 3) Paid preparers will be required to fulfill due diligence requirements when preparing EITC claims -- subject to a \$100 per return penalty.
- 4) Fraudulent EITC claimants will be ineligible for the EITC for ten years. People who erroneously claim credit due to reckless or intentional disregard of rules and regulations will be denied EITC eligibility for the subsequent two years.
- 5) A taxpayer denied the EITC as a result deficiency procedures will be ineligible in future years unless further evidence of eligibility is furnished by the taxpayer.
- 6) Unemployment benefits and means-tested public assistance will no longer be fully exempted from levy for any purpose -- Up to 15 percent of these benefits will be subject to continuous levy.

While we take this issue very seriously, and have long championed addressing it, our friends on the Republican side's singular focus on this one small area of the tax code seems to indicate an unfair double standard. Let's put this in perspective:

- The IRS estimates that individuals fail to pay about \$95 billion in income taxes that are owed each year (1992 last year of data). Over 40 percent of this stems from under reporting of business income, including self employed people and partnerships that are not paying the taxes they owe. That's a big part of the tax gap. On the other hand, less than 10 percent of this tax gap stems from compliance with all credits in the tax code, of which the EITC is just one. EITC non-compliance is therefore just a tiny sliver of the overall non-compliance problem.

Benefits of providing the EITC through the tax code that are often ignored:

- The EITC is a non-bureaucratic way to reward work. It is a critical pro-work anti-poverty policy that required new bureaucracy of its own. Almost 95 percent of people who receive the EITC would have to file an individual tax return anyway. Consider it cost \$3.7 billion to administer the Food Stamp program in FY95. The entire IRS budget was \$7.6 billion in FY95.

(January 8, 1998)

Earned Income Tax Credit Rewarding Working Families

GENERAL DESCRIPTION AND GOALS OF EITC

Earned Income Tax Credit: General Description

- The earned income tax credit (EITC) is a refundable tax credit for working families with low incomes.
- For every dollar a low-income worker earns up to a limit, between 8 and 40 cents are provided as a tax credit. Above a given level, the size of the tax credit is gradually reduced.
- Because the credit is refundable, individuals can receive the full amount to which they are entitled even if the amount exceeds the taxes they owe.
- In 1997, the EITC is providing a tax credit averaging \$1,510 for nearly 19 million workers and their families. Working families with earnings of up to \$29,290 per year may be eligible for the EITC.

Two Goals of the EITC

- **Encourage Families To Move From Welfare to Work** by making work pay.
 - **Reward Work for Working Families** so parents who work full-time do not have to raise their children in poverty -- and families with modest means do not suffer from eroding incomes.
- By providing an offset against other Federal taxes, the EITC increases disposable income for workers and their families.

Moving Families From Welfare To Work

- Social Security taxes and various means-tested benefits create economic disincentives for welfare recipients to move to work. For each additional dollar a worker earns, benefits decline and payroll taxes increase.
 - The EITC offsets these disincentives with a strong incentive to work. About 85 percent of EITC payments offsets the individual income, social security, and other Federal taxes borne by families receiving the credit.
- The EITC encourages families to work two ways.
 - The EITC is only available to working families. If you don't work, you don't get the EITC.
 - At the lowest income levels, the EITC grows with each dollar of earnings. For people with very little income, more work means more benefits from the EITC.

Rewarding America's Working Families

- People who work hard and play by the rules should be rewarded for their efforts.
 - Parents who work full-time for an entire year should not have to raise their children in poverty.
 - Parents with moderate incomes should not see their standards of living decline.
- The condition of low- and moderate-income families has deteriorated since 1979.
 - Payroll taxes increased five times between 1983 and 1990.
 - In the early 1970s, most states provided AFDC benefits as a wage supplement to a mother with two children whose earnings equaled 75 percent of the poverty level. By the mid-nineties, only three states provided comparable benefits.
 - The poverty rate for families with children grew by nearly half from 1979 to 1993. Even after two years of steady declines in the poverty rate, 16.3 percent of families with children still lived in poverty in 1995.
 - Between 1979 and 1992, the earnings of a male without a high school degree declined by more than 23 percent in real terms. Among male workers with a high school degree, real earnings declined by 17 percent over this period.
- The EITC rewards work. But there is still more to do to ensure that full-time workers do not raise their children in poverty.

Providing the EITC Through the Tax System

- The EITC is a non-bureaucratic way to reward work effort. There are no middlemen or service providers. There are no long lines at government offices. There is no need to take valuable time off from work in order to apply for the credit. The tax refund is provided by the IRS directly to the working families.
- EITC claimants are taxpayers. If the EITC did not exist, almost 95 percent of EITC filers would still file an individual income tax return (in addition to paying payroll and excise taxes), and the IRS would still have to process their returns and verify much of the same information regarding their filing status, number of children, and income.
- Participation in the EITC tends to be higher than many other assistance programs targeted to low-income families. In 1990, 80 to 86 percent of those eligible received the credit. This high participation rate is striking when compared to the food stamp participation rate of 54 to 66 percent.
- Because most EITC claimants would be filing a tax return even if the credit did not exist, the direct budgetary costs of administering the EITC are significantly lower than if the credit were provided through another means. In FY 1995, the food stamp program cost \$3.7 billion to administer, while AFDC administrative costs were an additional \$3.5 billion -- nearly 14 percent of the combined costs of these two programs. By way of comparison, the entire IRS budget in FY 1995 was \$7.6 billion, almost the combined total administrative budgets of the AFDC and food stamp programs.

CURRENT LAW

The EITC After OBRA 1993

- In February 1993, the Clinton Administration made several proposals to expand and simplify the EITC. With certain modifications, Congress enacted these proposals as part of the Omnibus Budget Reconciliation Act of 1993 (OBRA 1993).
- For every dollar a very low-income working parent with one child earns, the EITC was increased from 23 cents to 34 cents.
- For every dollar a very low-income working parent with two or more children earns, the EITC was increased from 25 cents to 40 cents.
 - The maximum credit was increased by nearly \$1,500.
 - Eligibility for the credit was extended to families with two or more children that have incomes of up to \$29,290 (or about \$3,500 above the prior law level).¹
- A small EITC, designed to help offset the employee portion of payroll taxes, was extended for the first time to very low-wage workers without qualifying children.
- OBRA 1993 eliminated two complex supplemental credits for health insurance coverage and for taxpayers with children under the age of one.

¹ Some critics of the program have argued that the EITC should not be available to families with incomes of \$29,000. But if the income thresholds had not been changed in 1993, the increase in the maximum credit would have resulted in a phase-out rate of 30 percent, raising the marginal tax rate much too high. By modifying the income thresholds slightly, the EITC phase-out rate for a family with two or more children was increased from 17.86 percent to 21.06 percent. Moreover, the income cut-off is far less than the median income for a family of four. In 1997, the median income for a family of four will be over \$52,500.

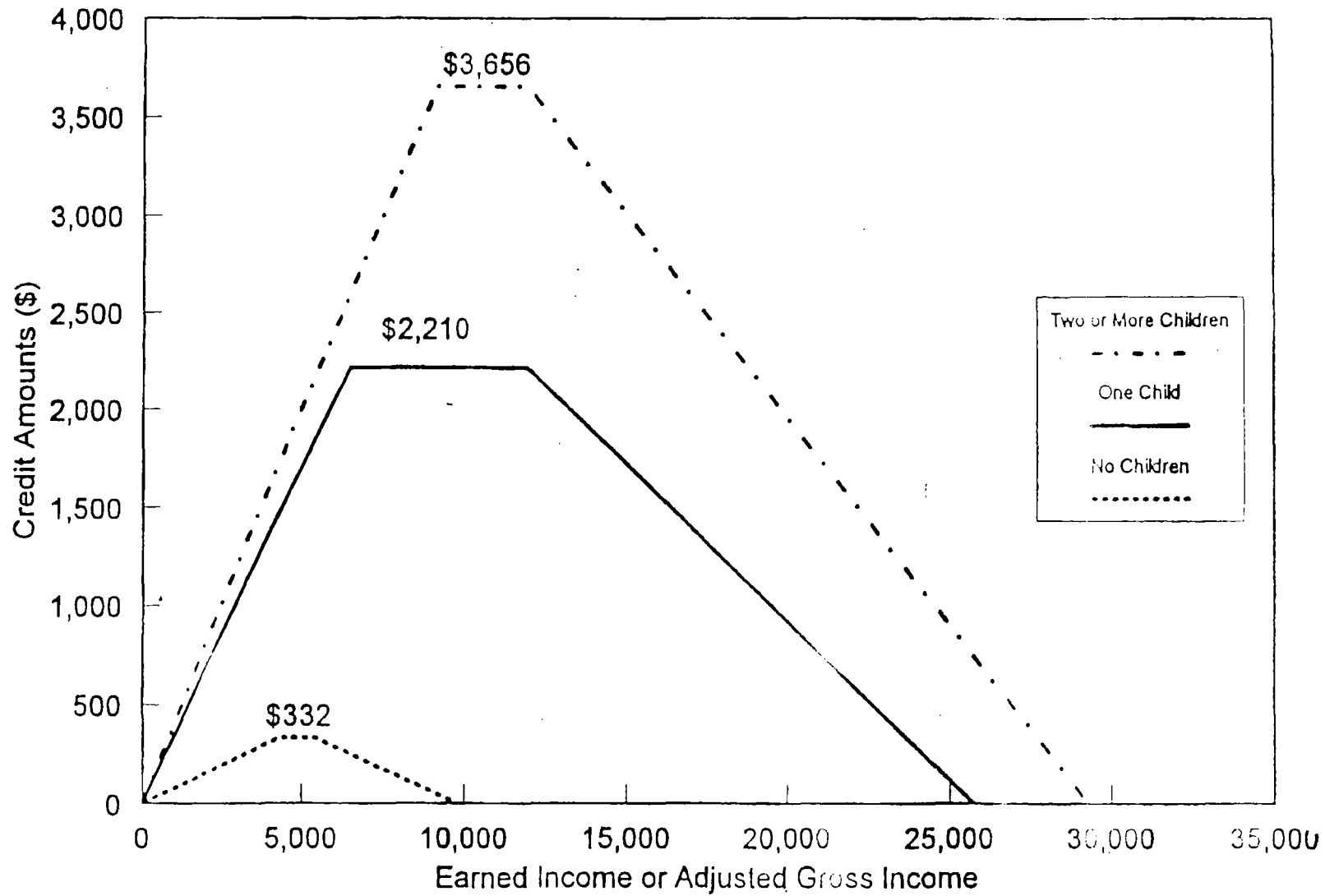
OBRA 1993 Achieved Goals of Program

- OBRA 1993 supported welfare over work by bolstering the incomes of families moving from welfare to work.
 - From every added dollar a low-income family earns, payroll taxes take 15.3 cents while Food Stamp benefits decline by 24 cents. For a low-wage family with two children, the EITC fully offsets these effects by providing a 40 cent credit for every dollar earned.
- OBRA 1993 rewarded work for working families by moving toward the goal that a full-time worker should not live in poverty if he or she works throughout the year.
 - Since the minimum wage did not keep pace with inflation, the job was not completed with the enactment of OBRA 1993. The recent increase in the minimum wage moves us much closer to this goal.
- In addition, OBRA 1993 simplified the EITC by repealing the two complex supplemental credits for health insurance coverage and for taxpayers with children under the age of one.

Extending the EITC to Low-Income Workers Who Do Not Reside with Qualifying Children

- OBRA 1993 extended a small earned income tax credit (EITC) to very low-wage workers who do not reside with children.
 - To be eligible for this credit, a worker must have adjusted gross income of less than \$9,770 in 1997.
 - The credit is equal to 7.65 percent of earned income up to a maximum credit of \$332 in 1997. It was designed to help offset the work disincentive effects of the social security tax rate (7.65 percent for employees and employers, each).
 - This provision reduces taxes, on average, by \$186 for 3.4 million workers in 1997.
- To be eligible for the EITC without children in residence, workers must be over age 24 and below age 65. In 1994, about three-quarters of recipients were under age 50 -- a group adversely affected by the food stamp reductions in last year's welfare reform bill.
- In 1994, nearly half of the claimants for this credit had adjusted gross income of less than \$5,000. On average, their wage income was \$4,800. Despite their low income, only about 8 percent reported receipt of unemployment benefits -- possibly because many may have worked in jobs which were not covered under FUTA.

The Earned Income Tax Credit, 1997



Earned Income Tax Credit Parameters
1997

	Credit Rate	Beginning Point	<u>Plateau</u> End Point	Maximum Credit	Phase-out Rate	Income Cut-off
<i>Current Law</i>						
Families with one child	34.0%	\$6,500	\$11,930	\$2,210	15.98%	\$25,760
Families with two or more children	40.0%	\$9,140	\$11,930	\$3,656	21.06%	\$29,290
Workers without children	7.65%	\$4,340	\$5,430	\$332	7.65%	\$9,770

Department of the Treasury
Office of Tax Analysis

December 24, 1996

Disqualified Income Amount: \$2,250

EITC Growth Rate

- Some have claimed that EITC growth is "explosive" or "out of control."
 - The EITC is growing as it was designed to grow because of expansions signed into law by Presidents Clinton, Bush, and Reagan. As soon as those expansions are fully phased in, the rapid growth in the EITC will cease.
- After 1997, EITC costs will grow in tandem with inflation and population growth.

Helping to Move Families from Welfare-to-Work

- The EITC helps workers stay in the labor force and off of welfare by increasing their take-home pay. About 18.9 million workers are expected to claim the EITC for tax year 1997. They will receive an average credit of \$1,511.
 - About 15 million of these claims will be for workers living with children, who will receive an average credit of \$1,805.
- Dickert, Hauser, and Scholz (1995) found that the EITC could result in an increase in labor supply of 19.9 million hours in 1996 relative to 1993 law and induce 516,000 families to move from welfare to the workforce.
- The number of individuals receiving welfare fell by 20 percent from January 1993 to January 1997 -- the largest decline in over 50 years. According to the Council of Economic Advisers, this dramatic decline is due to the economic expansion, statewide welfare reform waivers, and other policies, including the 1990 and 1993 expansions of the EITC.

EITC Reduces Poverty

- The Census Bureau reports that the EITC lifted 4.3 million persons out of poverty in 1996.
- The EITC helps children and single mothers out of poverty.
 - Among the 4.3 million persons lifted out of poverty by the EITC, over half -- 2.3 million -- were children under the age of 18.
 - Nearly 1.7 million persons, living in families headed by an unmarried female, were removed from poverty as a consequence of the EITC.
- Minority working families benefit from the EITC.
 - The EITC removed about 1.1 million African-Americans and over 1.3 million persons of Hispanic origin from poverty in 1996.

August 15, 1997

The Honorable Newt Gingrich
Speaker of the House
United States House of Representatives
Washington, D.C. 20515

Dear Newt:

During the recent negotiations on the budget, we discussed how to achieve earned income tax credit (EITC) noncompliance savings of \$5 billion over the next decade. I am confident that the EITC provisions enacted in the "Taxpayer Relief Act of 1997," in combination with sufficient budgetary resources to support IRS administrative actions, will meet this target.

