

Facts

About the Earned Income Credit:



Tax Time
Can Pay for
Working
Families

The Earned Income Credit
and Child Tax Credit



2005

The Center on Budget and Policy Priorities would like to thank the following:

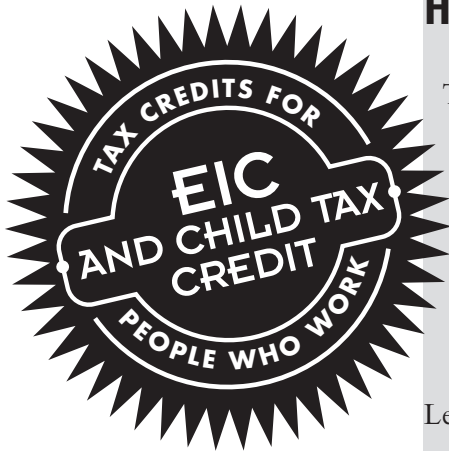
Photos:

**Chicago Women in Trades, cwitinfo@cwit2.org
Sam Hollenshead**

Design:

Hasten Design Studio

Facts About the Earned Income Credit: Tax Time Can Pay for Working Families



Here's what's inside this booklet:

The Earned Income Credit: Extra Money for People Who Work	3
The EIC Can Help Low-Income Workers Not Living With Children	5
Boost Take-Home Pay! The Advance EIC Payment Option . . .	7
Learn More: Questions and Answers About the EIC	9
NEW! Rules for Workers with Disabilities and Families Raising Children With Disabilities	17
The EIC Can Help Multiply Assets	19
Saver's Tax Credit for 2004: Workers Can Save for Retirement and Reduce Income Taxes	21
NEW! Roth IRAs: A Flexible Approach to Developing Assets	23
Examples of Earned Income for the Earned Income Credit . . .	24
EIC Benefits for Tax Year 2004 at Various Income Levels . . .	Back Cover

More Money for Workers in the District of Columbia, Illinois, Indiana, Kansas, Maryland, Massachusetts, Minnesota, New Jersey, New York, Oklahoma, Rhode Island, Vermont, and Wisconsin!

In addition to the federal EIC, low-income workers in these states can receive extra money for 2004 from a refundable state EIC. Because the state EIC is in addition to the federal credit, the EIC amounts you see in this kit will be lower than the combined federal and state EIC benefits available to workers in these states. Revise the materials in this kit to reflect the full amount of the EIC — federal and state — along with instructions for how to claim them. For more information, contact your state department of revenue.

For more information on state and local EICs, see the booklet in this kit "Making Tax Time Pay: How to Promote the Earned Income Credit and the Child Tax Credit."

You don't have to be a tax expert to promote the Earned Income Credit!

Each year, community organizations, human services providers, businesses, employers, labor unions, government agencies and a host of others find effective ways to incorporate Earned Income Credit (EIC) outreach activities into their routine operations. Most Outreach Campaign partners have no specialized tax knowledge — but they successfully alert working families and individuals about this critical tax benefit and direct them to free tax filing assistance. Their efforts mean millions of working families and individuals get a significant boost to their paychecks.

This booklet will help you get started.

This booklet provides the background you need to understand the basics of the EIC — who is eligible and how to claim it. In addition, you will find the answers to commonly asked questions and more

detailed information pertaining to special groups of eligible workers, such as members of the military or immigrant workers.

Many families can also get *Extra Credit* by claiming the Child Tax Credit.

Many working families can qualify for the Child Tax Credit and get up to \$1,000 for each child — in addition to the EIC for which they may qualify. You will want to get familiar with the Child Tax Credit, so you can help families take advantage of the full range of tax benefits. The rules for claiming the Child Tax Credit are different from the rules for claiming the Earned Income Credit. While this adds some complexity to the picture, the bottom line is that the outreach message to families can remain simple: **Get all the tax credits you earned!** For detailed information, a separate booklet, *Facts About the Child Tax Credit*, is included in this kit.

The EIC Certification Test: The IRS Tests a New Eligibility Verification Procedure on 25,000 Taxpayers for 2004 Tax Returns

The IRS sent notices in November 2004 to 25,000 previous EIC claimants letting them know that if they wish to claim the EIC for 2004, they will be required to submit verification proving that their child lived with them for more than half the year. These workers have the choice to submit the required documents in advance of filing their return (to avoid unnecessarily delaying their refund) or with their 2004 tax return. To test how this procedure works in a community setting, and to gauge its impact on the agencies that workers would likely ask to provide the documents, about 8,000 of the 25,000 workers selected for the test will come from Hartford County, Connecticut. **Only those tax filers selected by the IRS — a tiny fraction of those who claim the EIC — will be required to participate in this test.** It is very unlikely organizations outside of Hartford County will see anyone selected for this test. The test should have no effect on your outreach efforts for the EIC. See the *Special Alert: IRS Continues to Test EIC Certification Procedure in 2005 Tax Filing Season*, enclosed in this kit for more detailed information about this test and how Outreach Campaigns can assist workers in their communities who might be affected.



The Earned Income Credit: Extra Money for People Who Work

What is the Earned Income Credit?

The EIC is a special tax benefit for working people who earn low or moderate incomes. It has several important purposes: to reduce the tax burden on these workers, to supplement wages, and to provide a work incentive.

Workers who qualify for the EIC and file a federal tax return can get back some or all of the federal income tax that was taken out of their pay during the year. They may also get extra cash back from the IRS. Even workers whose earnings are too small to owe income tax can get the EIC. What's more, the EIC offsets any additional taxes workers may owe, such as payroll taxes.

Who can get the EIC and how much is it worth?

Single or married people who worked full-time or part-time at some point in 2004 can qualify for the EIC, depending on their income.

- Workers who were raising one child in their home and had family income of less than \$30,338 (or \$31,338 for married workers) in 2004 can get an EIC of up to **\$2,604**.
- Workers who were raising more than one child in their home and had family income of less than \$34,458 (or \$35,458 for married workers) in 2004 can get an EIC of up to **\$4,300**.
- Workers who were not raising children in their home, were between ages 25 and 64 on December 31, 2004, and had income below \$11,490 (or \$12,490 for married workers) can get an EIC up to **\$390**.

