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Using the EITC and CTC to Smooth Income Instability: Potential Effects of a "Lookback" on Poverty

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Though the Earned Income Tax Credit (EITC) and the Child Tax Credit (CTC) are some of the nation's most effective antipoverty policies, they track earnings and therefore mirror the instability of recipients' earnings over the prior year. A one-year "lookback" is a mechanism that would help reduce this instability—we take a first look at its potential effects on poverty. A lookback provision would allow EITC and CTC claimants to look back one year when filing taxes to maximize their credit and smooth earnings instability.

Findings

By linking year-to-year data from the Annual Social and Economic Supplement (ASEC) of the Current Population Survey (CPS), we find:

- *A one-year lookback would reduce poverty among the total US population: Using averaged data from 2009-2015, an EITC/CTC lookback would reduce poverty by 0.4 percentage points for the whole population and by 0.8 percentage points for recipients of one or both of these tax credits (Figure 1). This translates to approximately 1.3 million fewer Americans in poverty.*

- *The same one-year look back would reduce child poverty among the total US population as well: An EITC/CTC lookback would reduce child poverty overall by 0.8 percentage points, and by 0.9 percentage points for recipients of one or both of these tax credits (Figure 2). This translates to approximately 600,000 fewer American children in poverty.*

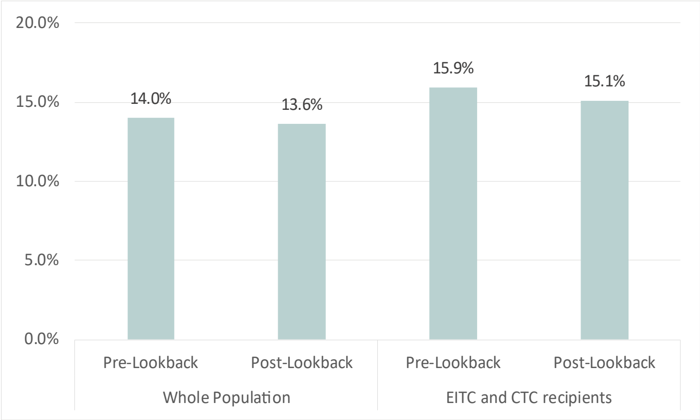

Figure 1: Effect of an EITC/CTC Lookback on SPM Poverty, Total Population

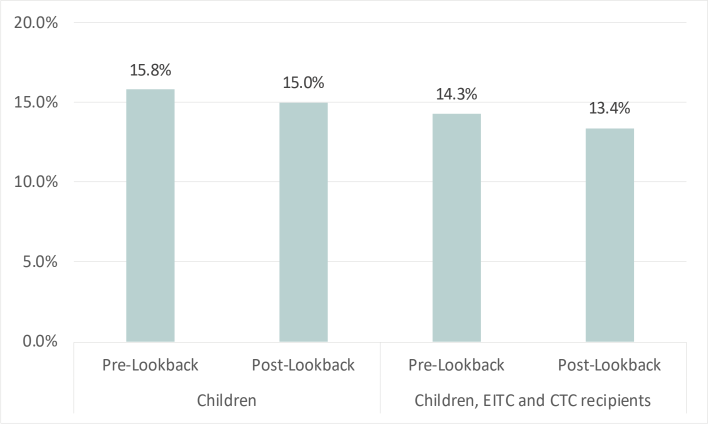

Figure 2: Effect of an EITC/CTC Lookback on SPM Poverty, Children

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Income instability has increased over time for American families, particularly for those in the low-wage labor force and the results are far reaching.[i] Volatility in earnings can contribute to a domino effect of destabilization across multiple domains, negatively impacting health, food security, housing, and access to resources.[ii] Research shows that young children especially bear the burden, as income instability has some of the harshest effects on child development.[iii] A well-documented reason for a family's loss in year-to-year income is the arrival of a new baby—at a time when a family needs the most support, instability in income coupled with the instability of a tax return can be detrimental, increasing a family's risk of entering or staying in poverty.[iv] For many American families, the EITC and CTC credits are critical to staying afloat and paying for basic needs, such as transportation, food, household bills, education and housing.[v] The evidence for the consequences of income instability is robust and many believe that policy should be oriented towards stabilizing family income and increasing economic security.

This brief examines the likely effects of a revision of the EITC and CTC—the implementation of a one-year lookback period, ensuring that if earnings decline year to year, a family would be eligible for the larger credit of the past two years, creating greater stability in income and ultimately reducing poverty. The idea of a lookback provision to the tax code is not new; in fact, the proposal follows from the actual implementation of a temporary lookback provision that was used in response to Hurricanes Katrina, Wilma, and Rita in 2005. Just last week, a temporary lookback provision was again implemented, this time in response to Hurricanes Harvey, Irma, and Maria. A Nationwide legislation has been proposed, but there have been no estimates of its effects on poverty.[vi] While the tax code provides opportunities for income smoothing for businesses and for wealthier individuals, there are rarely such tax mechanisms in effect that benefit the majority of working families.

This brief is the first to simulate antipoverty effects of a lookback provision using linked year-to-year files of the CPS ASEC in conjunction with tax estimates, providing a first-order estimate of the antipoverty impacts for low-income families, particularly low-income families with children. Based on our models (Figures 1 and 2), the lookback would reduce poverty for the population as a whole, but especially for children. The lookback would have the largest poverty reducing effects among those in families receiving the credit. Children in EITC and/or CTC recipient households would benefit from a 0.9% reduction in poverty compared to a 0.8% reduction for children in all households. For adults in EITC and/or CTC recipient households, poverty would be reduced by 0.8%, compared to 0.4% for those in non-recipient households. We focus here on families who would move above the poverty line. Of course, many more families would benefit—moving further above the poverty line or moving further out of deep poverty.

Reducing the current poverty rate among American families is possible with the implementation of a one-year lookback provision to the EITC and CTC. Based on our simulation, using data from 2009-2015, the anti-poverty effects would benefit America's most vulnerable populations, especially children, by bolstering income stability—a crucial indicator for poverty risk and overall wellbeing.

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