The 1997 Act contains six legislative provisions that will improve EITC compliance by reducing the risk of unintentional errors by law-abiding taxpayers and their preparers, reducing abuse of the credit, improving the IRS's ability to detect errors before EITC refunds are paid out, and imposing new, more effective penalties on EITC claimants and preparers. Under the Act:

- The Treasury Department will have access to an expanded Federal Case Registry of Child Support Orders, which will allow the IRS to better identify erroneous EITC claims by parents who do not live with their children. This provision is particularly important because 39 percent of EITC overclaims in 1994 were caused by taxpayers who claimed children who did not reside with them for the requisite amount of time during the year.
- The Social Security Administration will be required to obtain the social security numbers of parents of minor children when applications for social security numbers are made for these children. The IRS will also have access to this information, better enabling the agency to identify erroneous EITC claims by taxpayers who are unrelated to the children for whom they are claiming the credit.
- Paid preparers will be required to fulfill certain due diligence requirements when preparing EITC claims for taxpayers. Failure to fulfill these due diligence requirements will subject preparers to a \$100 penalty per return.
- Any person who fraudulently claims the EITC will be ineligible to claim the EITC for a subsequent period of ten years. In addition, any person who erroneously claims the credit, and such error is due to the reckless or intentional disregard of rules or regulations, will be denied eligibility for the EITC for two subsequent years.

- A taxpayer who has been denied the EITC as a result of deficiency procedures will be ineligible to claim the credit in subsequent years unless he or she provides further evidence of his or her eligibility for the credit.
- Unemployment benefits and means-tested public assistance will no longer be fully exempted from levy for any purpose. Up to 15 percent of these benefits will be subject to continuous levy.

While these measures should significantly reduce EITC noncompliance, the IRS must also have sufficient resources to use these new capabilities and procedures effectively. In the Balanced Budget Act of 1997, Congress recognized the importance of ensuring that the IRS has sufficient resources to fund EITC compliance initiatives. As you know, the Balanced Budget Act of 1997 contains a provision that authorizes adjustment of the discretionary caps for an EITC compliance initiative by \$138 million in FY 1998, \$143 million in FY 1999, \$144 million in FY 2000, \$145 million in FY 2001, and \$146 million in FY 2002. Appropriations actions consistent with this cap adjustment authority will substantially improve EITC compliance.

The EITC provisions in the Taxpayer Relief Act of 1997 and the Balanced Budget Act of 1997, in conjunction with sufficient budgetary resources to support IRS administrative actions, are critical steps toward reducing EITC noncompliance by at least \$5 billion over the next decade. We look forward to continuing to work with the Congress to ensure that these EITC savings are realized.

Sincerely,

Robert E. Rubin

cc: The Honorable Thomas Daschle
The Honorable Richard Gephardt



DEPARTMENT OF THE TREASURY
WASHINGTON
October 28, 1997

Ms. Lynda D. Willis
Director, Tax Policy and Administration Issues
United States General Accounting Office
Washington D.C. 20548

Dear Ms. Willis,

I am responding to your letter of July 23, in which you requested (1) data on the causes and extent of earned income tax credit (EITC) noncompliance that drive Treasury's proposals to improve EITC compliance; (2) IRS implementation procedures and cost estimates for each compliance effort; and (3) analysis of opportunity costs and other trade-offs associated with each proposal. We provided you with some of this information in a meeting on June 3, when I invited you and members of your staff to Treasury to discuss the rationale for the EITC compliance proposals. I am pleased to have the opportunity to provide you with more detailed information.

Recent Legislative History -- In April 1997, the Administration announced six legislative proposals and two administrative actions to improve EITC compliance. The legislative proposals were:

1. Paid preparers would be required to fulfill certain due diligence requirements when preparing EITC claims for taxpayers. Preparers who fail to fulfill these due diligence requirements would be subject to penalties ranging from \$50 to the full amount of the overclaim.
2. Any person who fraudulently claims the EITC would be ineligible to claim the EITC for a subsequent period of ten years. In addition, any person who erroneously claims the credit, if such error is due to the reckless or intentional disregard of rules or regulations, would be denied eligibility for the EITC for two subsequent years.
3. A taxpayer who has been denied the EITC as a result of deficiency procedures would be ineligible to claim the credit in subsequent years unless he or she provides further evidence of his or her eligibility for the credit.
4. Unemployment benefits and means-tested public assistance would no longer be fully exempted from levy for any purpose. Up to 15 percent of these benefits would be subject to levy.
5. The definition of an EITC qualifying child would be clarified. Under the proposal, a

foster child would be defined to be either the taxpayer's niece, nephew, sibling, or any other child placed in the taxpayer's home by the courts or a state agency.

6. Demonstration projects would be established in four states to test alternative ways of providing the EITC throughout the year. States would be required (subject to penalties) to verify eligibility for the EITC before paying out credit. Effects on advance payment participation and compliance would be studied by Treasury.

The two administrative actions were:

7. The IRS announced that it would develop new profiles of potentially erroneous EITC claimants to select for pre-refund audits during the 1998 filing season and earmark substantial resources for this intensified compliance effort.
8. To improve access to free taxpayer assistance and electronic filing, the Treasury Department contacted businesses and tax professional organizations to make sure that they are aware of the need for volunteers and computers at these sites.

With some modification, the first four of the six legislative proposals were enacted in the Taxpayer Relief Act (TRA) of 1997.¹ In addition, the TRA 1997 also included two other provisions, which had been developed in the intervening months by the Administration in consultation with Congress. These provisions are:

9. The Treasury Department will have access to an expanded Federal Case Registry of Child Support Orders, which will allow the IRS to better identify erroneous EITC claims by non-custodial parents. The Registry will include the social security numbers of children for whom child support is owed, as well as the social security numbers of the persons owing or receiving child support.
10. The Social Security Administration will be required to obtain the social security numbers of parents of minor children, when they apply for their own social security numbers. The IRS will also have access to this information, better enabling the agency to identify erroneous EITC claims by taxpayers who are unrelated to the children for whom they are claiming the credit.

The Balanced Budget Act (BBA) of 1997 contains another provision, which will help improve EITC compliance.

¹ The effective dates for the taxpayer and preparer penalties and recertification provisions were moved forward by a year. In addition, the penalty for failure to meet the paid preparer due diligence requirements was set at \$100 per return, instead of ranging from \$50 to the full amount of the EITC overclaim.

11. Under the BBA, the discretionary appropriations caps are increased to provide additional funding for EITC compliance. The caps are lifted by \$138 million in FY 1998, \$143 million in FY 1999, \$144 million in FY 2000, \$145 million in FY 2001, and \$146 million in FY 2002.

On September 17, the President submitted to Congress a budget amendment for FY 1998 that contained a request for \$107 million in additional funding for an EITC compliance initiative. A copy of this request is attached. The amendment requested funding to implement the new legislative provisions, as well as to expand IRS administrative actions. In particular, the funding will allow the IRS to expand customer service efforts significantly with dedicated toll-free telephone assistance, to increase community based tax preparation assistance sites, and to develop a marketing and educational campaign. It will also enable the IRS to expand compliance research efforts, to enhance computer capabilities in order to better identify and select questionable EITC claims prior to refund issuance, and to increase examination and criminal investigation staff to focus on questionable EITC activity among both taxpayers and preparers.

Pursuant to this request, the conference report on the fiscal year 1998 Treasury-Postal Appropriations act (HR 2378) includes \$138 million for EITC compliance initiatives. The amount, in excess of the Administration's request of \$107 million for FY 1998, provides funding for existing EITC activities.

Linkage Between Analysis and Proposals -- The Administration's legislative and administrative proposals were derived, in large part, from our analysis of the data from the IRS studies of EITC compliance. This analysis was also informed by our discussions with representatives of the major IRS functions (including Returns Processing, Examination, and Criminal Investigation).

An attachment to this memorandum contains a more detailed discussion of the analysis of the data from the tax year 1994 study. The key findings of our analysis were:

- EITC overclaims were largely associated with three errors: (1) the taxpayer had not resided with a qualifying child for the requisite period of time; (2) the taxpayer had filed as single or head of household when he or she was legally married; and (3) the taxpayer lived with another adult (usually the taxpayer's parent or boyfriend/girlfriend) who could also claim the child as his or her own for EITC purposes and whose adjusted gross income (AGI) was greater than the taxpayer's.
- About half of EITC claimants use paid preparers to help them complete their tax returns. In the aggregate, there was little discernable difference in the returns completed by paid preparers and by taxpayers on their own. However, the EITC compliance study showed that the type of preparer was associated with differences in the overclaim rate; error rates were significantly higher on returns that had been

prepared by local or informal preparers than on those prepared by lawyers, certified public accountants, enrolled agents, or representatives of one of the national tax preparation companies.

- Enforcement actions helped reduce EITC errors. The combination of validation of social security numbers (SSN) and broader mathematical error authority are largely responsible for reducing the EITC overclaim rate from 25.8 percent to 20.7 percent. But, IRS efforts to further reduce EITC overclaims were limited by the lack of independent information to verify eligibility criteria and the large volume of overclaims relative to existing resources.

Based on these findings, our proposals were designed to improve EITC compliance by:

- Providing the IRS with access to data containing information on the residency of the child (#9 in the list at the beginning of the letter). According to the study, \$1.7 billion of EITC overclaims (39 percent of all overclaims) resulted from taxpayers who claimed children who did not meet the residency test. Under current law, the IRS does not have access to independent information regarding the residency of the child, and as a consequence it is difficult for the IRS to efficiently target audit resources. Under TRA 1997, the Federal Child Support Case Registry will be expanded to link data on children with their parents and caretakers who owe or are owed child support (an indicator of custody). We are working with IRS and HHS to ensure that these data will be available to the IRS to be used during processing of returns and can thus be used to identify questionable claims before the refunds are paid out.
- Providing the IRS with access to data containing information on the relationship of the child (#10). According to the 1994 EITC compliance study, over \$500 million of EITC overclaims resulted from taxpayers who claimed children who did not meet the relationship test. Under current law, the IRS does not have access to independent information regarding the relationship of the filer to the child. As a consequence of TRA 1997, the IRS will have access to a file, from the SSA, which will link the social security numbers of parents to the social security numbers of their children. As with the Federal Child Support Case Registry, we are working with IRS and SSA to ensure that these data will be available to the IRS to be used during the processing of returns in order to identify questionable claims before refunds are paid out.
- Reducing the risk of unintentional errors by taxpayers who share living arrangements with other adults, by clarifying the definition of foster children (#5). The third largest source of EITC overclaims was the failure of taxpayers to meet the AGI tiebreaker test. In our analysis of the compliance data, we found that the parent of the child was sometimes deemed ineligible for the EITC because he or she lived with a boyfriend or girlfriend who had higher AGI but was not the biological parent of the child. Such cases represented about 25 percent of overclaim amounts resulting from the failure to

meet the AGI tiebreaker test. Under the Administration's foster child proposal (but not included by Congress in TRA 1997), this situation could not occur because the taxpayer could claim a child for EITC purposes only if he or she was the child's parent, grandparent, sibling, aunt or uncle, legal guardian or foster parent (as established by a state agency).

- Decreasing EITC errors by preparers by establishing and enforcing certain due diligence requirements for tax professionals who prepare returns for EITC claimants and by increasing taxpayer access to trained volunteer preparers (#1 and #8). The study showed a much higher overclaim rate (about 31 percent) on tax returns prepared by local or informal preparers than on those prepared by attorneys, certified public accountants, enrolled agents, or nationally recognized services (about 20 percent). It is possible that this discrepancy reflects the characteristics of the clientele who frequent different types of preparers; for example, taxpayers with less education might be more likely to use local or more informal preparers. It is also possible that the differences in overclaim rates may reflect differences in preparers' practices. Special agents' and examiners' comments, included in the study, suggested that some preparers did not ask taxpayers questions about key EITC eligibility criteria or asked the questions and ignored the taxpayers' answers.

The due diligence proposals and the expansion of access to volunteer preparers were prompted by these observations. We are working with the IRS on the interpretation and implementation of these due diligence requirements. As part of this effort, we have met with representatives of the preparer community in order to learn more about differences among types of preparers, and how the IRS can help ensure that preparers understand the EITC criteria and prepare accurate returns.

- Reducing the IRS workload of potential questionable cases, by requiring recertification if a taxpayer's EITC claim has been denied in a prior year in a deficiency procedure and by denying the credit if an EITC error in a prior year is due to reckless or intentional disregard, or fraud (#2 and #3). The study suggested that there was a significant volume of EITC overclaims remaining, even after taking into account the enactment of new mathematical error procedures in 1996. While we do not know how often "repeat offenders" continue to erroneously claim the EITC, we suspect that the number is significant. Among those with overclaims in the 1994 compliance study, about two-thirds had claimed the EITC in the previous year. (As further detailed in the discussion regarding opportunity costs, this proposal was also prompted by discussions with IRS staff, who indicated the need for new, nontraditional approaches to deter EITC overclaims.)
- Increasing IRS resources for both taxpayer education and enforcement activities (#7, #8, and #11). Both the content and the magnitude of the IRS appropriations request for EITC compliance initiatives were influenced by the findings of the study. The volume

of overclaims remaining after the implementation of mathematical error procedures, suggested the need for additional resources for EITC compliance. The nature of the errors also suggested the need for a multi-faceted approach to noncompliance. IRS officials have testified that the study indicated erroneous EITC claims were about evenly divided between unintentional and intentional taxpayer errors. Because the special agents and examiners were not provided with guidance as to the distinction between an unintentional and intentional error, we do not believe that the study provides conclusive evidence of the extent to which EITC errors were intentional or unintentional. However, the study suggests that both types of errors were present. Taxpayer and preparer education and assistance can help prevent unintentional errors, allowing IRS enforcement actions to be better targeted towards those taxpayers and preparers who intentionally abuse the EITC.

- Enhancing the IRS's ability to collect erroneous overclaims (#4). It is preferable to deny erroneous claims before refunds are paid. However, IRS has indicated that it is not feasible nor efficient to conduct all examinations of questionable EITC claims during the filing season. (In addition, some claimants will have a tax balance due after their EITC is denied in a pre-refund audit.) Therefore the IRS must collect EITC overclaims and tax underpayments from some filers. Under TRA 1997, up to 15 percent of unemployment benefits and means-tested public assistance will be subject to levy, increasing the probability that erroneous claims will be recovered.
- Experimenting with alternative methods of delivering the EITC, to determine if alternative approaches are more efficient than current practices (#6 and #11). The EITC compliance studies, as conducted in the past, have yielded significant information on the sources of EITC noncompliance, but little data on the effectiveness of alternative enforcement strategies. The Administration's advance payment option demonstration project was proposed as a way of testing and evaluating alternative mechanisms of delivering the EITC. Although this proposal was not enacted, we are discussing with the IRS ways in which more emphasis can be placed on researching alternative enforcement activities, which do not require legislative authority.

In combination, we found that the legislative proposals, as enacted under Congress, would increase revenues by \$5.5 billion between FY 1998 and 2007. In addition, the EITC appropriations initiatives that are planned for the next five years would increase revenues by \$2.7 billion between FY 1998 and 2002.