How does the EIC work?

- **Eligible workers can pay less in taxes and get a check from the IRS.** Mr. and Mrs. Johnson have two children, ages 20 and 21, in college. They earned \$29,000 in 2004 and owe the IRS \$690 in income tax, none of which was withheld from their pay during the year. Their income makes them eligible for an EIC of

Which children qualify for the EIC?

- Sons, daughters, stepchildren, grandchildren and adopted children
- Brothers, sisters, stepbrothers, or stepsisters — as well as descendants of such relatives — if they were cared for as members of the family
- Foster children who are placed with the worker by an authorized government or private placement agency

“Qualifying children” must live with the worker for more than half of the year. They must be under age 19, or under age 24 if they are full-time students. Totally and permanently disabled children of *any age* also may be qualifying children. Valid Social Security numbers are required for qualifying children born before December 31, 2004.

\$1,366. So, the EIC eliminates their \$690 income tax (now they don't owe IRS anything) and still gives them a refund of \$676.

- **Eligible workers can get a check from the IRS.** Marlene Rogers is raising two children and earned \$10,000 in 2004. Her Social Security and Medicare payroll tax was \$765. She is eligible for an EIC of \$4,000, which pays her back her payroll tax and gives her an EIC refund of \$3,235.
- **Eligible workers who aren't raising children can get a check.** Joe Smith has no children. He worked part-time in 2004 and earned \$5,200. Because of his low earnings he had no income tax taken out of his paycheck and owes nothing to the IRS. His earnings entitle him to an EIC check for \$390, offsetting most of the payroll taxes that were withheld from his pay.

How do you get the EIC?

- Workers raising a “qualifying child” in 2004 must file either Form 1040 or 1040A and **must** fill out and attach Schedule EIC. Workers with children cannot get the EIC if they file Form 1040EZ or do not attach Schedule EIC. Married workers must file a joint return to get the EIC.
- Workers who were not raising a “qualifying child” in their home in 2004 can file any tax form — including the 1040EZ. These workers write “EIC” (or the dollar amount of their credit) on the Earned Income Credit line on the tax form. They do **not** file Schedule EIC.
- A correct name and Social Security number must be provided for every person listed on the tax return and Schedule EIC. If this information is incorrect or missing, the IRS will delay the refund.
- Workers don't have to calculate their own EIC; if they choose, the IRS will do it for them!

Workers raising children can get the EIC in their paychecks! Workers who are raising children can get part of their EIC in their paychecks throughout the year and part in a check from the IRS after they file their tax return. This is called the Advance EIC payment option. *For more information, see “Boost Take-Home Pay! The Advance EIC Payment Option” on p. 7 of this booklet.*

Workers can get FREE help filing their tax forms

Many families that apply for the EIC pay someone to complete their tax forms. This can often cost between \$55 and \$100, and can be more. Getting a “quick tax refund” that comes back in a few days costs even more. Paying for tax preparation takes away from the value of the EIC. But low-income workers can get free help with tax preparation through a program called VITA (Volunteer Income Tax Assistance). *For more information, see the booklet in this kit, “Helping Workers Claim the Tax Credits They've Earned.”*

Does the EIC affect eligibility for other public benefits?

The EIC does not count as income in determining eligibility for benefits like cash assistance (“welfare”), Medicaid, food stamps, SSI, or public housing. Some benefit programs count the EIC against resource tests in certain circumstances. *For more information, see “Learn More: Questions and Answers About the EIC,” on p. 9 of this booklet.*

Can immigrant workers get the EIC?

Many legal immigrants can qualify for the EIC, as long as they meet the eligibility requirements.

The materials in this kit should answer many questions about the EIC. *For more information, call the IRS at 1-800-TAX-1040.*



The EIC Can Help Low-Income Workers Not Living With Children

Very low-income workers who are not raising children in their home are eligible for a small Earned Income Credit. In tax year 2003, more than 3.9 million such workers received credits worth over \$820 million. The credit is available to people who worked full- or part-time in 2004 and:

- were at least age 25 and under age 65 on December 31, 2004;
- had earnings of less than \$11,490 (or \$12,490 for married workers);
- were *not* raising children in their home who were under age 19 (or under age 24 if the child was a full-time student) for more than six months during 2004; and
- were *not* the dependent or qualifying child for the EIC of another taxpayer in 2004.

The credit for workers not raising children is worth up to \$390 for tax year 2004 — the average is expected to be about \$220. This credit works the same way as the EIC for families: it gives back some or all of the federal income tax taken out of a worker's pay during the year. The worker may also get additional cash back from the IRS. Even workers whose earnings are too small to have paid federal income tax can get the credit.

How do you get this credit?

Eligible workers not raising children get the EIC by filing a federal income tax return. They can use Form 1040, 1040A, or 1040EZ. On the “Earned

Income Credit” line they simply fill in the amount of their credit or write “EIC” and the IRS will calculate the amount of the credit for them. Married workers must file a joint return to claim this credit.

Good News! If a worker doesn't fill in the credit amount or write “EIC” on the tax form, the IRS will automatically figure out if he or she appears to be eligible for the credit. If so, the IRS will send the worker a notice requesting additional information, such as whether the worker could be claimed as a dependent by another taxpayer. The worker claims the EIC by submitting the additional information requested. Any refund owed to the worker will be received later in the year.

Phone it in! In 2004, over 3.7 million taxpayers filed their 1040EZ tax returns automatically by telephone. In 2005, this option will be available to single and married workers with no dependents who used the 1040EZ to file their tax returns in 2004 and are still at the same address. The IRS will send these workers a special “Telefile” packet with instructions and a special personal identification number (PIN). Using the tax forms and worksheets provided, taxpayers call the IRS Telefile number and key in the PIN and their tax form information. A touch-tone telephone is necessary. (Telefile is available for the hearing impaired who have access to TDD/TYY equipment.) *If the taxpayer is eligible for the EIC for workers not raising children, the credit will be calculated automatically.*

Why is the credit for workers not raising children important?