IRS Implementation Procedures and Costs -- During the development of the proposals, the Office of Tax Policy worked closely with the IRS in order to ensure that administrative concerns were identified and addressed. Based on those discussions, I believe that the IRS will be able to implement the new compliance initiatives, if provided with sufficient resources and time. The modification to the discretionary appropriations cap, as well as the language of the FY 1998 budget amendment, anticipates and incorporates sufficient funding for the costs of

implementing these procedures, as well as the costs associated with an expansion of IRS efforts in other EITC compliance areas. The IRS, as the administering agency, is ultimately responsible for the implementation of these provisions, and you should consult with them regarding their procedures and costs.

Congress made one modification to the compliance initiatives, which may affect implementation. Congress accelerated the effective dates on several of the provisions, thus shortening the amount of time that the IRS will have for their implementation. Under the Administration's proposals, the preparer and taxpayer penalties and recertification requirements did not become effective until the 1999 filing season in order to provide the IRS with sufficient time to implement necessary computer programming and tax forms. Under the Taxpayer Relief Act of 1997, these provisions take effect for tax years beginning after December 31, 1996.

Opportunity Costs -- Finally, in your letter, you requested an analysis of the opportunity costs and other trade-offs associated with each proposal. In our view, the proposals should not be evaluated in isolation. They were developed as a comprehensive response to the multi-faceted problem of EITC noncompliance, and we view the effectiveness of the proposals as interdependent. In combination, these actions are aimed at improving taxpayer education and service, as well as compliance, and direct scarce public resources in the most sensible way that we can to reduce EITC error rates.

For example, our approach recognizes that EITC claimants (and many of their preparers) might not have the training or resources to understand eligibility criteria; thus, the legislative and administrative proposals are directed at providing taxpayers with more assistance from the IRS and better trained preparers in the private sector, in order to prevent overclaims from occurring in the first place. Second, the approach also recognizes that the largest EITC overclaims are not due to income reporting errors, which the IRS can generally detect through an extensive independent income reporting system of Forms W-2 and 1099. Rather, the typical overclaims are due to taxpayers misreporting family structure or relationships. Our proposals to expand IRS access to new HHS and SSA data bases will allow the Service to better detect relationship and residency errors, thereby improving the accuracy of audit selection criteria and the productivity of enforcement resources devoted to EITC compliance.

Our discussions with IRS employees also suggested that traditional methods of audits and collections were not effective with respect to EITC claimants. They indicated that it is often difficult and relatively expensive to try to recapture overclaims from low-income taxpayers who have already received their EITC refunds. This is because the disputed amounts are relatively small, yet the taxpayer may not have the resources to repay the IRS. The IRS employees expressed some uncertainty regarding how taxpayers might respond to proposals that increased monetary penalties for erroneous claims, highlighting the need for both new nontraditional approaches (such as denial of eligibility and recertification) as well as

further research regarding the effectiveness of alternative approaches.

In response to these concerns, the plan places greater emphasis on pre-refund audits -- both by increasing the amount of resources applied to pre-refund audits and by providing the IRS with data on relationships and residency to better identify erroneous claims during processing. IRS collection efforts, following post-refund audits, will be improved by the new ability to place liens and levies on public assistance and unemployment compensation. The new recertification and taxpayer penalty provisions were established in order to deter noncompliance, particularly among repeat offenders, but in nontraditional ways that did not encourage taxpayers to inflate refunds in subsequent years in order to repay penalties and liabilities from prior years. These provisions were also viewed as a way of reducing the total volume of overclaims by making it more difficult for taxpayers to repeatedly, erroneously claim the EITC. IRS compliance research will also increase as a consequence of the additional appropriations.

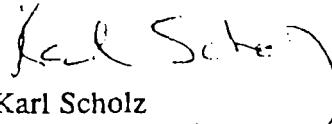
We realize that this enforcement effort devotes additional IRS resources (though perhaps fewer resources than a traditional enforcement effort that has the same outcome) to EITC compliance efforts. While we were mindful of the alternative use of IRS resources when developing our proposals, we determined that we could not afford to relax our efforts to address the EITC compliance problem. The tax year 1994 study found that the EITC net error rate would still have exceeded 20 percent, if the IRS had the authority in 1994 to use mathematical error procedures when taxpayers reported invalid social security numbers. This error rate is significantly lower than the 35.4 percent rate estimated from the last systematic compliance study, conducted for tax year 1988. Still, in our view, and in the view of many in Congress, this error rate is unacceptably high.

In evaluating EITC compliance initiatives against other efforts, the Administration places a significant weight on benefits associated with the EITC. In particular, the Administration is deeply committed to the goals of the EITC, which are to make work pay and to lift working families out of poverty. As we examined the EITC compliance data, we must also consider the findings of other studies. For example, in a paper that appears in a National Bureau of Economic Research publication, *Tax Policy and the Economy*, Stacy Dickert, Scott Hauser, and I found that the recent EITC expansion could result in an increase in labor supply of 19.9 million hours in 1996 relative to 1993 law and reduce participation in the AFDC and food stamp programs by over half a million families. Our findings suggest that recent expansions of the EITC may have played an important part in reducing welfare rolls. The number of individuals receiving welfare fell by 20 percent from January 1993 to January 1997 -- the largest decline in over 50 years. According to a May 1997 report of the Council of Economic Advisers, this dramatic decline is due to the economic expansion, statewide welfare reform waivers, and other policies, including the 1990 and 1993 expansions of the EITC. The most recent data from the Census Bureau also demonstrates the importance of the EITC in combating poverty. In 1996, 4.3 million persons were removed from poverty as a consequence of the EITC.

Reports of high error rates and noncompliance threaten the integrity of the EITC and make it vulnerable to attacks. Over the past several years, some in Congress have proposed deep reductions in the EITC in response to noncompliance. These proposed reductions would have an uncertain effect on EITC compliance rates, but surely would raise taxes on working families who play by the rules. The EITC would be endangered if its compliance problems were not addressed directly, as we have done over the past several years.

I hope that you find this discussion, and the attached materials, helpful in responding to Chairman Archer's request for a study of EITC compliance.

Sincerely,

A handwritten signature in dark ink, appearing to read "Karl Scholz", with a large, sweeping flourish extending from the end of the name.

Karl Scholz
Deputy Assistant Secretary (Tax Policy)

Attachments

Appendix: OTA Analysis of EITC Compliance Study

Summary of IRS Study of EITC Claimants in Tax Year 1994

The Criminal Investigation Division (CID) of the IRS conducted a study of compliance among 2,046 taxpayers who claimed the EITC on tax returns filed and accepted by the IRS between January 15 and April 21, 1995. CID Special Agents visited a random sample of EITC claimants, shortly after they filed their paper or electronic tax returns. Taxpayers (and often their employers, tax return preparers, family members, and neighbors) were interviewed at length and asked to produce verification that they met the EITC eligibility criteria. While the Special Agents made initial judgements about the legitimacy of the EITC claim, these judgements were reviewed -- and sometimes changed -- in subsequent review by Examination staff who had access to other sources of independent information (such as the Forms W-2 and 1099 sent by employers and other payers).

The study found that of the \$17.2 billion claimed in EITC between January and April 1995, \$4.4 billion, or 25.8 percent of total EITC claimed, exceeded the amount to which taxpayers were eligible. The overclaim rate among EITC claimants was slightly higher among paper filers (26.1 percent) than for electronic returns accepted by the IRS (25.3 percent). Noncompliance was found to be much higher among filers who claim EITC qualifying children than for those EITC claimants without qualifying children. Among those who claimed EITC qualifying children, the overclaim rate was 26.1 percent, while the overclaim rate was 15.7 percent for those who did not reside with a qualifying child. IRS enforcement practices, in place during the 1995 filing season, reduced the estimated net overclaim rate from 25.8 percent to 23.5 percent. If the IRS had been able to treat a taxpayer's failure to provide valid social security numbers for EITC qualifying children over the age of one as a mathematical error on 1994 tax returns, the net overclaim rate would have been reduced further, to an estimated 20.7 percent.¹

Further information on the CID study methodology and its general findings are found in "Study of EITC Filers for Tax Year 1994," released by the IRS in April 1997.

Sources of EITC Noncompliance Among Taxpayers

The IRS report did not contain any information regarding the sources of the EITC errors. To better understand the sources of noncompliance, the Office of Tax Analysis conducted its own analysis of the data from the tax year 1994 study. This analysis was largely based on information collected by the IRS special agents and service center examiners during the course of the study.

Methodology: As part of the study, the special agents (who conducted the initial

¹Other steps to improve compliance, such as requiring claimants to provide valid social security numbers for themselves, could not be examined with the existing data.

investigation) were asked to indicate which of the EITC eligibility criteria were met by the filer. The service center examiners (who made the final determination about each case) were asked to indicate which (if any) of the EITC eligibility criteria were failed by the filer:

- For filers claiming qualifying children, the EITC eligibility criteria include residency in the U.S. with a child, relationship to the child, age of the child, filer not a qualifying child of another, AGI tiebreaker, income (including positive earned income as defined for EITC purposes) and filer not married filing separately. The service center questionnaire does not include information on filing status and includes only limited information on income errors. However, the agents' and examiners' corrections to the tax returns can be used to identify income and filing status errors.
- For filers without qualifying children the EITC eligibility criteria include residency in the U.S., age of the filer, filer not the dependent of another, income and filer not married filing separately. However, only the special agents were asked to provide details about errors by filers who did not claim qualifying children. Since the service center examiners made the final determination about the case, the special agents' responses do not provide conclusive guidance as to the nature of the error. The agents' and examiners' corrections to the tax returns can also be used to identify some sources of errors.

OTA provided copies of the questionnaires used by the special agents and the service center examiners, along with other documentation about the study, to GAO staff on July 30.

Additional details about the nature of most types of errors (e.g., the actual amount of time the filer lived with the child, if less than the required period; the true relationship of the filer to the child if the relationship test is failed; and so on) was not obtained. There are codes indicating whether a child who fails the residency test lived within or outside of the U.S. There are also codes indicating whether a child who fails the relationship or residency test is a child or grandchild of the filer (who should have lived with the filer for at least 6 months) or a foster child (who should have lived with the filer for the entire year). However, the wording of this area of the questionnaire (particularly the service center examiner's questionnaire) appears to have confused some of the examiners, and we have not found these more detailed codes to be consistently useful or accurate.²

² OTA has conducted tests and made corrections to ensure that the Form 1040 amounts and primary codes from the service center examiner's questionnaire are consistent and accurate. We have not made any corrections to the codes from the special agent's questionnaire. Information from the special agents' questionnaires may be inaccurate or incomplete and should be used only as supporting or clarifying evidence in examining a case, rather than as a primary source of information about the types of errors.

The special agents and service center examiners were asked to provide comments about certain aspects of each case, and summary comments about each case. However, these comments vary in length, emphasis and quality. In addition, while a brief portion of these comments was transcribed to the data tapes, no information has been systematically extracted from them. As a result, the transcribed comments provide a qualitative sense of the nature of EITC non-compliance, rather than quantitative information.

To a very limited extent, OTA has used information in these comments (along with the codes and return data) to create new codes, which provide more quantitative evidence regarding the sources of EITC errors. For example, the service center questionnaire did not include a distinct code for cases in which the qualifying child did not exist, and the service center examiners did not follow uniform coding practices in these cases. (Some coded the filer as failing all of the qualifying child criteria; some left all of the codes blank; others coded the filer as failing only the relationship criterion, or some other criterion.) Therefore, OTA searched the invalid SSN and coded questionnaire data for particular patterns and re-coded any cases identified as involving the existence of the qualifying child. (These coding corrections and additions were provided to IRS and to JCT.)

In addition, in cases where the filer failed the AGI tiebreaker, OTA tried to identify the taxpayer with the higher AGI, using the agent and examiner comments, and the answer to a question regarding the relationship of the "AGI tiebreaker winner" to the child that was included on the agent's questionnaire (item 9). As discussed below, analysis of the AGI tiebreaker by OTA contributed to the development of the proposal to clarify the definition of foster child for purposes of the EITC.

Tax return and other data available to the IRS can also be used to determine the nature of the EITC error.³ If the EITC is denied or reduced due to a change in income, then the amount and type of income can also be observed from changes to the Form 1040. The source of the additional income (whether it be income omitted by the filer or the income of a spouse previously omitted from the return) can be discerned by examining information returns data (which OTA obtained directly from Information Services, in IRS's National Office), or in many cases by reading the examiner's comments.

Results: Table 1A shows the major sources of EITC errors amongst taxpayers who claimed qualifying children. Table 1B provides further detail regarding the specific sources of errors among taxpayers who incorrectly claimed an EITC qualifying child. As Tables 1A and 1B show, the most common EITC error is caused by taxpayers claiming qualifying children who do not reside with them for over half the year. Among taxpayers with children, such

³ The tax return data must be used to identify income and filing status errors. The service center examiner questionnaire includes no information on filing status, and very limited information on income errors.

errors account for about 39 percent of overclaimed EITC amounts. Under current law, taxpayers are required to reside with their qualifying children for at least six months or a full year, depending on the relationship of the child. Taxpayers fail the residency test for many different types of reasons. For example, divorced parents who share the custody of their children might both claim the EITC because they both feel the child lived with them for over half the year. At the other extreme, a taxpayer may claim a child with whom he or she has never resided.

A second common error is due to misreporting of filing status among married taxpayers. Filing status errors account for about 31 percent of overclaimed EITC amounts among taxpayers with children.⁴ These errors occurred when legally married taxpayers filed as single or head of household. Sometimes, separated couples did not appear to understand that they must still file as married persons if they have not yet obtained a legal separation. In other cases, married couples, who were still living together, did not file either a joint return or a "married filing separate" return. In the study, the IRS corrected these returns by either adding the spouse's income to the taxpayer's and redetermining their eligibility for the EITC or by changing their filing status to married filing separately, and thereby automatically denying them eligibility for the EITC. The IRS resolution of the case depended, to a large extent, on whether or not they had obtained the social security number of the missing spouse during the initial interview with the taxpayer.

The third most common error results from complicated living arrangements. In such situations, a child lives with more than one adult who appears qualified to claim him or her for EITC purposes. However, about 18 percent of overclaimed EITC amounts result when, in such households, the caregiver with the lower AGI claims the child. In some cases, the other caregiver was, in fact, qualified to claim the EITC but did not. The study does not measure the offsetting errors that occur because the taxpayer's relative, with the higher AGI, did not claim the EITC when he or she was eligible.

OTA reviewed the notes from each of the cases that had been denied the EITC due to the AGI tiebreaker test and, where possible, made a determination regarding the identity of the taxpayer with the higher AGI. About 47 percent of overclaim amounts, associated with the AGI tiebreaker test, resulted from the presence of a member of the opposite sex with higher income. About 38 percent of these overclaim amounts were attributable to the presence of the taxpayer's parent with higher income. The remainder were attributable to the presence of another relative, friend, or an individual whose relationship to the taxpayer could not be identified from the agent's notes. In a number of cases (about 25 percent of the overclaim amounts associated with the AGI tiebreaker), the taxpayer was deemed ineligible for the credit, even though the other individual present (generally, the taxpayer's girlfriend or

⁴ Some taxpayers misreport their filing status and also claim children who did not reside with them. They are included in both error categories.

boyfriend) did not appear to be the parent of the child. Hence, in many of those cases, the IRS denied the EITC to the parent of the child, deeming that the child was the foster child of the other person in the household.

Even among EITC claimants without qualifying children, many errors are caused by the misreporting of family structure. Among these taxpayers, about 40 percent of overclaims are attributable to the misreporting of filing status among married taxpayers. However, most errors among EITC claimants without qualifying children are due to the misreporting of income.

The analysis, described above, examined the sources of EITC errors among claimants prior to any enforcement actions or mathematical error procedures that had not been in place during the 1995 filing season. We also examined the extent to which these errors would have been reduced by the implementation of social security number validation and the mathematical error procedures enacted in the Personal Responsibility and Work Opportunity Act of 1996. This analysis is shown in Tables 2A and 2B and reveals that the new mathematical error procedures would have their greatest impact in reducing EITC residency errors. Presumably, taxpayers who do not reside with the child that they are claiming for EITC purposes are not likely to be able to provide a valid social security number for that child. But even after implementation of the mathematical error procedures, residency errors would still account for about 34 percent of total overclaims.

While we can identify the sources of EITC errors in this study among taxpayers, we do not know from the study the extent to which the EITC, itself, is the root cause of the noncompliance on the part of the taxpayers. By misreporting filing status, child dependents, and income, taxpayers may be able to reduce their tax liability through other provisions in addition to the EITC. Because this study focused only on EITC claimants, it does not isolate the effect of the EITC on noncompliance, or the extent to which higher income taxpayers are benefiting from misreporting their income or family circumstances.

The study does provide evidence that the refundable nature of the credit does not induce ineligible individuals to enter the tax system simply to claim the credit. The overclaim rate among those with a positive pre-EITC tax liability is nearly three times larger than the rate among those who did not have a tax liability. The data thus suggest that noncompliant EITC claimants do not enter the tax system merely to claim the credit.

Role of Preparers

Using data from the 1994 EITC compliance study, OTA also examined the effect of paid preparers on EITC overclaims.

Methodology: The data from the 1994 EITC compliance study include information on the use of a paid preparer from the original Form 1040, from the corrected Form 1040, and

from a questionnaire completed by the IRS field agent. For original paper returns, we have only an IRS code, indicating that the return was prepared by the IRS, by a large corporate preparer, or by some other preparer.⁵ For original electronic returns, we have an indication that the return was prepared by the IRS and identifying information (names, SSN's and EIN's, and addresses) for the preparer and preparation firm. The corrected Form 1040 includes preparer identifying information, for both returns filed electronically and on paper. The questionnaire includes identifying information, an indicator that the preparer failed to sign the return, a code describing the type of preparer, and other data.

About 47 percent of returns in the 1994 EITC compliance study have evidence of paid preparation on the filer's original return. For electronic returns, the figure is about 73 percent; for paper, it is 36 percent. About 54 percent of returns have some indication of a paid preparer on the filer's return, the corrected return or questionnaire. For electronic returns, the figure is 79 percent; for paper, it is 43 percent.

This discrepancy between the number of returns with a paid preparer identified on the original return (47 percent) and the number with a paid preparer identified on an original return, corrected return, or questionnaire (54 percent), could mean that paid preparers fail to sign about 13 percent of their returns. The discrepancy could also arise if some agents mistakenly completed paid preparer forms for electronic return originators who were not preparers, or if IRS coding for the original paper return is incomplete. In addition, in some cases, it appears that the filer claims to have used a preparer in order to deflect the examiner's attention from himself or herself. Yet in other cases, it is apparent that a preparer was paid, and that the preparer failed to sign the return.

There are also a number of cases with a preparer identified on the original return, but no agent questionnaire data. In some of these cases, the agent indicates that the "preparer" who signed the return did not in fact prepare it, but was only the electronic return originator. In other cases, it appears that the agent could not locate the preparer, or purposely did not contact the preparer, because the agent did not want to interfere with an ongoing investigation. In a number of other cases, it appears that the agent simply neglected to complete the questionnaire. While the data are sometimes incomplete or inconsistent, they suggest that approximately half of EITC claimants use paid preparers, and that preparers' signatures were missing on 5 to 13 percent of returns.⁶

⁵ IRS preparers include Community Outreach Tax Education, IRS "walk-in" services, VITA and Tax Counseling for the Elderly.

⁶ IRS agents coded about 5 percent of prepared returns as having missing signatures or other information. However, we are unsure of the reliability of this code; it is clearly inconsistent with other questionnaire information in some cases.

Results: Using the more expansive definition of paid preparation (i.e., evidence of paid preparation on either return or on the questionnaire) it appears that fewer than 2 percent of 1994 EITC claimants use IRS assistance to prepare their returns. About 4 percent of filers appear to use an attorney or certified public accountant, 5 percent use an enrolled agent, 16 percent use a nationally recognized corporation, and 30 percent use some other type of paid preparer. (See Table 3.)

Electronically filed returns are much more likely to be prepared by an attorney, certified public accountant (CPA), enrolled agent or large firm. Among filers using paid preparers, about 60 percent of electronic filers but only 33 percent of paper filers use an attorney, CPA, enrolled agent or large preparation firm, rather than a local or unknown preparer. The questionnaire data suggest that 20 to 28 percent of electronic filers who use a paid preparer, use a paid preparer that is different from their electronic return originator.⁷

The gross overclaim rate among filers who appear to use no assistance is about 26 percent; the overclaim rate for returns completed by paid preparers is also about 26 percent. However, overclaim rates vary widely by type of preparer. The overclaim rate for returns filed by an attorney, CPA, enrolled agent or nationally recognized service is about 20 percent; the overclaim rate for returns filed by a local or unknown preparer is 31 percent.⁸ As shown in the second part of Table 3, the overclaim rate patterns are not very different when a more restrictive definition of paid preparation (evidence of paid preparation on the original Form 1040) is used.

There do not appear to be substantial differences in the types of errors made by different kinds of preparers. Rather, some types of preparers appear to be better than others at comprehending and applying all of the EITC eligibility criteria to their clients' situations. The special agents and examiners reported that in some cases the preparers had not asked the taxpayers the right questions before determining their eligibility for the EITC.

⁷ The agent's questionnaire asks whether or not the electronic return originator (ERO) is also the return preparer. On 20 percent (weighted) of electronic returns with some indication of paid preparation, the answer is coded as "N", on 73 percent, it is coded "Y". On the remaining 8 percent of questionnaires, the variable is not coded or mis-coded (coded "1" or "3"). It therefore appears that at least 20 percent of ELF filers using paid preparers use a preparer that is different from their ERO; but the figure could be as high as 28 percent.

⁸ The overclaim rates are lower for enrolled agents (14 percent) and attorneys and CPA's (16 percent) than for large preparation firms (23 percent) or the IRS (22 percent). However, only 69 filers in the sample used an attorney or CPA, only 94 used an enrolled agent, and only 29 used IRS assistance; therefore these detailed figures are based on relatively few observations. The error rate for IRS assisted preparation is particularly sensitive to the inclusion of one observation with an EITC overclaim and a very large weight.

It is also possible that the differences in the overclaim rates reflected the characteristics of the clientele who frequent different types of preparers. We are not able to fully control for these differences, because some of the key characteristics (such as the education level of the taxpayer, his or her propensity for deceit) are not readily observable in the current data.

THE WHITE HOUSE
WASHINGTON

Speaker of the

House of Representatives

Sir:

I ask Congress to consider the enclosed amendment to the FY 1998 appropriations request for the Department of the Treasury. This proposal would provide \$107,105,000 for implementing legislation and expanding administrative actions to improve overall compliance with the Earned Income Tax Credit (EITC), as provided for in the "Taxpayer Relief Act of 1997." The \$107 million for the Internal Revenue Service was anticipated in and authorized by the Balanced Budget Act of 1997.

The details of these actions are set forth in the enclosed letter from the Director of the Office of Management and Budget. I concur with his comments and observations.

Sincerely,

Enclosure



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

THE DIRECTOR

The President

The White House

Submitted for your consideration is an amendment to your FY 1998 appropriations request for the Department of the Treasury.

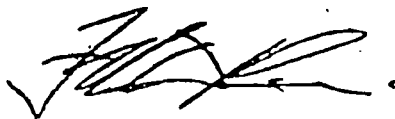
The \$107 million requested herein is for funding an Internal Revenue Service (IRS) compliance effort for the Earned Income Tax Credit (EITC) in FY 1998. In April 1997, the IRS released a compliance study of EITC claims filed for the 1994 tax year that detailed the need for reforms to reduce EITC overclaims. Of an estimated \$17.2 billion in EITC claims received by the IRS, \$4.4 billion, or 25.8 percent, was overclaimed. IRS enforcement actions in 1994 reduced the amount overclaimed to an estimated \$4.1 billion, or 23.5 percent. Had the tighter procedural tools in last year's welfare reform act been in place in 1994, overclaims would have been reduced further, to \$3.6 billion, or 20.7 percent. The \$107 million requested in this amendment would be used to reduce further the EITC overclaims while ensuring that EITC-eligible taxpayers receive the tax benefit. Treasury has projected that these resources will protect or generate additional revenue of \$2.7 billion over the five-year life of the initiative.

The IRS plans to expand customer service efforts significantly with dedicated toll-free telephone assistance, to increase community based tax preparation assistance sites, and to develop a marketing and educational campaign. IRS will also expand compliance research efforts. Enhanced computer capabilities will allow IRS to identify and select questionable EITC claims prior to refund issuance. Funds also are included to reimburse State vital statistics offices, through the Social Security Administration, for expanded data associated with social security numbers. Finally, expanded examination and criminal investigation staff will focus on questionable or fraudulent EITC activity among both taxpayers and preparers.

The requested funds are authorized by section 5702 of the Balanced Budget Act of 1997. Section 10205 (a) of that Act provides for an upward adjustment to the discretionary spending limits to reflect this initiative.

I have carefully reviewed this proposal and am satisfied it is necessary at this time. Therefore, I join the Secretary of the Treasury in recommending that you approve this request by signing the enclosed letter to the Speaker of the House of Representatives.

Sincerely,

A handwritten signature in black ink, appearing to read 'Franklin D. Raines', with a stylized flourish at the end.

Franklin D. Raines
Director

Enclosures

FY 1998 Budget Amendment

Agency: DEPARTMENT OF THE TREASURY

Bureau: INTERNAL REVENUE SERVICE

Heading: Earned Income Tax Credit Compliance Initiative

FY 1998 Budget Appendix Page: 877

Pending Request: --

Proposed Amendment: \$107,105,000

Revised Request: \$107,105,000

(Insert the above heading and the appropriations language that follows immediately after the material under the heading "Information Technology Investments" :)

For funding essential earned income tax credit compliance and error reduction initiatives pursuant to section 5702 of the Balanced Budget Act of 1997 (P.L. 105-33), \$107,105,000, of which not to exceed \$10,000,000 may be used to reimburse the Social Security Administration for the costs of implementing Section 1090 of the Taxpayer Relief Act of 1997.

This amendment would provide \$107 million and 974 full-time equivalents (FTEs) to implement error reduction initiatives for the Earned Income Tax Credit (EITC).

Of these funds, \$45 million and 632 FTEs would implement customer service and tax processing initiatives. IRS would expand customer service efforts with dedicated EITC toll-free telephone assistance (72 FTEs), perform maintenance on its computer data files, and correct previously submitted invalid taxpayer identification numbers (10 FTEs). Tax forms and instructions would be revised to assist taxpayers in filing correct EITC claims (eight FTEs). IRS would develop a coordinated marketing and educational campaign specifically designed to reach EITC eligible communities. With respect to tax processing, IRS would fully implement the math-error program that recalculates the tax return and reduces refund overclaims (36 FTEs). IRS correspondence staff (456 FTEs) would send notices, prior to refund issuance, to EITC taxpayers with questionable returns. IRS has estimated that 50 FTEs would be needed for administrative support.

The amendment would provide \$30 million and 342 full-time equivalents (FTEs) to implement expanded compliance and enforcement efforts. IRS would staff community-based tax preparation assistance sites located in areas with high numbers of EITC eligibles specifically for EITC recipients (20 FTEs). This includes significantly expanded compliance research work related to EITC claimant characteristics and patterns of non-compliance that will support overall efforts to improve education and outreach products, enhance abuse detection capabilities, and improve enforcement efforts (113 FTEs). IRS would use its criminal investigation "Questionable Refund Detection Teams" (173 FTEs) to screen for and identify questionable EITC claims, EITC-based refund schemes, and questionable EITC preparers. IRS would increase audit staff to conduct face-to-face due diligence reviews of return preparers for EITC compliance requirements, applying penalties for non-compliance (36 FTEs).

The amendment would provide \$22 million for IRS to make computer programming changes for processing additional data to support the EITC initiative, including changes for processing additional transcribed data, updating the master file to track past EITC abuses, and performing compliance research studies. To support IRS's compliance efforts, \$10 million would be used by the IRS to reimburse the Social Security Administration (SSA) for enhancements to SSA's social security number database. With these funds, SSA would begin to reimburse State vital statistics offices for costs associated with providing SSA additional data relating to current and future social security numbers.