It provides a financial boost to those who work at very low wages or are only able to find part-time work. This includes many day laborers, migrant workers, temporary employees, people who are homeless and general assistance recipients who worked part of the year.

What do we know about the workers eligible for this credit?

Population statistics tell us about workers likely to qualify for this credit.

- The average annual earnings for these workers are about \$5,900. Almost half (48 percent) of them work in service industries. About 22 percent work full-time, year round.
- Almost 80 percent of these workers have at least a high school diploma.
- The majority of these workers — approximately 61 percent — are non-Hispanic white. About 15 percent are African American and about 18 percent are Latino.
- Only about 15 percent are married. About 47 percent are single men and 38 percent are single women.

What are the special outreach challenges?

- For some, the EIC may seem too small to make filing a tax return worthwhile.
- Some may fear entering the tax system either because they haven't filed taxes in a long time or because they owe child support.

- Very low-income workers may be skeptical of information about programs from government agencies such as the IRS. Your outreach materials should contain the name and number of a contact organization that is trusted by low-income workers in your community.

Extra Credit for Non-custodial Parents

Lower-income workers whose children do not live with them may also qualify for the Child Tax Credit (CTC). A non-custodial parent who earned more than \$10,750 in 2004 may be eligible for a CTC of up to \$1,000 per child under age 17 claimed as a dependent on his or her tax return. Outreach messages that target this group of parents and highlight the CTC as a new opportunity are critical. *For more details on the CTC, see the booklet in this kit, "Facts About the Child Tax Credit."*

For more ideas on reaching workers not raising children likely to be eligible for the EIC, and those who might be able to claim the CTC, see p. 20 in the booklet in this kit, "Making Tax Time Pay: How to Promote the Earned Income Credit and the Child Tax Credit."

Boost Take-Home Pay!

The Advance EIC Payment Option



What is Advance EIC payment?

Most workers get the EIC in one large check from the IRS after they file a tax return. But there is another choice: employers can add part of a worker's EIC to every paycheck, and the worker gets the rest of the credit after filing a tax return. This is called "Advance EIC payment." Advance payments are not taxable income.

In 2005, Advance EIC payments are available to any worker with at least one qualifying child who expects 2005 income of less than \$31,030 (or \$33,030 for married workers). Advance EIC payments are not available to workers who are not raising a qualifying child in their home.

What are the advantages of Advance EIC payment?

For many workers, getting part of their EIC in each paycheck can make a difference in paying the rent, buying groceries, and meeting other day-to-day needs. A worker earning between \$490 and \$1,300 a month, for example, can get about *\$50 to \$60 extra in each bi-weekly paycheck*. Advance EIC payments are not counted as additional income in determining eligibility for public benefits such as cash assistance, housing assistance, food stamps and Medicaid. Employers also benefit from promoting Advance EIC payments — they can help employees increase their take-home pay at no cost to the business. This can decrease turnover in the workplace.

Protection against overpayment

Some workers decide against advance payments because they want a larger refund at tax time. But some workers also fear they will receive too much in advance and owe money back to the IRS after the end of the year. However, the advance payment procedure has built-in protections against overpayment. Workers who choose advance payment can get up to about half of the EIC amount to which they're entitled for the year. They get the rest as a refund when they file their tax return. This means workers can get advance payments *and* a year-end refund! And, because workers receive only part of their EIC during the year, they're protected against getting too much in advance and owing some back at the end of the year.

Some workers should not choose Advance EIC payment

Eligibility for Advance EIC payments is based on the total income a worker expects to earn in a year, including the income of a spouse. Major changes in family income, marriage or the eligibility of a qualifying child during the year can decrease the EIC for which workers are eligible. If a worker continues to receive advance payments based on an incorrect estimate of eligibility, these payments may exceed the amount of the EIC. In this case, the worker would have to send the IRS a check at tax time to make up the difference.

The following workers should not use the advance payment option:

- Workers who hold two or more jobs simultaneously
- Workers with a working spouse, unless both spouses take advance payments during the year
For more information, see the next section.
- Workers who get married during the year, if both spouses work
- Workers whose earned income increases a lot

How do you get the Advance EIC payment?

To get the Advance EIC eligible workers fill out a **W-5** form called the “Earned Income Credit Advance Payment Certificate” and give part to their employer. The W-5 is available from employers. *The W-5 form may be photocopied and distributed. The W-5 form for 2005 is available for free by calling 1-800-TAX-FORM, or download it from the IRS website at: www.irs.gov/formspubs.*

Eligible workers can file a W-5 at any time during the year, but then they must file a new W-5 at the beginning of each new year to continue getting the EIC in their paychecks.

Married workers can choose advance payment, but if they do, *both spouses should give a W-5 to their employers.* The box on the W-5 indicating the worker’s spouse also has a W-5 in effect should be checked “yes.” This signals the employer of each spouse to figure the correct amount of the advance payment and avoid an EIC overpayment. If only one spouse chooses advance payment, the amount he or she receives may be too high.

A worker already receiving Advance EIC payments who is planning to get married to someone who also works, or expects a large pay increase during the year, should ask his or her employer to stop the

advance payments. To do this, workers file a new W-5 form with their employer and indicate they don’t want to receive advance payments any more.

Remember! Workers who get Advance EIC payments during the year must file a tax return after the end of the year and fill in the correct line to show the total amount received in advance payments. They must also complete Schedule EIC and attach it to their tax return.

Some workers aren’t eligible to get Advance EIC payments

Some workers who are eligible for the EIC are not allowed to get Advance EIC payments, including:

- Workers without qualifying children
- Workers who get paid day by day
- People with no Social Security and Medicare taxes withheld from their pay
- Self-employed workers, who cannot advance the EIC to themselves

What is the employer’s role?

Advance payments don’t cost employers money. Employers simply subtract the advance payments they have added to their workers’ paychecks from the total taxes withheld from all employees they would otherwise deposit with the IRS. Most automated payroll systems handle Advance EIC.