Table 1A
Reasons for Disallow or Reduction of Claims of EITC with Qualifying Children
Tax Year 1994 Compliance Data

	EITC Claimed \$ mil.	EITC Allowed \$ mil.	EITC Error \$ mil.
Total with Children	16,722	12,354	4,368
Total with Error	5,992	1,625	4,368
EITC Claim Disallowed			
Total	3,405	0	3,405
<u>Total Denied for One Reason Only</u>			
Qualifying Child(ren) Denied	2,076	0	2,076
Taxpayer Filed as Single or HOH when Married			
-- IRS Changed to Married, filing Separate	611	0	611
-- IRS Changed to Joint, Added Spouse's Income	168	0	168
Earned or Adjusted Gross Income Over Threshold	87	0	87
<u>Total Denied for Multiple Reasons</u>			
IRS Changed to Married, filing Separate and Also Denied Qualifying Child	403	0	403
Other Combinations	60	0	60
EITC Claim Reduced			
Total	2,587	1,625	962
<u>Total Reduced for One Reason Only</u>			
Qualifying Child(ren) Denied			
-- IRS Changes EITC Status to Childless	586	89	498
-- IRS Allows One Qualifying Child	155	124	31
Filer Income Increased	1,554	1,274	281
Taxpayer Filed as Single or HOH when Married			
-- IRS Changed to Joint, Added Spouse's Income	170	63	107
Other	53	40	13
<u>Total Reduced for Multiple Reasons</u>			
Filer Income Increased and Other Reason	69	36	33
Department of the Treasury			
Office of Tax Analysis			

Table 1B
Reasons for Disallow or Reduction of EITC Claims Due to Problematic Qualifying Child Claims
Tax Year 1994 Compliance Data

	EITC Claimed \$ mil.	EITC Allowed \$ mil.	EITC Error \$ mil.
Total with Children	16,722	12,354	4,368
Total with Overclaim	5,992	1,625	4,368
Total Denied or Reduced Due to Qualifying Child Error	3,312	232	3,080
EITC Claim Disallowed			
Total	3,405	0	3,405
Total Denied Due to Qualifying Child Error	2,537	0	2,537
<u>Failed One Qualifying Child Test Only</u>			
Residency	1,223	0	1,223
AGI Tiebreaker	649	0	649
Relationship	257	0	257
Age	82	0	82
Existence	41	0	41
<u>Failed More than One Qualifying Child Test</u>			
Residency and Relationship	158	0	158
Age and Other Criteria	82	0	82
<u>Unspecified Reason</u>	45	0	45
EITC Claim Reduced			
Total	2,587	1,625	962
Total Reduced Due to Qualifying Child Error	775	232	543
<u>Failed One Qualifying Child Test Only</u>			
Residency	371	124	247
AGI Tiebreaker	157	24	132
Relationship	98	31	67
Age	62	31	31
Existence	10	2	8
<u>Failed More than One Qualifying Child Test</u>			
Residency and Relationship	33	10	23
Age and Other Criteria	10	3	7
<u>Unspecified Reason</u>	33	5	28
Department of the Treasury			
Office of Tax Analysis			

Table 2A
Reasons for Disallow or Reduction of Claims of EITC with Qualifying Children
Tax Year 1994 Compliance Data
After Math Error Correction for Invalid Social Security Number

	EITC Claimed \$ mil.	EITC Allowed \$ mil.	EITC Error \$ mil.
Total with Children	16,722	13,172	3,550
Total with Error	4,942	1,392	3,550
EITC Claim Disallowed			
Total	2,778	0	2,778
<u>Total Denied for One Reason Only</u>			
Qualifying Child(ren) Denied	1,627	0	1,627
Taxpayer Filed as Single or HOH when Married			
-- IRS Changed to Married, filing Separate	580	0	580
-- IRS Changed to Joint, Added Spouse's Income	139	0	139
Earned or Adjusted Gross Income Over Threshold	87	0	87
<u>Total Denied for Multiple Reasons</u>			
IRS Changed to Married, filing Separate and Also Denied Qualifying Child	298	0	298
Other Combinations	48	0	48
EITC Claim Reduced			
Total	2,164	1,392	772
<u>Total Reduced for One Reason Only</u>			
Qualifying Child(ren) Denied			
-- IRS Changes EITC Status to Childless	397	60	337
-- IRS Allows One Qualifying Child	129	102	28
Filer Income Increased	1,379	1,111	268
Taxpayer Filed as Single or HOH when Married			
-- IRS Changed to Joint, Added Spouse's Income	151	48	103
Other	53	40	13
<u>Total Reduced for Multiple Reasons</u>			
Filer Income Increased and Other Reason	54	31	23
Department of the Treasury			
Office of Tax Analysis			

Table 2 B
Reasons for Disallow or Reduction of EITC Claims Due to Problematic Qualifying Child Claims
Tax Year 1994 Compliance Data
After Math Error Correction for Invalid Social Security Number

	EITC Claimed \$ mil.	EITC Allowed \$ mil.	EITC Error \$ mil.
Total with Children	16,722	13,172	3,550
Total with Overclaim	4,942	1,392	3,550
Total Denied or Reduced Due to Qualifying Child Error	2,521	178	2,344
EITC Claim Disallowed			
Total	2,778	0	2,778
Total Denied Due to Qualifying Child Error	1,971	0	1,971
<u>Failed One Qualifying Child Test Only</u>			
Residency	880	0	880
AGI Tiebreaker	631	0	631
Relationship	168	0	168
Age	36	0	36
Existence	30	0	30
<u>Failed More than One Qualifying Child Test</u>			
Residency and Relationship	129	0	129
Age and Other Criteria	53	0	53
<u>Unspecified Reason</u>	45	0	45
EITC Claim Reduced			
Total	2,164	1,392	772
Total Reduced Due to Qualifying Child Error	550	178	372
<u>Failed One Qualifying Child Test Only</u>			
Residency	226	100	126
AGI Tiebreaker	155	23	132
Relationship	76	27	49
Age	47	18	29
Existence	0	0	0
<u>Failed More than One Qualifying Child Test</u>			
Residency and Relationship	15	6	10
Age and Other Criteria	4	0	4
<u>Unspecified Reason</u>	26	5	21

Department of the Treasury
Office of Tax Analysis

Table 3
Overclaim Rates by Type of Paid Preparation (All TY94 EITC Claimants)
Tax Year 1994 Compliance Data

Paid Preparer is Coded if Preparer is Indicated on Filer's Return,
Corrected Return, or Questionnaire

	<u>% Filers</u>	<u>Overclaim Rate</u>
All	100.0%	25.8%
No Assistance	44.2%	26.1%
IRS Assistance*	1.6%	21.7%
Paid Assistance	54.2%	25.7%
- Attorney or CPA	4.1%	15.9%
- Enrolled Agent	4.8%	13.9%
- Nationally Recognized Service	15.6%	23.1%
- Other Paid Preparation	29.7%	30.6%

Paid Preparer is Coded Only if Preparer is Indicated on Filer's Return

	<u>% Filers</u>	<u>Overclaim Rate</u>
All	100.0%	25.8%
No Assistance	51.1%	25.9%
IRS Assistance*	1.5%	21.8%
Paid Assistance	47.4%	25.8%
- Attorney or CPA	3.7%	18.0%
- Enrolled Agent	4.4%	14.6%
- Nationally Recognized Service	15.2%	23.0%
- Other Paid Preparation	24.1%	31.3%

Department of the Treasury
Office of Tax Analysis



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220
May 23, 1997

MEMORANDUM FOR DEPUTY SECRETARY SUMMERS

**FROM: JANET HOLTZBLATT
DEPUTY DIRECTOR, INDIVIDUAL TAXATION DIVISION
OFFICE OF TAX ANALYSIS**

SUBJECT: Tax Gap and EITC Errors

As a follow-up to your discussion today at the White House, Karl Scholz asked me to provide you with some information regarding the relative magnitudes of the tax gap and EITC errors.

According to the most recent tax gap study (released in April, 1996), the gross individual income tax gap was estimated to be between \$93.2 and \$95.2 billion in 1992. Of this amount, over 40 percent (\$39.1 to \$39.9 billion) was attributable to underreporting of business income. All credits together (including the EITC) accounted for about 6 percent (\$6 billion) of the tax gap. The tax gap study did not include a separate estimate of the amount of EITC errors. Enforcement actions were estimated to reduce the total tax gap to between \$78.3 and \$80.4 billion.

According to a more recent IRS study, there were \$4.4 billion of EITC erroneous claims on 1994 returns filed and accepted between January 15 and April 21, 1995. Enforcement actions (including procedures which were not enacted until 1996) could have reduced EITC erroneous payments to \$3.6 billion. These results are not strictly comparable to the 1992 tax gap estimates; the EITC study is not representative of the entire filing season (it omits about 20 percent of returns with EITC claims accepted after the April 21 cut-off), while EITC costs increased by over 50 percent between 1992 and 1994 as a consequence of OBRA 1990 and 1993.

A one page description of the tax gap study is attached. I have also attached a page from Karl's testimony before the Ways and Means Committee, in which he cited the 1992 tax gap results in order to place EITC compliance problems in perspective. During the hearing, Representative Levin also asked Karl a number of detailed questions about the other, larger sources of the tax gap.

cc: Lubick
Scholz

Key Findings from IRS Study of Tax Gap

- Last April, the IRS released a study showing that the gross individual income tax gap in 1992 was between \$93.2 and \$95.2 billion. These estimates are based on the most recent Taxpayer Compliance Measurement Program (TCMP) data, collected from tax year 1988 returns.
 - The IRS estimated that the total "true" individual income tax liability was between \$550.2 and \$552.3 billion for tax year 1992. The overall individual noncompliance rate was estimated to range from 16.9 to 17.3 percent.
 - The gross tax gap estimates do not take into IRS enforcement actions. The IRS estimates that the net tax gap would be lowered by \$14.9 billion. Thus, the net tax gap was estimated to range from \$78.3 to \$80.4 billion.
- The estimates for 1992 show that other areas of the tax code are a much greater source of the tax gap than the earned income tax credit.
 - Over 40 percent (\$39.1 to \$39.9 billion) of the gross tax gap for 1992 was attributed to the underreporting of business income (including self-employment income, partnership income and rents and royalties).
 - About 20 percent (\$18.1 to \$18.7 billion) of the gross tax gap was due to the underreporting of non-business income.
 - Over 14 percent (\$13.5 to \$13.8 billion) of the gross tax gap was due to persons who failed to file tax returns.
 - All credits together accounted for about 6 percent (\$6 to \$6.2 billion) of the tax gap. The study did not include a separate estimate of the amount of the tax gap attributable to the EITC.

Background

- In the TCMP, a random sample of taxpayers is subjected to audit. The results allow the IRS to determine the size and sources of income tax noncompliance. The last TCMP was conducted in 1988.
- The individual noncompliance rate, cited in the tax gap study, is not calculated in the same manner as the EITC error rate which was contained in another recent IRS study. The individual noncompliance rate is the ratio of the gross tax gap to total true tax liability (i.e., what should have been paid by both filers and nonfilers). The EITC error rate is the ratio of the total overclaimed amount to the total amount actually claimed. An estimate of the amount of the EITC, which should have been claimed both by those claiming the credit and those who did not, is not available.

programs. For example, in FY 1995, the food stamp program cost \$3.7 billion to administer, while AFDC administrative costs were an additional \$3.5 billion -- nearly 14 percent of the combined costs of these two programs. For these administrative costs, the AFDC program served, on average, about 4.9 million families in a given month, while over 10 million households received food stamps. By way of comparison, the entire IRS budget in FY 1995 was \$7.6 billion, and the IRS served over 116 million individual taxpayers and 15 million corporations.

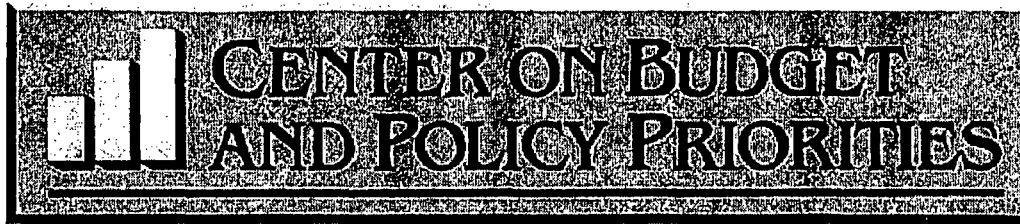
Taxpayers also benefit from obtaining the EITC through the tax system. Many low-income workers learn about the EITC when they file a tax return to obtain a refund. By claiming the credit on tax returns, EITC claimants do not have to take time off from work to apply for the credit at a government office.

Not surprisingly, then, participation in the EITC tends to be higher than many other assistance programs targeted to low-income families. In my research prior to joining Treasury, I found that 80 to 86 percent of those eligible received the credit in 1990. This high participation rate is striking when compared to the AFDC participation rate of 62 to 72 percent and the food stamp participation rate of 54 to 66 percent. International comparisons also confirm this finding. The United Kingdom has an EITC-like program called the Family Credit. It is administered through the transfer system and directed toward families with children. Official estimates place the participation rate of the Family Credit at around 50 percent. Thus, both compared to cash and in-kind transfers in the United States and comparable work-related benefits in the United Kingdom, the EITC is much better at reaching those who are eligible for the credit.

Notwithstanding these benefits, there are costs associated with operating the EITC, as with other tax provisions, through the tax system. A system based largely on self-assessment will have lower administrative costs than a more bureaucratic approach, but it will also lead to higher noncompliance. Many of us were very concerned when EITC compliance data, from the 1980's, first became available. The Taxpayer Compliance Measurement Program (TCMP), last conducted in 1988, showed that 35.4 percent of the EITC claimed (\$2 billion) exceeded the amounts to which taxpayers were eligible.

But the same TCMP also places the problems of the EITC in perspective. Last April, the IRS released a study, based on the 1988 TCMP, showing that the gross individual income tax gap in 1992 was between \$93.2 and \$95.2 billion. The IRS estimated that the total "true" individual income tax liability was between \$550.2 and \$552.3 billion for tax year 1992. Over 40 percent (\$39.1 to \$39.9 billion) of the gross tax gap for 1992 was attributable to the underreporting of business income (including self-employment income, partnership income and rents and royalties). About 20 percent (\$18.1 to \$18.7 billion) of the gross tax gap was due to the underreporting of non-business income. Over 14 percent (\$13.5 to \$13.8 billion) of the gross tax gap was due to persons who failed to file tax returns. These problems exceed any noncompliance problems associated with the EITC.

Nonetheless, the Administration and Congress have recognized that the EITC can best



March 11, 1998

New Research Findings on the Effects of the Earned Income Tax Credit

by Robert Greenstein and Isaac Shapiro

1. POVERTY
2. WEALTHY
3. LABOR SUPPLY

Overview

It has been widely recognized that one of the not-so-bright spots in today's glowing economy is the lack of significant economic progress for low- and moderate-income working families. It is somewhat surprising therefore that until recently, one of the nation's principal programs to assist these families — the federal Earned Income Tax Credit — received relatively little attention among researchers. This now appears to be changing. In recent years, as the EITC has expanded substantially, researchers have conducted an increasing amount of work on the EITC's effects.

The EITC was enacted in 1975. Substantial expansions were adopted in 1986, 1990, and 1993. The credit goes only to households with earnings, with the size of the credit initially rising as earnings increase. EITC benefits both offset taxes and, frequently, provide a wage supplement. More than 19 million low- and moderate-income households — the vast majority of whom are families with children — received the credit in 1996.

This analysis examines recent research, data, and findings on the EITC. The principal theme that emerges from this analysis is an encouraging one — in a world where academic research often finds social programs to have modest effects at best in increasing work effort and employment, the emerging research literature on the EITC is strikingly positive. The research findings indicate the EITC increases work effort substantially among single mothers. The research also finds that the EITC moderates the widening of income gaps between the wealthy and the working poor and is now lifting 4.6 million people in working families out of poverty, including 2.4 million children.

- A series of studies have been conducted in the past few years on the EITC's effects on work behavior. These studies have consistently found that the EITC has substantial positive effects in inducing single parents to go to work. One of the most important of these studies finds that the proportion of single mothers who are in the labor force rose sharply between 1984 and 1996 and that the EITC expansions instituted during this period are responsible for more than half of this increase.
- Another study finds that the EITC offsets between one-fourth and one-third of the decline during the past 20 years in the share of national income received by the poorest fifth of households with children.

- Recent Census data show that among working families, the EITC lifts substantially more children out of poverty than any other government program or category of programs. The EITC is particularly important in reducing poverty among children in the South, where working families tend to have lower wages and consequently are more likely to qualify for the EITC. In addition, a just-released study by Columbia University's National Center for Children in Poverty found that the EITC reduces poverty among young children by nearly one fourth.

As the EITC has expanded, it also has become more politically controversial. In recent years, the EITC has begun to draw criticism in some political quarters on two grounds — that its costs are escalating rapidly, making it one of the fastest growing federal programs, and that it is error-ridden. New data and research shed light on these issues as well.