Some employers may not be aware of the Advance EIC payment option. But under federal law, any eligible employee who files a W-5 must be given advance payments. Employers are not required to make sure employees are eligible for the EIC — that is the employee’s responsibility. *For more information, see the IRS “Employer’s Tax Guide, Circular E,” available free by calling 1-800-TAX-FORM, or from the IRS website at: www.irs.gov/formspubs.*

Learn More: Questions and Answers About the EIC



People often have questions about whether they can qualify for the EIC. This chapter provides the answers to many commonly asked questions, including questions about how the EIC affects public benefits, college aid, eligibility for non-traditional families, military families and immigrants, as well as how to claim the EIC for past tax years.

EIC and Public Benefits

Can people who work and also get welfare benefits, still get the EIC?

Yes. As long as they earn wages and meet the income and other eligibility requirements. These workers may use the Advance EIC payment option, if they wish.

Note: Some welfare recipients are required to participate in “work experience” and “community service programs” (often called “workfare”) in exchange for their cash assistance benefits. These benefits are not counted as income to determine eligibility for the EIC. However, current or former recipients who are employed in private or public sector jobs for which employers are subsidized through state welfare block grants or other government programs do earn wages that count in determining eligibility for the EIC. *For more information, contact the Center on Budget and Policy Priorities, (202) 408-1080.*

Will getting the EIC lower other government benefits? Could someone lose benefits altogether?

Generally, no. Under federal rules, the EIC (including Advance EIC payments) is not counted as income for Medicaid, food stamps, SSI or federally assisted housing programs. The EIC can count as a resource in determining eligibility for some benefit programs. Often, if the recipient has few or no other resources, saving part of an EIC refund is not enough to cause that recipient to exceed the resource limit for a benefit program. For example, if your state has an resource limit for Medicaid, here’s how it works: the EIC refund must be spent by the end of the month after the month in which it is received or the amount saved may be counted against the dollar limit on resources. However, many states now have no resource limit for families on Medicaid; that is, they do not count assets in determining eligibility. Thus, saving an EIC refund would not affect eligibility for Medicaid in those states. For SSI, under new rules passed by Congress in 2004, the EIC does not count toward the resource limits for nine months after the refund is received. For food stamps, the EIC does not count as a resource for 12 months after the refund is received.

Note: The rules for the Child Tax Credit are similar to the rules for the EIC, but there are some important differences. *For more information, see p. 6 of the booklet in this kit, “Facts About the Child Tax Credit.”*

Deposits in certain types of Individual Development Accounts (IDAs), which may include some of a worker's EIC refund, do not count as a resource in determining eligibility for the above programs or for state cash assistance programs.

For more information, see the fact sheet on p. 19 in this booklet, "The EIC Can Help Multiply Assets."

Welfare cash assistance programs are administered by states under a block grant called Temporary Assistance for Needy Families (TANF). Each state can set its own rules for how the EIC will be treated in determining eligibility for cash assistance. Currently no state counts the EIC refund as income to determine eligibility, except that in Connecticut, under some circumstances, Advance EIC payments may affect a worker's TANF eligibility. The rule for most state TANF programs is that the EIC must be spent by the end of the month after the month in which it is received or it can count as a resource. However, some states may have adopted less restrictive policies. *Contact your state welfare agency for the rule in your state.* Rules on how the EIC may affect "General Assistance" benefits are different in each state where a general assistance program is in place. *Contact your state or local welfare agency for information.*

How to Claim Back EICs and Other Filing Questions

What if a worker was eligible for the EIC in past years but didn't claim it?

Workers can file for the EIC for the last three years. For example, a worker who was eligible for the EIC in 2001 but did not claim it can fill out a Form 1040X, "Amended U.S. Individual Income Tax Return," and attach it to a copy of the 2001 tax return he or she filed that year. Workers claiming a child for the EIC also must fill out and attach Schedule EIC for 2001. For copies of prior-year forms, call 1-800-TAX-FORM.

For more information, see p. 16 in the booklet in this kit, "Helping Workers Claim the Tax Credits They've Earned."

What happens if a worker files for an EIC and the IRS finds out that taxes are owed?

The worker must pay whatever is owed. **But:**

- The EIC may be enough to cover the taxes owed.
- The IRS is usually willing to work out payment plans for back taxes.
- The worker may be able to make an "offer in compromise" that is less than the tax bill.

What about workers who did not file a return and discover they had been eligible for the EIC?

An eligible worker can file a return and claim the EIC for three back years. For example, in 2005 workers are filing taxes for 2004. If a worker failed to file or claim the EIC in the past, he or she could still file for 2003, 2002 and 2001. A worker must file a separate return for each prior year and, if claiming a child for the EIC, also fill out and attach the Schedule EIC for that year. A Form 1040X is not required. There is no late filing penalty, unless the worker owed income tax in the prior year. The amount owed the IRS will be deducted from the EIC. Workers who may owe taxes in excess of their EIC should seek assistance from a Low Income Taxpayer Clinic, accountant, or attorney and, if necessary, arrange a payment agreement with the IRS.

Will the IRS require additional information beyond what a worker provides with his or her tax return?

Generally, the IRS will not require any additional information. But, if information provided on the tax return or Schedule EIC seems questionable, the

IRS may request additional documentation to verify the EIC claim. In such cases, the IRS will send the filer a questionnaire that specifies the type of documentation that must be submitted. For example, a filer may be asked to submit a copy of a qualifying child's birth certificate. It is important that the name on the birth certificate match the name on that child's Social Security card. If a child is over age 24 and permanently and totally disabled, proof of disability status could be requested. The IRS also may require documents verifying that a qualifying child actually lived with the filer at least half the year (or a full year if a foster child, for years prior to 2002).

Filers claiming the EIC should not mail in any additional documentation with their tax returns unless such documentation is specifically requested by IRS. If additional information is requested, filers need submit only the documents specified.

Exception: Workers whose EIC claim was disallowed in a previous year, but who now claim they are eligible, must attach Form 8862, "Information to Claim Earned Income Credit After Disallowance," to their tax return in order to submit a new claim.

Workers who are in the test group for EIC Certification are required to submit an additional tax form and supply additional documents to submit an EIC claim. For more details, see the Special Alert: IRS Continues to Test EIC Certification Procedure in 2005 Tax Filing Season enclosed in this kit.