- EITC costs rose significantly between 1986 and 1996 as a result of the EITC expansions enacted in 1986, 1990, and 1993, each of which phased in over several years. New cost estimates issued by the Congressional Budget Office, however, indicate that with the 1993 EITC expansion having phased in fully, significant EITC growth has ended. In fact, the EITC has now become one of the *slowest* growing of all entitlement programs — between 1998 and 2003, the EITC is projected to grow more slowly than 13 of the 14 other largest entitlements. EITC growth is projected to be so modest that, when adjusted for inflation and population, EITC costs will *decline* between 1998 and 2003.
- The EITC error rate remains high, although it has fallen considerably over the past decade as a result of a number of legislative changes and tightened administrative procedures. Further error rate reductions are likely in the years ahead, moreover, as a result of a battery of significant legislative measures that either have very recently taken effect or will take effect in coming years, including a series of measures incorporated into the Taxpayer Relief Act of 1997 that were specifically designed to curb the types of EITC errors identified by IRS studies.
- Data from the Internal Revenue Service and the General Accounting Office show that EITC errors account for a relatively small share of total losses due to errors in the income tax. The IRS and GAO data indicate the amount lost to EITC errors accounts for less than five percent of the total amount the Treasury loses due to income tax errors. IRS and GAO data also show that a number of other provisions of the tax code have higher error rates than the EITC does and lose larger amounts of revenue. The errors in these other provisions, however, have not been the subject of much legislative scrutiny.

The EITC, whose early supporters include Ronald Reagan (who championed a similar proposal as early as 1972 while governor of California), has received bipartisan support throughout most of its history. This bipartisan support has eroded in Congress in the past few years, as the program has become increasingly associated with President Clinton, who proposed the major EITC expansion enacted in 1993. This erosion has occurred despite the fact that Presidents Reagan and Bush were heavily involved in the large EITC expansions enacted in 1986 and 1990. But outside the national political arena, the EITC's unique features have continued to generate strong support across the political spectrum. Several states have established state earned income tax credits in recent years with bipartisan support, and the EITC has drawn praise from some leading conservative thinkers, as well as from liberals and moderates.

For example, in a 1996 *Wall Street Journal* column, conservative Harvard economist and *Journal* contributing editor Robert J. Barro observed: "...There exists a serious program in the form of the earned income tax credit that actually helps the working poor in a way that promotes work and discourages welfare. The EITC was originally a Republican idea — started by the Ford administration in 1975 and expanded by the Reagan administration during the glorious 1980s and the Bush administration in 1990....Mr. Clinton's support is not sufficient reason to regard the program as mistaken. In fact, it has a well conceived structure that ought to be retained and perhaps expanded in a comprehensive welfare reform package."⁽¹⁾

Similarly, in a 1996 *Business Week* article, the well-known conservative economist and Nobel laureate Gary S. Becker praised the EITC for aiding poor families without reducing employment, discouraging work, or increasing reliance on public assistance. Becker wrote that the EITC "rewards rather than penalizes poor families with working members....Empirical studies confirm the prediction of economic theory that the EITC increases the labor force participation and employment of people with low wages because they need to work in order to receive this credit." Becker also applauded the EITC for being "fully available to families with both parents present, even where only one works and the other cares for their children...."⁽²⁾ [i.e., for being available to low-income working families with stay-at-home mothers].

Background on the EITC

Although the benefits of economic growth have been shared across the income spectrum in the last couple of years, that has not been true for most of the past two decades. Income disparities — the gaps between high-income families and those in the low or middle parts of the income range — have grown considerably and remain close to their post-World War II highs.

- Census data show that both the poorest fifth of families and the next-to-the-poorest fifth had lower average incomes in 1996 than in either 1989 or 1979, comparable years of the business cycle to 1996. For example, after adjusting for inflation, the average income of the poorest fifth of families in 1996 was more than 10 percent lower than in 1979.
- In contrast, higher-income families experienced large income gains. In 1996, the average income of the top fifth of families was 28 percent higher than in 1979.⁽³⁾

These trends reflect the growing disparities between wages and salaries paid for highly compensated work and those paid for low-paying work.⁽⁴⁾ Those at the top of the wage scale have secured large wage and salary gains. Less-educated workers have fared poorly. An analysis of Census Bureau data by the Economic Policy Institute found that from 1979 to 1996, the average hourly wage of workers with less than a high school education fell 26 percent, after adjusting for inflation. High school graduates experienced a wage decline of 13 percent.

A study by economist Rebecca Blank found the same pattern of erosion in the wages of less-educated workers between 1979 and 1993. Blank also found that fringe benefits deteriorated for low-wage workers, with the proportions of low-wage workers that receive employer-based health insurance and pension benefits dropping significantly between 1979 and 1993.⁽⁵⁾

These wage and compensation trends among less-educated workers are of particular note because these are precisely the groups of workers on which the EITC is targeted. Jeffrey Liebman, a Harvard economist who has conducted a series of studies of the EITC, found that in 1990, some 78 percent of EITC beneficiaries had no more than a high school education. Some 41 percent did not have a high school diploma.⁽⁶⁾

How the EITC Works

The Earned Income Tax Credit was established in 1975 to offset the adverse effects of Social Security and Medicare payroll taxes on working poor families and to strengthen work incentives by increasing the remuneration from low-paid work.⁽⁷⁾ Administered through the federal income tax system, the EITC is a refundable tax credit. If the amount of a family's credit exceeds its income tax liability, the family receives a refund check for the difference from the Internal Revenue Service.

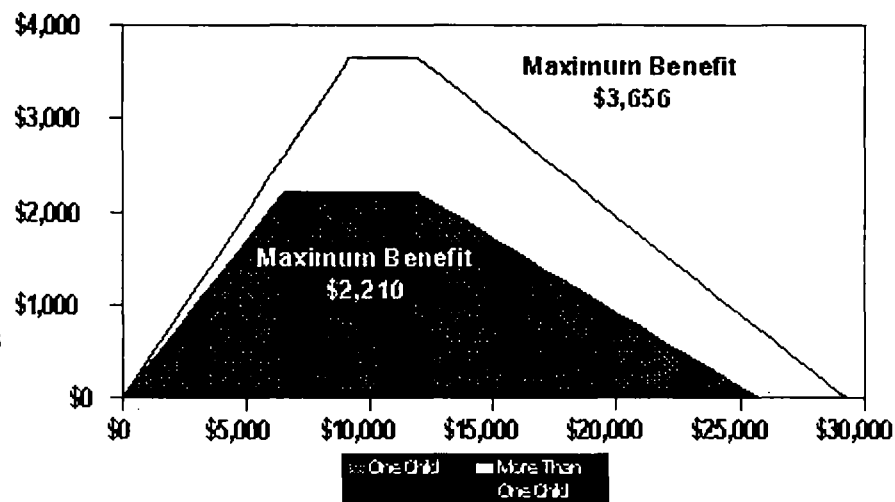
The EITC is targeted on low- and moderate-income workers. In 1997, approximately 16 million working families with children benefited from the credit.

The maximum benefits for tax year 1997 are \$2,210 for families with one child and \$3,656 for families with two or more children. These maximum amounts go to families with one child that have earnings of at least \$6,500 and adjusted gross income of no more than \$11,930, and to families with two or more children that have earnings of at least \$9,140 and adjusted gross income of no more than \$11,930. Benefits phase down gradually once income exceeds \$11,930. (See Figure 1.)

Unlike public assistance programs in some states, the EITC does not treat two-parent families less well than single-parent families by restricting the eligibility of two-parent families. Two-parent and single-parent working families at the same income level receive the same EITC benefit.⁽⁸⁾

Similarly, two-parent families receive the same EITC benefit amount if they have the same level of income, regardless of whether both parents or only one parent in the

The Federal Earned Income Tax Credit for Families in Tax Year 1997



Center on Budget and Policy Priorities

family works. In the past, the EITC has been strongly praised by some conservatives for the support it provides to low-income working families with stay-at-home mothers.

Only families with children may receive the *family* EITC. Parents who do not live with their children do not qualify for the family credit, although they may be eligible for the small EITC for workers without a child in the home if their income is below \$9,770. About three million very low-wage workers not raising minor children receive this small EITC, for which the maximum credit is \$332 (and the average credit is \$186). Because this credit is so small and the income limits for it are so low, it accounts for less than three percent of total EITC benefits.

Finally, only those who work can qualify for the EITC, and for families with very low earnings, the value of the credit increases as earnings rise. This is the opposite of how most means-tested benefit programs work; under most other programs, benefits *fall* as earnings rise. This aspect of the EITC operates effectively as a work incentive for those with no or very low earnings.

Academic Research on the Effects of the EITC on the Employment of Single Parents

As the size and prominence of the EITC has grown in recent years, so has the volume of academic research conducted on it. Perhaps the most striking research findings are those relating to the EITC's effects in increasing the workforce participation of single mothers.

Northwestern's Bruce Meyer and Dan Rosenbaum as well as Harvard's Liebman have noted that the percentage of single women with children who work has risen dramatically since the mid-1980s. In 1984, some 72.7 percent of single women with children worked during the year. In 1996, some 82.1 percent did. This increase has been most pronounced among women with less education.⁽⁹⁾

During this same period, there was *no* increase in work participation among single women *without* children. This raises a question — why did the proportion of single women *with* children who work rise dramatically while the proportion of single women *without* children who work remained unchanged? Recent studies indicate the large expansions since the mid-1980s in the EITC for families with children have played a substantial role.

Studies by Liebman and University of California economist Nada Eissa, which have been published by the National Bureau of Economic Research and in the *Quarterly Journal of Economics*, find the EITC expansion contained in the Tax Reform Act of 1986 had a significant effect in inducing more single women with children to go to work.⁽¹⁰⁾

Of particular interest is a new study by Northwestern University economists Bruce Meyer and Dan Rosenbaum. Meyer and Rosenbaum find that a large share of the increase in employment of single mothers since the mid-1980s can be attributed to expansions of the EITC. They find these expansions explain more than half of the substantial increase in employment rates among single mothers over the 1984 to 1996 period; that is, the EITC expansions had a larger effect during this period than all other factors combined in spurring more single mothers to go to work. They also find that over just the 1992 to 1996 period, when many states instituted major welfare policy changes, the EITC expansions accounted for somewhat less than half of the increase in employment rates among these mothers.⁽¹¹⁾

These findings are consistent both with the Eissa and Liebman study and with a study by Stacy Dickert, Scott Hauser, and John Karl Scholz of the University of Wisconsin. Dickert, Hauser, and Scholz projected that the EITC expansions in the 1993 budget law would induce a sizeable number of non-working single parents to seek employment and, in so doing, generate a reduction in welfare receipt. The Dickert, Hauser, Scholz study, published in a book edited by MIT economist James Poterba, estimated that the 1993 EITC expansions would induce approximately 500,000 families to move from welfare to the workforce.⁽¹²⁾ The study suggests that a movement of 500,000 families from welfare to work means a reduction in spending on these families of an estimated \$2 billion a year net of the increase in EITC payments to these families.

Recent academic research also contains encouraging findings regarding another issue related to the EITC — whether the EITC reduces work effort among parents who already are working and are in the income range over which EITC benefits phase down as earnings rise. Some analysts have theorized that particularly among two-earner families in these income ranges, the EITC may cause some reductions in hours worked. The largest effects have been assumed to occur among mothers in two-earner families who take advantage of the income the EITC provides to work less and spend more time with their children.

The research conducted to date on this issue, however, does not bear out these theories. As Liebman noted in a recent paper: "While there is only limited evidence so far, the evidence that does exist suggests that the phase-out of the EITC has little or no impact on hours of work." He explains that he and Eissa examined taxpayers who were already in the labor force when the number of workers in the EITC phase-out range was increased substantially as a result of the EITC expansions enacted in 1986. He notes that "We observed no decline in hours [of work]...."⁽¹³⁾

Effects on Poverty and Income Disparities

Recent research also finds that the EITC reduces poverty significantly, especially among children, and moderates the degree to which income gaps have widened between rich and poor.

The EITC has a strong impact in reducing poverty both because it is a refundable tax credit and because of its targeting on working families with low incomes. If a family's EITC is larger than the income taxes the family owes, the family receives a check from the Internal Revenue Service for the difference; this is why it is termed a "refundable" tax credit. This feature is essential to the working poor since they typically do not owe federal income taxes. (For the working poor, payroll taxes constitute their largest tax burden.)

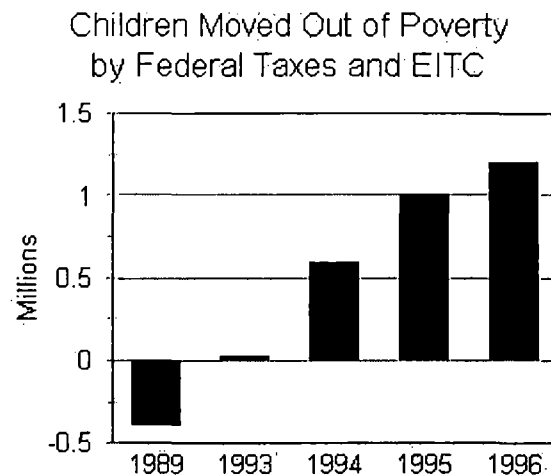
The targeting of the EITC, along with the fact that the largest EITC benefits go to working families below the poverty line, make it more likely to lift families out of poverty than programs that provide their largest benefits to families with no or little earnings. The EITC can provide the boost needed to lift low-income working families somewhat below the poverty line to above the poverty line. The EITC also is somewhat unique in that it provides substantial assistance, in the form of offsetting taxes and a wage supplement, to adults who find jobs and leave the welfare rolls but continue to be poor or to have modest incomes.

As the EITC has expanded in recent years, its impact in raising families out of poverty has grown much stronger. This effect does not show up in the Census

Bureau's *official* poverty figures because those figures neither subtract income and payroll taxes from family income nor count the EITC as part of family income. Most economists who have analyzed these issues, however, believe that employment-related taxes and the EITC, as well as certain non-cash benefits such as food stamps, should be counted in measuring poverty. A National Academy of Sciences panel recommended such a change in the measurement of poverty in 1995.

The Census Bureau issues data and alternative poverty measures that include such effects. When income and payroll taxes, the EITC, and non-cash benefits are taken into account in measuring poverty, the effects of the EITC are seen to be large and to have grown noticeably over time.

- Census data show that in 1989, prior to the EITC expansions enacted in 1990 and 1993, federal income and payroll taxes pushed more families with children into poverty than the EITC lifted out of poverty. The net effect of federal income and payroll taxes and the EITC was to push 400,000 children from low-income working families into poverty in 1989.⁽¹⁴⁾
- By 1993, the impact of the EITC was large enough to offset fully the extent to which income and payroll taxes increase poverty among working families with children. The net effect of these policies was to move a very small number of children out of poverty.
- In 1994, the final phase of the EITC expansion enacted in 1990 took effect, and the expansion approved in 1993 began to phase in. With a larger EITC, the net effect of federal income and payroll taxes and the EITC was to lift 600,000 children out of poverty.
- The number of children removed from poverty due to the combined effect of federal income and payroll taxes and the EITC increased to 1.2 million in 1996, the year the EITC expansions enacted in 1993 phased in fully.