Can self-employed workers get the EIC?

Yes. They will need to fill out additional forms to accompany their Form 1040 and Schedule EIC (if they were raising children in their home): Schedule C, "Profit or Loss from Business," (or Schedule C-EZ) and Schedule SE, "Self

Employment Tax," (if their self-employment income is more than \$400). Call the IRS at 1-800-TAX-FORM to get the necessary forms or download them from the IRS website at: www.irs.gov/formspubs.

EIC and Social Security Numbers

Who needs a Social Security number?

Valid Social Security numbers must be provided for everyone listed on the tax return, including infants born before December 31, 2004. Only valid Social Security numbers issued to U.S. citizens or Social Security numbers issued to non-citizens who have permission to work legally in the United States are acceptable. For more information see p. 12 of this booklet. The IRS now verifies the Social Security number of every adult claiming the EIC, as well as the Social Security number of every child in families claiming the EIC, before it sends out EIC payments. The IRS also checks to make sure that no child is claimed more than once.

The processing of an EIC claim and the receipt of any refund will be delayed if the tax return or Schedule EIC is incomplete or contains incorrect information. Workers who file paper returns with missing or mismatched Social Security numbers will be sent a notice by the IRS stating that the return was incomplete and requesting that the missing information be mailed in. This can delay processing several weeks. Electronically-filed returns will be rejected by the IRS computer if a Social Security number is missing or the name and number do not match. The corrected return must then be filed as a paper return.

It also is important to be sure that each name and Social Security number is recorded on the tax return exactly as it appears on the person's Social Security card. For example, if a woman records her married name on the tax return, but her Social

Security card bears her maiden name, the discrepancy will need to be resolved before the tax return can be processed. (To avoid such an error, the woman can apply to the Social Security Administration to have her name changed on her Social Security card. Correcting this discrepancy also will help ensure that Social Security taxes are being deposited in the proper account.)

Workers who don't have Social Security numbers for their children by the tax filing deadline can still get the EIC by:

- Filing their tax return without claiming the EIC and then, after receiving the Social Security number, filing an “amended return” (Form 1040X) and attaching Schedule EIC, OR
- Filing Form 4868 to request an extension on their tax filing deadline to August 15. *To have an application for a Social Security number sent to your home, call 1-800-772-1213. Or call the Social Security Administration in your state to find out how to apply.*

EIC and Immigrant Workers

Can immigrant workers get the EIC?

Many legal immigrants who are employed can get the EIC. Previous changes in federal law that denied public benefits such as food stamps and SSI to many legal immigrants did not apply to the EIC. *In order to claim the EIC, immigrant workers, their spouses, and children listed on Schedule EIC must each have valid Social Security numbers that permit them to work legally in the United States.* Individual Taxpayer Identification Numbers (ITIN) issued by the IRS to non-citizens and non-work Social Security numbers issued to applicants or recipients of federally funded benefits programs cannot be used to claim the EIC. (**Note:** An ITIN can be used to claim the Child Tax Credit refund.

See the booklet in this kit, “Facts About the Child Tax Credit.”)

In addition, an immigrant must be a “resident alien for tax purposes” for the entire tax year to claim the EIC. An immigrant who was a non-resident alien at any time during the year cannot claim the EIC unless he or she:

- was married to a U.S. citizen or a resident alien as of December 31 of the tax year, and
- files a joint tax return with the spouse and chooses to be treated as a resident alien for the entire year.

For more information on how resident alien status is determined, see IRS Publication 519, U.S. Tax Guide for Aliens.

Immigrants who are “resident aliens for tax purposes” may be legal permanent residents, meaning they have a “green card” (I-551 card). However, many legal immigrants who do not yet have their “green cards” may still be resident aliens for tax purposes. For example, the following immigrants might qualify for the EIC if they *and family members have legal work authorization and Social Security numbers:*

- Amnesty temporary residents and amnesty family members granted “Family Fairness” or “Family Unity” status
- Refugees, asylees and those granted Temporary Protected Status
- Applicants for these and other immigration statuses who have legal work authorization and Social Security numbers.

Remember! Immigrant workers’ children must have lived with them in the United States for more than six months of the year to be considered qualifying children for the EIC. Also, the worker’s main home must be in the United States.

Can immigrant workers get the Advance EIC payment?

Generally, yes. But some workers (whether they are immigrants or not) are not allowed to use the Advance EIC. They include workers who get paid day-by-day, self-employed workers and workers whose employers don't withhold Social Security and Medicare taxes from their pay.

Can immigrant workers who obtain legal work status claim the EIC for a previous year?

Workers who otherwise met all the EIC eligibility requirements in previous years, and later obtain legal work status from the U.S. Citizenship and Immigration Services (USCIS), may be able to claim the EIC for up to three previous years. A worker's spouse or qualifying children, if any, must also have legal work status. After receiving legal work status from the USCIS, the worker, spouse and qualifying children must obtain Social Security numbers. Such workers may claim the EIC by amending their tax return for the previous year, even if they had been denied the EIC in that year because they had not yet obtained a valid Social Security number. Or workers can file an original return for the previous year if they had not already done so. *For more information see IRS National Office Chief Counsel Advice Memorandum, CCA 2000028034, "Claiming Previously Denied Earned Income Credit due to Invalid Social Security Numbers," June 9, 2000. Contact the IRS at (202) 622-6060.*

Does getting the EIC cause problems for immigrant workers?

The EIC does not create "public charge" problems for immigrant workers. Receiving the EIC is not considered an indication that the immigrant is unable to support him- or herself financially.

In general, information on a tax return is confidential. The IRS cannot share tax return

information with other government agencies, including the USCIS. There are exceptions in cases involving federal criminal or terrorism investigations or when the IRS thinks someone is breaking a tax law. *For more information about which immigrant workers qualify for the EIC, how to obtain Social Security numbers and other immigrant tax issues, call the National Immigration Law Center at (213) 639-3900.*

EIC and Non-Traditional Families

EIC eligibility rules in effect since 2002 give parents priority in claiming the EIC. A working custodial parent can claim the EIC even if he or she is living with another relative who earns more.