To see the full effects of the EITC in reducing poverty, we need to separate its impact from that of the rest of the federal tax system. A new Center report, *Strengths of the Safety Net: How the EITC, Social Security, and Other Government Programs Affect Poverty*, uses Census data to compare the number of people poor after all government programs and taxes are counted, but before the EITC is taken into account, with the number of people poor after counting programs and taxes *including* the EITC. The difference is the number of people lifted out of poverty by the EITC. When this is done, the EITC is shown to lift more children out of poverty than any other government benefit program.

- Data from the Census Bureau's most recent Current Population Survey show that in 1996, the EITC lifted out of poverty 4.6 million people in low-income working families that would have been poor without it.
- More than half of those whom the EITC lifted out of poverty — 2.4 million people — were children.

- In 1996, more than one in every seven children who would have been poor in the absence of any government benefits — 14.5 percent — were lifted from poverty by the EITC.
- Various other government programs, from Social Security and unemployment insurance to cash welfare assistance, food stamps, and housing assistance, also lift families out of poverty. Of all children moved out of poverty by government programs in 1996, some 37 percent — nearly two in every five — were lifted from poverty by the EITC. No other government benefit program or category of programs lifted as many children out of poverty. (This does not mean the EITC provides more support for poor families with children than any other program. The TANF cash assistance program provides more aid to poor families with children than the EITC program does. But since a much larger proportion of TANF families than of families receiving the EITC have incomes far below the poverty line — and since the size of TANF benefits is reduced as a family's earnings increase — TANF grants are much less likely than the EITC to lift families out of poverty. The same is true of the food stamp program.)

Not surprisingly, among children in *working* families that would be poor without the EITC, the effects are even larger. Some 30 percent of all children in families that otherwise would be poor despite significant earnings are lifted from poverty by the EITC.⁽¹⁵⁾ This constitutes about half of all children in working families moved out of poverty by all government benefit programs combined. The EITC provides more support to working families with children than any other government program.⁽¹⁶⁾

The EITC is especially effective in reducing poverty among certain groups of children and in certain regions of the country.

- The EITC lifted 800,000 Hispanic children out of poverty in 1996. This was nearly one-fifth — 18 percent — of all Hispanic children who were poor before counting government benefits. Nearly half of all Hispanic children moved from poverty by government benefit programs are lifted out by the EITC.
- Similarly, the EITC lifted out of poverty 18 percent of all children in the South who were poor before government benefits were counted, a higher proportion than in any other region. Here, also, close to half of all children lifted from poverty by government benefit programs are removed from poverty by the EITC.

The EITC has its most pronounced effect in the South because the South has a larger proportion of families in which a parent works but remains poor than the other regions due largely to a lower wage structure. Similarly, the EITC has a particularly large effect in reducing poverty among Hispanic children because the proportion of poor children living in families with a full-time worker is considerably greater among Hispanics than among either whites or blacks.⁽¹⁷⁾

The effect of the EITC on families with young children also is notable. A March 1998 study by the Columbia University's National Center for Children in Poverty found that in 1996 the EITC reduced the poverty rate among children under age six from 23 percent to 18.7 percent. This amounts to a reduction in poverty among young children of nearly one quarter.⁽³²⁾

In addition to reducing poverty, the EITC has moderated the degree to which income gaps have widened between rich and poor. During the past 20 years, the

share of national income that the poorest fifth of households with children receive has declined, while the share the top fifth receives has risen markedly. Liebman's work shows the EITC offsets 29 percent of the decline that occurred between 1976 and 1996 in the share of income that the poorest fifth of households with children receives.⁽¹⁸⁾

How Fast is the EITC Growing?

In recent years, some EITC critics have characterized the Earned Income Tax Credit as one of the nation's fastest-growing entitlement programs. Although once true, this characterization is no longer accurate. The EITC grew rapidly for a number of years as EITC expansions approved by Congress were phasing in. Now that the last expansion, enacted in 1993, has phased in fully, significant EITC growth has ended.

Congressional Budget Office projections show that from fiscal year 1998 to fiscal 2003, the EITC is expected to grow at a much *slower* rate than the economy and to *decline* in cost as a share of the Gross Domestic Product. The projections also show that the EITC is now one of the slowest growing entitlements. Of the 15 largest entitlement programs, the EITC is growing more slowly than all others except farm price supports.⁽¹⁹⁾ The Office of Management and Budget's cost projections are very similar.

Projected Growth in EITC Costs, 1998-2003 (CBO Projections)		
	Average annual growth rate	Growth rate adjusted for inflation and population
The economy (GDP)	4.5%	1.2%
EITC	2.5%	-0.7%

CBO projects that from 1998 to 2003, the EITC will grow at a 2.5 percent annual rate, well below the projected annual rate of 5.3 percent for overall mandatory spending and just more than half the 4.5 percent average nominal growth rate projected for the economy. In fact, after adjustment for inflation and population growth, EITC costs are projected to decline at a rate of 0.7 percent per year.

The EITC Error Rate

The major criticism that continues to be levied against the EITC is that its error rate is too high. House Speaker Newt Gingrich has cited savings from eliminating EITC errors as one of the principal ways to finance a tax cut this year.⁽²⁰⁾ Several other Republican Congressional leaders have made similar comments, and House Republican conference chairman John Boehner has argued that increased highway spending could be financed by reductions in EITC errors.

The EITC error rate is high. An IRS study released in April 1997 estimated that 20.7 percent of EITC benefits are paid in error.⁽²¹⁾ This is the figure Speaker Gingrich cited.

Nevertheless, a 20.7 percent error rate represents substantial progress in reducing EITC error rates since the late 1980s, when IRS studies estimated the error rate at approximately 35 percent. Tougher compliance measures and simplification of

EITC rules have helped to lower the error rate appreciably.

It should be noted that the IRS study from which the 20.7 percent figure is taken is a study of tax returns for 1994 and that this figure appears to overstate the *current* error rate. More important, further significant reductions in EITC errors are expected in the years ahead as a result of substantial legislative measures enacted in the past few years, especially in 1996 and 1997.

The Limitations of the IRS Study

The 20.7 percent figure appears to overstate the current error rate for two reasons. First, the study does not reflect the effects of several legislative changes now in effect that were not in place during the period the study covered. These changes, summarized in the Appendix, are enabling the IRS to make much more effective use of Social Security numbers in verifying EITC eligibility and preventing payment of erroneous claims.

Second, due to limitations in the data that the IRS study collected, the study overstated the size of the errors in a number of cases it examined. For example, the study found nearly one-fifth of the errors occurred when a parent claimed a child for EITC purposes but, under the EITC's complex rules, another relative in the household such as a grandparent should have claimed the child instead. The loss to the Treasury in these cases is the amount by which the EITC amount paid to the parent exceeds the amount that should have been paid to the grandparent. The IRS study, however, was not designed to collect the data needed to determine the amount the grandparent should have received in such cases; as a result, the study simply classified the *entire* amount paid to the parent in these cases as being in error. The Treasury Department has noted that the study overstates the magnitude of the error in such cases.

In addition, the 20.7 percent figure does not adjust for underpayments. The IRS study indicates the EITC underpayment rate is at least 1.7 percent. The net loss to the Treasury is thus something less than 19 percent.⁽²²⁾

Recent Legislative and Administrative Actions to Curb Error

The Taxpayer Relief Act of 1997 and the Balanced Budget Act of 1997 contain a series of major error-reduction measures. These new measures are based on the IRS study and were designed to reduce errors the study found. The measures, summarized in the Appendix and described in more detail in a Center analysis, *The Earned Income Tax Credit and Error Rates*, hold promise of reducing EITC errors significantly in coming years.

These measures include new mechanisms through which the IRS will be able to access the Federal Child Support Case Registry, which the welfare law established, to ascertain if a parent claiming a child for the EITC is a *non*-custodial parent and thus ineligible for the EITC. The 1997 law also requires that starting in 1998, whenever a child receives a Social Security number, the numbers of the child's parents be listed. This will link a child's Social Security numbers to those of his or her parents in the Social Security database, enabling the IRS to verify, by accessing the Social Security database, whether EITC filers presenting themselves as parents of children they claim for the EITC actually are the parents. In addition, the 1997 legislation effectively provides the IRS \$716 million over five years for substantially intensified efforts to curb EITC errors. The IRS has received the first installment of these funds and instituted an aggressive error-reduction program that includes screening approximately four million returns claiming the EITC this year.

A substantial portion of the EITC errors did not reflect deliberate misrepresentation

on the part of the tax filers. The IRS study found relatively few EITC errors to have resulted from actions by families to conceal incomes, a more common source of error in some other means-tested programs. Much larger shares of EITC errors were related to the varied and often-changing living arrangements of families and the complex and sometimes contradictory rules the tax code establishes with regard to family relationships, tax filing status, and the tax treatment of children in divorced, separated, and multi-generational families and families where the caretaker is someone other than the parent. This is true both for most inadvertent errors and for most errors that appear intentional. The new error-reduction measures, such as the expansion of the child support registry and granting IRS access to it, are designed to respond to these findings (although the findings indicate that simplification of complex tax rules relating to the EITC also could lower error rates).

Finally, the study contains one other significant finding — it indicates EITC errors are not due primarily to the EITC's refundable nature. The study found the error rate among working families that have incomes too low to have a pre-EITC income tax liability (and consequently receive their full EITC payment in the form of a refund check) was *only one-third as high* as the error rate among families that *do* have an income tax liability before the EITC is applied.

Is Reducing EITC Error Rates a Realistic Way to Raise Revenue?

Statements that large, additional EITC error-reduction savings can be secured this year to help finance a new round of tax cuts are very questionable. There presently are no legislative options that would yield billions of dollars in savings from EITC error rate reduction. All known viable options that yield significant savings have been enacted, and Congressional leaders who have spoken about eliminating or reducing EITC errors to finance tax cuts or highway spending increases appear not to have any specific EITC error-reductions proposals in mind that would yield such savings. (The Administration's budget contains several useful legislative proposals to reduce EITC errors, but these provisions are not large enough to finance significant tax cuts; the Treasury Department estimates they will save approximately \$400 million over the next five years.)⁽²³⁾

Recent history is instructive here. Although a number of members of Congress cited the EITC error rate during the 1995 budget debate as justification for alterations in the EITC, the budget bill Congress passed that year (and President Clinton later vetoed) contained no error-reduction measures except for those the Treasury Department had proposed. Cost estimates issued by the Joint Tax Committee on Taxation, Congress' official scorekeeper, showed that approximately 95 percent of the large EITC savings in the 1995 budget reconciliation bill came from cuts in EITC benefits — which would primarily have affected low-income working families that completed their tax returns accurately — not from error-reduction measures.

Furthermore, during the final stages of the 1997 budget negotiations, some Congressional negotiators sought EITC savings in return for agreeing to an Administration request to allow more low- to moderate-income families to qualify for the new child tax credit. Here, too, Congressional leaders were unable to come up with EITC error-reduction proposals. All of the EITC error-curtalement measures ultimately included in the new tax law came from the Treasury Department.

There are no remaining Treasury legislative proposals that would produce sizeable EITC savings. In addition, as in previous years, Congressional leaders have not advanced specific error-reduction proposals. It is unclear how new EITC legislation could produce large savings to finance substantial tax cuts this year unless the savings came from sizeable EITC *benefit* reductions that penalized honest

low-wage working families and bore little relationship to error reduction.

Are EITC Errors a Principal Cause of Income Tax Error and Fraud?

The EITC error rate exceeds the average error rate for the income tax as a whole, which is approximately 15 percent. Many elements of the income tax, however, have higher error rates than the EITC does.

For example, the Internal Revenue Service has reported that 29 percent to 30 percent of business income is not reported on tax returns. The IRS also estimates that sole proprietors who formally operate businesses other than farms fail to report 31 percent to 32 percent of their business income. Similarly, some 31 percent to 32 percent of farm income and 27 percent to 28 percent of income from the sales of business property go unreported.⁽²⁴⁾

The IRS and the General Accounting Office have estimated that the amount lost due to errors and fraud in the individual and corporate income tax is well over \$100 billion a year. Data from the GAO and the IRS indicate that EITC losses account for less than five percent of this amount.⁽²⁵⁾ Unreported business income alone results in \$40 billion in lost individual income tax collections, substantially more than the EITC's entire cost.⁽²⁶⁾

Statements from Congressional leaders that tax cuts can be financed partly by reducing errors have focused solely on EITC errors. No mention has been made of reducing errors in other parts of the tax code, such as errors and abuses in tax credits for corporations or for individuals at higher income levels.

In addition, some experts have warned that pending legislation to restructure the Internal Revenue Service could lead to an increase in undetected tax fraud in areas other than the EITC. The IRS legislation the House of Representatives approved last fall limits the use of "economic reality audits." As the *New York Times* has reported, "in an economic reality audit, IRS agents try to show that an individual cannot support his way of life with the income shown on his tax return — for example, a taxpayer with a mansion and yacht whose tax return lists a modest income." The *Times* cited tax experts such as Donald C. Alexander, IRS Commissioner during the Nixon administration, as expressing concern that this provision would inhibit aggressive enforcement against tax evaders.⁽²⁷⁾

EITC Continues to Draw Support From Across the Ideological Spectrum

Throughout most of its history, the EITC has received support across the political spectrum. Presidents Reagan, Bush and Clinton all proposed EITC expansions and signed expansions into law. In addition, in recent years, EITCs have been established or expanded in some states with bipartisan support; in 1997, Republican governors and Democratic legislatures worked together to establish a state EITC in Massachusetts and to expand a state EITC in Minnesota. In Oregon, a state EITC was established by a Republican legislature and a Democratic governor.

Similarly, the EITC has frequently drawn support from unusually broad coalitions. In March 1998, for example, a coalition of business, labor, and anti-poverty organizations jointly called for expanding New York's state EITC. Those endorsing the expansion include what the *New York Times* described as the state's two "foremost" groups representing large and small businesses, the Business Council of New York State and the National Federation of Independent Business.⁽²⁸⁾

To some degree, however, bipartisan support in the U.S. Congress has eroded since the expansion sponsored by President Clinton was enacted in 1993. Even so, the EITC continues to draw support from various conservative policy experts.

For example, in a *Wall Street Journal* column published in 1996, conservative economist Robert J. Barro — a Harvard economics professor who is a fellow of the conservative Hoover Institution and a *Wall Street Journal* contributing editor — praised the EITC highly. Barro noted the bipartisan roots of the EITC and its positive work incentive effects. Barro wrote:⁽²⁹⁾

"...there exists a serious program in the form of the earned-income tax credit that actually helps the working poor in a way that promotes work and discourages welfare. The EITC was originally a Republican idea — started by the Ford administration in 1975 and expanded by the Reagan administration during the glorious 1980s and the Bush administration in 1990. However, the program has been identified with Democrats since the increase in benefits in 1993 (arguably the one sensible feature of the 1993 tax law).

"In 1996, a family with two or more children receives a 40% wage subsidy on earnings up to \$8,890 (to yield a maximum credit of \$3,556). This aspect of the program motivates labor-force participation, particularly by offsetting the work disincentives from the Social Security payroll tax and lost welfare payments....

"....Mr. Clinton's support is not sufficient reason to regard the program as mistaken. In fact, it has a well conceived structure that ought to be retained and perhaps expanded in a comprehensive welfare reform package.

"Nada Eissa of the University of California at Berkeley and Jeff Liebman of Harvard University have examined the effect of the EITC on labor supply.... Their study compares work experience in 1984-86 — before the increase of the credit in the 1986 tax reform — with that in 1988-90. The key finding is that labor-force participation of people likely to be eligible for the credit — notably single women with children — rose by two to three percentage points relative to those people unlikely to be eligible. Moreover, since the EITC was made far more generous in the 1990 and 1993 tax laws, the positive effects of the present system on labor-force participation are likely to be greater....

"Opposition to the EITC focuses on two issues — the large budget outlays and the high incidence of fraudulent claims. Two offsets to the extra spending are the reduced welfare dependency and the benefits from distributing income to a group that much of society regards as deserving — the working poor with children. This seems to be a case (admittedly rare) where an excessive focus on budget numbers would curtail an effective government program....

"Two mitigating points about the fraud problem can be raised. First, transferring money to the working poor without EITC eligible children is not entirely bad.⁽³⁰⁾ Second, the IRS can and apparently now is doing better at policing the EITC.

"It makes sense that a comprehensive welfare program would include EITC-type payments to the working poor...."

Two weeks after Barro's column appeared, a column praising the merits of the EITC on similar grounds appeared in *Business Week*. This column was authored by noted conservative economist and Nobel laureate Gary S. Becker. Becker declared that the EITC helps the working poor without raising employer costs or encouraging dependence on welfare, increases work effort among those with no or very low wages, helps single-earner as well as two-earner families, and is well targeted.⁽³¹⁾

Conclusion

The ongoing support for the EITC across the ideological spectrum constitutes a relatively rare case of agreement about a method to combat poverty. The new evidence emerging from the academic literature about the positive effects of the EITC on workforce participation, as well as the evidence concerning the EITC's powerful effects in reducing poverty among the working poor and moderating income disparities, is likely to strengthen this support. Moreover, past concerns about the program's escalating costs should be allayed by the new projections indicating that significant program growth has halted and that costs are projected to decline modestly over the next several years, after adjusting for inflation and population growth.

The high rates of error in the program remain a concern. This concern has led to important legislative changes and intensified administrative efforts, many of which have either been implemented recently or are slated to take effect in the next few years. EITC error rates have already fallen substantially from their mid-1980 levels, and — as a result of the new initiatives — should fall further in coming years.

A paramount economic challenge facing the United States is to how to help ensure that the benefits of economic growth are shared broadly among workers at all income levels without interfering with the basic workings of the marketplace. In the face of the long-term trend of eroding wage levels for workers on the lower rungs of the earnings scale, there is growing evidence that the EITC is an important — and effective — policy tool to help address this challenge.

Appendix

New Measures Should Further Reduce EITC Error Rates

The IRS study of error rates in the EITC does not reflect the effects of several significant anti-error measures that were enacted prior to 1997 and are now in effect, but were not in effect in tax year 1994, the period the study covered.

- In filing tax returns for 1994, filers did not have to provide Social Security numbers for children under age one. This created a potential for abuse; fictitious children could be claimed without much risk of detection if they were listed as being less than one year of age. Accordingly, legislation was enacted requiring taxpayers to provide Social Security numbers for *all* children, including those under age one. The requirement to provide Social Security numbers for infants took full effect in tax year 1997.
- In 1994, the IRS could hold up an EITC claim if it found what appeared to be a discrepancy in the Social Security number provided for a tax filer or his or her spouse. But the IRS ultimately paid most of these claims. It lacked the legal authority to deny such claims unless it could *prove* the Social Security number was not valid, and the IRS generally lacked the resources to secure such proof. As a result of legislation enacted in 1996, the IRS now simply denies these claims, with the burden of proof being shifted to the tax filer to demonstrate he or she has provided a valid Social Security number.

Last year's budget agreement contains measures that hold considerable promise for reducing EITC errors in coming years. These measures were specifically

designed to address some of the principal causes of error the IRS study identified.

- The study found that errors occurring when a parent claims a child who did not reside with the parent more than six months of the year accounted for nearly two-fifths of all erroneous EITC claims. In the past, it was difficult for the IRS to verify the residency of children claimed for the EITC without corresponding with the taxpayer. To help address this problem, the 1997 act expands the data to be included in the Federal Child Support Case Registry and gives the IRS access to this important new database, which was established by the 1996 welfare law. In processing an EITC claim from an individual who files as a single individual or head of household, the IRS will be able — when this database is fully developed in coming years — to key into the database and ascertain whether an individual claiming a child for the EITC is classified as the child's custodial parent. If so, the IRS will be able to withhold the EITC payment and release it only if the claimant can show he lived with the child for more than half of the tax year.
- Until now, the IRS also has had no good way of determining whether an adult claiming a child for EITC purposes and presenting himself or herself as the child's parent actually is the parent. The IRS study found more than \$500 million of EITC overclaims resulted from taxpayers claiming children who did not meet the EITC's relationship test. Accordingly, the 1997 Tax Act requires that starting in 1998, whenever a parent seeks a Social Security number for a child, he or she must provide the Social Security numbers of the child's parents. Social Security datafiles will link information on children's Social Security numbers to their parents' numbers. This will enable the IRS to verify parental status by keying into the Social Security datafiles.

Last year's budget agreement also takes one other important step. It effectively provides \$716 million over the next five years to the IRS to beef up EITC enforcement activities. These funds should enable the IRS to institute the reforms described here and also conduct much more substantial efforts to identify questionable EITC claims and follow up on such claims. The IRS received the first installment of these funds in fiscal year 1998 and has begun to institute an aggressive error reduction program that includes the following components:

- The IRS is stopping returns with missing or invalid Social Security numbers; no EITC payment is being made on these claims unless filers provide valid Social Security numbers. The IRS projects these activities will result in 830,000 returns claiming the EITC being stopped this year, saving some hundreds of millions of dollars.
- The IRS has substantially enhanced the resources for the "Questionable Refund Detection Teams" it has established in its service centers. The additional resources will enable the teams to screen more returns and identify more questionable claims and questionable preparers. The IRS expects to screen four million EITC returns this year, some of which will be selected for more intensive examination. The IRS also is hiring and training 40 new special agents to investigate preparers whom the Teams identify as having submitted questionable EITC claims.
- The IRS sent out warning notices earlier this year to all taxpayers who last year claimed the EITC or the dependent exemption for a child also claimed on another tax return. Such action has never been taken before; it should have a strong deterrent effect. In addition, the IRS plans this year to examine 750,000 EITC claims, including claims submitted by tax filers who claimed the EITC last year for a child also claimed by another tax filer and claims

identified for more intensive scrutiny by the Questionable Refund Detection Teams.

The 1997 legislation also toughens penalties for EITC fraud, enhances the IRS' ability to recoup EITC overpayments, and stiffens penalties on commercial preparers who fail to exercise adequate diligence in handling EITC claims. (The IRS study found the error rate to be 50 percent higher among claims filed by preparers who were *not* attorneys, CPAs, enrolled agents, or representatives of a nationally known firm.) This provision is designed to induce preparers to become better trained in EITC rules and more careful in handling EITC claims.

End Notes

1. Robert J. Barro, "Workfare Still Beats Welfare," *Wall Street Journal*, May 21, 1996.
2. Gary S. Becker, "How to End Welfare 'As We Know it' — Fast," *Business Week*, June 3, 1996.
3. The families included in these figures include those without children. If just families with children are examined, the poorest fifth of these families experienced on average a drop in income of 21 percent from 1979 to 1996, after adjusting for inflation. The most affluent fifth of families with children experienced an average income gain of 34 percent over this period.
4. Unpublished tables from the Economic Policy Institute indicate that wage inequality has grown in 15 of the 17 years since 1979. The Institute measured this trend by examining the "Gini coefficient" for wages, a technical measure of inequality generally regarded by economists as the best available measure.
5. Rebecca M. Blank, *It Takes a Nation: A New Agenda for Fighting Poverty*, Russell Sage Foundation and Princeton University Press, 1997.
6. Jeffrey B. Liebman, "The Impact of the Earned Income Tax Credit on Incentives and Income Distribution," included in *Tax Policy and the Economy*, National Bureau of Economic Research, edited by James M. Poterba, forthcoming.
7. The employee share of payroll taxes consumes 7.65 percent of the earnings of these families, with employers paying an equal amount. Most economists believe that the employer's share of the payroll tax effectively comes out of workers' paychecks as well — that is, wages would be higher if employers didn't have to pay this tax.
8. Some policymakers have expressed concern that the structure of the EITC creates "marriage penalties" because some individuals would receive a smaller EITC if they married than if they remained single. In actuality, the impact of the EITC on individuals who marry is mixed, with some families facing an increase in EITC benefits if they marry and others facing a reduced EITC benefit. Of particular note, the EITC provides a "marriage bonus" to unemployed single mothers and low-wage male workers; if they marry, they generally qualify for a substantially larger EITC.
9. Jeffrey B. Liebman, *op. cit.*
10. Nada Eissa and Jeffrey B. Liebman, "Labor Supply Response to the Earned Income Tax Credit," *Quarterly Journal of Economics*, May 1996, 112(2), pp. 605-637 and Liebman, *op. cit.*
11. Bruce D. Meyer and Dan T. Rosenbaum, "Welfare, The Earned Income Tax Credit, and the Labor Supply of Single Mothers," March 7, 1998.
12. Stacy Dickert, Scott Hauser, and John Karl Scholz, "The Earned Income Tax Credit and Transfer Programs: A Study of Labor Market and Program Participation," in James M. Poterba, ed., *Tax Policy and the Economy*, Vol. 9., MIT Press, 1995. Scholz is now deputy assistant secretary for tax analysis at the Treasury Department.
13. Liebman, *op. cit.* Liebman noted that the confidence intervals in the analysis were such that he and Eissa could not rule out a small decline in hours of work.
14. All data cited in this section of the report are from the Census Bureau. The Census Bureau makes data available each year on poverty rates both before and after government benefits are

counted as income. These data also show poverty rates after only social insurance benefits are counted, after *all* cash benefits (including means-tested benefits) are counted, after both cash *and non-cash benefits* — such as food stamps, housing assistance, and school lunch benefits — are counted, and after all such benefits are counted *and* the effects of federal income and payroll taxes — including the EITC — are taken into account. A new Center on Budget and Policy Priorities report, *Strengths of the Safety Net: How the EITC, Social Security, and Other Government Programs Affect Poverty*, examines in detail these Census data and what they show about the effects of various government benefit programs on poverty.

15. Poor families with significant earnings are defined here as families with earnings at least equal to current half-time minimum wage earnings throughout the year (i.e., earnings of at least \$5,150, which equals 20 hours a week for 50 weeks at the \$5.15-an-hour minimum wage).

16. This comparison does not include Medicaid, which is an insurance program rather than a program providing assistance families can use to meet ongoing expenses.

17. Census data show that in 1996, some 39 percent of Hispanic children classified as poor under the official poverty measure lived in families where someone worked full time throughout the year. By comparison, 32 percent of poor white children and 18 percent of poor black children lived in families with a full-time worker.

18. Liebman, *op. cit.*

19. In alphabetical order, the 13 mandatory programs expected to grow at a faster rate than the EITC from 1998 to 2003 are: child nutrition, civil service retirement, family support, food stamps, foster care, Medicaid, Medicare, military retirement, Social Security, student loans, Supplemental Security Income, unemployment compensation, and veterans compensation. Only farm price supports are projected to grow more slowly.

20. Speech before Cobb County Chamber of Commerce, Marietta, Georgia, January 5, 1998. Mr. Gingrich repeated this statement on February 11, 1998; see *Congress Daily/A.M.*, February 12, 1998, p. 7.

21. Internal Revenue Service, "Study of EITC Filers for Tax Year 1994," April 1997. The IRS study estimated that 25.8 percent of EITC benefits claimed in 1995 (for tax year 1994) were overclaimed erroneously. The 25.8 percent figure refers to the EITC amounts erroneously *claimed* on tax returns not to the amounts actually *paid out* erroneously; the IRS catches some erroneous claims before payment is made, so the actual error rate is lower than the rate of erroneous claims. The IRS study estimated the rate of erroneous payments at 20.7 percent.

22. The IRS study estimated the EITC underpayment rate at 1.7 percent, but this figure is a low estimate because it reflects only cases in which a tax filer eligible for the EITC filed for the EITC but claimed too small an EITC benefit. This figure does not include cases where individuals eligible for the EITC filed for the EITC but claimed too small an EITC benefit. This figure does not include cases where individuals eligible for the EITC filed a tax return but did not claim the EITC on their returns. Had such cases been included to provide a full accounting of underclaims by eligible tax filers, the underpayment rate would have been greater than 1.7 percent.

23. Simplification measures could reduce the EITC error rates but generally would not save significant amounts that could be used to finance tax cuts and in some cases could increase costs. See Robert Greenstein, *The Earned Income Tax Credit and Error Rates*, February 1998.

24. Internal Revenue Service, *Federal Tax Compliance Research: Individual Income Tax Gap Estimates for 1985, 1988, and 1992*, April 1996. The figures cited here are for tax year 1992, the latest year for which these data are available.

25. GAO and IRS reports estimate that individual and corporate income tax losses from error and fraud totaled \$128.4 billion for tax year 1992. The IRS estimates its enforcement actions reduced these losses by about one-sixth. If net revenue losses due to income tax errors and fraud are at the same dollar level today as in 1992, then losses due to erroneous EITC payments — using the 20.7 percent figure in the IRS report and current EITC cost levels — constitute less than five percent of these losses. (In fact, net revenue losses in the tax code as a whole are almost certain to be significantly higher today than in 1992, because total tax liabilities are larger. IRS studies show that the dollar amounts lost to error and fraud in the tax code as a whole increase as the total amount of income tax owed rises.) See General Accounting Office, "Earned Income Credit: Noncompliance Relative to Other Components of the Income Tax Gap," June 13, 1997, and Internal Revenue Service, *op. cit.*

26. Internal Revenue Service, *op. cit.*, and General Accounting Office, *op. cit.*

27. The *Times* quoted Lee A. Sheppard, a tax expert who critiques tax law for the highly regarded publication *Tax Notes*, as stating that the provision to limit the IRS' ability to use economic reality audits to detect tax evasion "should be called the mobsters and drug dealers tax relief act of 1997." David Cay Johnston, "Helping a Few Taxpayers At the Expense of Many?," *New York Times*, November 2, 1997.
28. Richard Perez-Pena, "Tax Credit Rise Urged for Poor in New York," *New York Times*, March 2, 1998.
29. Robert J. Barro, *op.cit.*
30. Liebman has found that most tax filers who receive the EITC erroneously have low incomes. Liebman found that in 1988, six of every seven ineligible EITC recipients had income below the EITC income limits. These recipients were ineligible for the EITC for other reasons, such as lack of a qualifying child.
31. Gary Becker, "How to End Welfare 'As We Know It' — Fast". *Business Week*, June 3, 1996.
32. National Center for Children in Poverty, Columbia School of Public Health, [Young Children in Poverty: A Statistical Update](#), March 1998.

[Background Information](#) | [Board of Directors](#)
[Publication Library](#) | [Center Staff](#) | [Search this site](#)
[Job Opportunities](#) | [Internship Information](#) | [Top Level](#)