What are the rules about filing status?

To get the EIC, workers can file as: "single," "head of household" or "married filing jointly." But the EIC is not available to taxpayers who file as "married filing separately."

What if parents are separated but not divorced?

Parents who are separated but not divorced often file as "married filing separately." But if they file this way, neither parent can claim the EIC. Separated parents have the option of filing as "married filing jointly." If they do so, they can claim the EIC.

In addition, there is *one* situation in which a separated parent can claim the EIC but not have to file jointly with the other parent — the parents must have lived apart for the last six months of the year **and** their child must have lived with one of them for more than half of the year. **Also**, the parent now living with the child must have paid more than half the cost of maintaining the household for the year and be able to claim the

child as a dependent. Under these circumstances, that parent is considered unmarried for tax purposes and can file as “head of household.” That parent may claim the EIC. This option can be important, for example, to workers who are victims of domestic violence or whose separated spouse is not cooperative.

What if the parents in a family are divorced?

If parents are divorced, the parent with whom the child lived for more than half the year is entitled to file for the EIC, regardless of which parent claims the child as a dependent. If both parents lived with the child for more than six months, either parent could claim the EIC, and the parents should decide which one will. However, if each parent separately claims the child for the EIC, the IRS will determine which parent lived the longest with the child and will deny the claim filed by the other parent. If the child lived with both parents for the same amount of time during the year, then the parent with the highest adjusted gross income is entitled to the EIC. (**Note:** A parent not living with his or her child for more than half the year may be eligible for the smaller EIC for workers without qualifying children.)

What if both parents and their child live together, but the parents are not married?

If the parents are not married, and each lived with the child for more than six months, either parent may claim the EIC based on that parent’s income. Since they are unmarried, they do not file a joint return. However, if each parent separately claims the EIC, the IRS will award the EIC based on which parent lived with the child the longest and deny the claim of the other parent. If the child lived with both parents for the same amount of time during the year, then the parent with the highest adjusted gross income is entitled to the EIC.

What about a three-generation household: a grandparent, parent and child?

In a three-generation household, only one person can claim the EIC, even if more than one family member works and has an income that would qualify for the credit. Under rules in effect since 2002, the child’s parent has the priority to claim the EIC. If the parent chooses not to claim the credit, an eligible grandparent may claim it. (In a household with no working parent and more than one relative who could claim a child, relatives may decide who will claim the EIC. However, if more than one worker claims the same child, the IRS will award the EIC to the person with the highest adjusted gross income.)

What about child support?

Child support payments a parent receives do not count as income when determining eligibility for the EIC or the amount of the EIC.

What about foster families?

A rule in effect since 2002 changed the definition of a foster child for purposes of the EIC. Under this rule, a child must be placed with the worker by an authorized placement agency, such as a licensed foster care agency, state agency or court. Such children must live with the worker for more than half of the tax year and meet the EIC age requirements for a qualifying child. (If the child is totally and permanently disabled he or she can be any age.)

Foster care payments generally do not count as income when determining eligibility for the EIC. Since such payments can affect a foster parent’s ability to claim a foster child as a dependent, foster parents may mistakenly think this jeopardizes their EIC claim. However, in general, the IRS does not require children to be claimed as dependents in

order to be claimed for the EIC. (However, a child must be claimed as a dependent to be claimed for the Child Tax Credit.) *For more information, see “Federal Tax Benefits for Foster and Adoptive Parents and Kinship Caregivers” at: www.casey.org/Resources/Publications and the booklet in this kit, “Facts About the Child Tax Credit.”*

Note: Under rules in effect before 2002, a brother, sister, stepbrother, or stepsister — or a descendant of such relatives, such as a niece or nephew — could be claimed as a foster child for the EIC if the child lived with the worker the entire year. Placement of the child with the worker by an official agency was not required for such related children. Under the new rules, in effect since 2002, such children may be considered qualifying children for the EIC if they live with the worker for more than half of the year. These qualifying children are no longer considered in the “foster child” category for the EIC. EIC claims for a year prior to 2002 must follow the eligibility rules that were in effect for that year.

EIC and College Financial Aid

College students who also work and are raising children may be eligible to claim the EIC. Students between ages 25 and 64 who are not raising children and who work may also be eligible. Parents of full-time students under age 24 may also be able to claim the EIC.

- Non-taxable scholarships and grants are not considered income in determining eligibility for the EIC; taxable grants and scholarships also are not considered “earned income,” but are included in determining “adjusted gross income,” which may affect eligibility for the EIC.
- An EIC refund is counted as family income in determining financial aid eligibility. However, for many low-income students who work, or their parents, the EIC will have no effect on financial

aid amounts or eligibility. Adding the EIC amount to other income often will not cause them to reach the threshold of income at which a contribution to the costs of education is required of a student or family. *For more information, contact your college’s financial aid office.*

For information on which scholarships and grants are taxable or non-taxable, call the IRS at 1-800-829-1040. For ideas on outreach to students, contact the Center on Budget and Policy Priorities at (202) 408-1080 to obtain the fact sheet, “Ten Ways Your College or University Can Promote the EIC.”

Can Military Personnel Claim the EIC?

Overseas assignments. Members of the military assigned overseas may wonder about their eligibility for the EIC. Military personnel can claim the EIC whether they live in the United States or overseas.

The IRS considers an individual assigned to an overseas tour of duty to be temporarily absent from the U.S. due to a special circumstance. The length of time the person is absent is treated as though he or she was in the U.S., as long as the individual plans to return to his or her main home in the U.S. at the end of the military assignment. Therefore, military personnel who live with qualifying children while stationed on active duty outside the U.S. can be eligible for the EIC. *Even if their qualifying children remain in the U.S., the children may be claimed for the EIC.* Military couples living apart due to a military assignment must still file a joint return to receive the EIC.

An individual in the military under age 19 may be claimed as a qualifying child for the EIC. If such an individual is temporarily absent due to an overseas military assignment, he or she still may be considered a qualifying child as long as he or she intends to return home at the end of the military assignment.

Combat pay. Military pay received in a combat zone is non-taxable earned income, but it is treated differently than other forms of non-taxable earned income for EIC and Child Tax Credit (CTC) purposes. Beginning in 2004, military personnel may choose to count combat pay when calculating their eligibility for the EIC. Under previous rules, such income was not counted for the EIC. In 2004, Congress passed legislation to permit military personnel to count combat pay for the EIC *if it is an advantage*. For example, adding combat pay to a family's other earnings might raise the family's total income above EIC eligibility levels, or the added income might reduce the amount of the EIC. Under these circumstances a family would not want to count the combat pay. But in families with little or no other income, counting combat pay is likely to result in a larger EIC.

The changes in treatment of combat pay also affect figuring eligibility for the CTC. It is now *required* that combat pay be counted as income for the CTC. The CTC is calculated differently than the EIC. Counting combat pay will enable more military families to qualify for the CTC and to not lose this benefit due to a deployment to a combat zone. *For more information, see the insert enclosed in this kit "Special Alert: Changes to Low-Income Tax Credits for 2004/2005."* *For more information about the CTC, see the booklet in this kit "Facts About the Child Tax Credit."*

Non-taxable military allowances for housing and subsistence — including meals and lodging furnished in-kind to personnel residing on military bases — are not considered earned income for EIC purposes. Such pay and allowances are indicated on W-2 forms, but are not added to regular wage income to calculate eligibility for the EIC. Veterans' benefits and military retirement pay are not considered earned income.

For further information on EIC rules for military personnel, see IRS Publication 3 "Tax Information for Military Personnel (Including Reservists Called to Active Duty)."

Rules for Workers with Disabilities and Families Raising Children With Disabilities



Can a person who receives disability benefits get the EIC and Child Tax Credit (CTC)?

To be eligible for the EIC, individuals must have earned income. Most disability-related benefits are not considered earned income, but a person who receives long-term, employer-paid disability benefits and is under minimum retirement age can qualify for the EIC, even if he or she did not work during the tax year. (Minimum retirement age is considered to be the earliest age at which a worker can receive a pension or annuity if he or she is not disabled.) Such disability benefits are considered taxable income, are reported as wages on tax returns and are considered earned income in determining eligibility for the EIC and the CTC refund. *For more information on the CTC, see the booklet in this kit, "Facts about the Child Tax Credit."*

Benefits such as Social Security Disability Insurance, SSI, military disability pensions, and payments from individually-purchased disability insurance policies are not counted as earned income. Individuals who receive these types of benefits may qualify for the EIC and the CTC refund if they, or their spouse, also have earned income.

Can children with disabilities be claimed for these tax credits?

A worker may claim a person of any age who is totally and permanently disabled as a "qualifying child" for the EIC if that person otherwise meets the qualifying child rules for the EIC (*see p. 3 of this booklet for these rules*). For example, parents may claim their adult children if they have such disabilities. Also, persons who are caring for certain relatives who are totally and permanently disabled

may be able to claim them. **Note:** If the person with disabilities is claimed under the qualifying child rules for a foster child, an authorized agency must have placed the person with disabilities in the care of the worker.

Under current law, any child claimed for the CTC, including a child with disabilities, must be under age 17 at the end of the year.

Qualifying children with disabilities may themselves receive income from benefits such as SSI. A worker's eligibility to claim such children for the EIC or CTC is not affected by the fact that the child receives SSI payments.

A person who is totally and permanently disabled, but who is able to earn income, may be eligible to claim the EIC, if the eligibility rules are met. However, if that person lives with parents or other relatives who can claim him or her as a qualifying child, the worker is not eligible to claim the EIC.

Will claiming the EIC or CTC affect eligibility for other benefits upon which people with disabilities rely?

Income. Federal law generally excludes counting either EIC or CTC as additional income in determining eligibility for other federal public benefits, including: Medicaid, SSI, food stamps, Veteran's Benefits, Head Start or federally assisted housing. The rules for welfare cash assistance are set by states, but only one counts the EIC as income. *See p. 10 of this booklet.* The CTC cannot be counted as income in determining eligibility for any federally-funded program, even if program rules are set by the states.

SSI recipients might be concerned that the EIC or CTC refund would affect their eligibility by exceeding the “substantial gainful activity” (SGA) level — the amount of earnings above which recipients are no longer eligible for SSI benefits. However, tax refunds are not considered employment income and they have no impact on SGA.

Resource tests. While there is little cause for concern that the EIC or CTC will affect eligibility for benefit programs by being counted as extra income, some government benefit programs also have rules about the value of resources individuals may have and remain eligible. This means that if individuals wish to save some or all of their tax refunds, they should be familiar with the resource rules for other benefits they may receive.

The standard rule for most benefit programs has been that EIC and CTC refunds, if saved, are not counted toward dollar limits on resources during the month the refund is received and the following month. That rule is contained in federal law covering the treatment of CTC refunds for any benefit program receiving federal funding. However, there are now several exceptions to this rule.

Welfare cash assistance (TANF) — In most states, the standard resource rule described above is followed. No state has implemented a stricter rule. However, some states have removed the resource test for their TANF program and so there is no limit on how long the credit can be saved.

Medicaid — The standard rule above applies to Medicaid resource limits. However, since states have the flexibility to broaden or remove Medicaid resource limits, this rule will not apply in some states. Medicaid recipients who wish to save tax refunds for longer than two months should check with the Medicaid program in their state.

SSI — Beginning in March 2004, EIC and CTC refunds are excluded from resources for nine months following the month the refund is received. (The interest paid on EIC and CTC amounts held in savings also does not count as income in determining SSI eligibility.)

Food stamps — The food stamp rules for the EIC are different from the rules for the CTC. EIC refunds are excluded from resources for 12 months for food stamp recipients who remain on the program during that time. However, CTC refunds are excluded from resources in the month the refund is received and the following month.

Veterans’ Benefits — If a veteran receiving a Veteran’s Administration (VA) means-tested benefit saved the EIC or CTC refund, the amount would count as a resource. However, because the resource limit for VA pension benefits is very high (\$80,000, not counting a home and a motor vehicle), unless a veteran already has substantial resources it is unlikely that saving the EIC or CTC refund would affect eligibility for VA benefits.

Other tax benefits. Individuals who claim the federal Credit for the Elderly or the Disabled on their tax returns may also claim the EIC and CTC, if eligible. *For more information on this tax credit, see IRS Pub. 524.*

State EIC refunds. Fifteen states and DC have state EICs. *See p.32 in the booklet in this kit “Making Tax Time Pay: How to Promote the Earned Income Credit and the Child Tax Credit”.* Federal and state public benefit program rules for state EIC refunds are not necessarily the same as those for the federal EIC. *For more information, contact the Center on Budget and Policy Priorities at 202-408-1080.*



The EIC Can Help Multiply Assets

Individual Development Accounts (IDAs) have emerged in the last few years as a new way for low-wage workers to develop a substantial savings account. IDAs are “matched savings accounts,” in which savings deposits made by a worker are matched by contributions from IDA program funds. Organizations administering IDA programs use federal or state funds authorized for IDAs, and additional funds from foundations and financial institutions, to supply the match.

IDA accounts are designed to enable workers to obtain a valuable asset, such as a down payment on a home, college education, job training, a computer, a car or small business financing. Low-wage workers often experience great frustration with the long time it takes to save enough to meet these goals. The matched savings feature of IDA accounts responds to this concern by helping depositors build their savings more quickly.

A limit is generally placed on the amount workers may deposit each year and also on the total amount that can be deposited. Since IDA programs are supported by a variety of sources and administered locally, the match rates and maximum deposit rules vary by program.

How the EIC Fits In

Even with the enticement of matching contributions, low-income workers may have difficulty saving part of their wages for long-range goals. EIC refunds — and Advance EIC payments in worker paychecks — can make it more feasible for them to make the modest monthly deposits

typically required in an IDA program. EIC refunds themselves are permitted to be deposited in IDA accounts.

A study of EIC recipients by the Center for Policy Research at the Maxwell School, Syracuse University, found that almost one-half of those surveyed said they planned to save some or all of their EIC refund check, rather than use it all to pay bills or make immediate purchases. Respondents mentioned asset-building goals, such as paying tuition or purchasing or repairing a car, as priority uses for their EIC.

The IDA match can multiply a worker’s own savings — doubling, tripling or even quadrupling the amount they deposit, depending on the IDA program and the purpose for which the worker has designated the IDA account.

For example, the weekly take-home pay of a full-time worker with three children who earns \$7 per hour (about \$14,500 per year) is about \$250. If the worker saves five percent of his or her weekly take-home pay — about \$12 each week or nearly \$50 each month — the annual savings comes to \$624. Over three years, the worker will have saved \$1,870. But, in an IDA account that matches two dollars for each dollar saved by the worker, those savings multiply to more than \$5,500, not counting interest on the account.

While this worker might struggle to save \$50 per month, the EIC can help take the pressure off. For work in 2004, this person could be eligible for an EIC worth \$4,209 and a Child Tax Credit refund

worth \$375. He or she could also opt to receive Advance EIC payments totaling over \$100 in additional take-home pay each month and use some or all of the extra cash to make deposits into an IDA account.

Some Asset Development Programs

Asset development programs for low-income workers are taking hold around the country. Following are some of the most notable programs and how to find out more about them.

Two organizations lead national efforts to develop IDA programs and other asset development policies: The Corporation for Enterprise Development in Washington, D.C. at (202) 408-9788, and the Center for Social Development, at Washington University, St. Louis, Missouri at (314) 935-7433. Their websites are provided below.

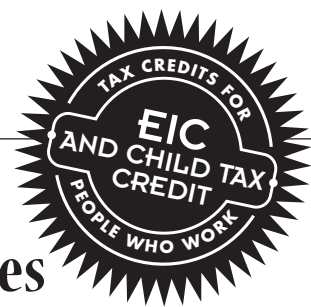
The IDA network. Successful federally supported IDA demonstration programs, such as those authorized by the Assets for Independence Act (AFIA) administered by the U.S. Department of Health and Human Services, have spurred a rapidly growing network of organizations that administer IDA programs. IDA programs already exist in about 350 communities across the nation. *For more information, visit the Corporation for Enterprise Development website at: www.cfed.org.*

IDAs for people who receive public benefits. Federal welfare law permits states to design IDA programs to benefit welfare recipients beginning the transition to employment. States may use their TANF block grant funds to support IDA programs. Individual savings and matching contributions in accounts under IDA programs which meet the requirements of federal welfare law (or IDAs in the AFIA demonstration program) do not affect a person's eligibility, or benefit amount, for cash assistance and other public benefit

programs. Assets in other types of IDAs, however, are not necessarily excluded as a resource in determining eligibility for benefit programs such as welfare or food stamps. *For more information, see the "2002 Federal IDA Briefing Book: How IDAs Affect Eligibility for Federal Programs" by the Center on Budget and Policy Priorities and the Corporation for Enterprise Development at: www.cbpp.org/10-29-02wel.pdf. For information and contacts regarding specific state IDA policies, visit the website of the Center for Social Development at: gwbweb.wustl.edu/csd/statepolicy.*

IDAs for refugees. The Office of Refugee Resettlement (ORR) under the U.S. Department of Health and Human Services provided grant funding in 2003 for 49 nonprofit organizations in 19 states to develop IDA programs for low-income refugees. *For more information about the Refugee Individual Development Account Program, contact Lisa Campbell, Office of Refugee Resettlement, (202) 205-4597 or lcampbell@acf.dhhs.gov.*

Family Self-Sufficiency Program (FSS). FSS is a program that promotes employment and saving among families that have Section 8 housing vouchers or live in public housing. Under FSS, tenants agree to reach certain employment and training goals. Usually, as tenants earn more from employment, their rent payments will increase. But FSS participants can get a refund of some or all of their increased rental charges in an amount equal to about 30 percent of their increased income. This amount is deposited by the housing agency into FSS escrow accounts established for tenants and HUD reimburses the agency for the escrow deposits. When tenants meet the goals of the FSS agreement, they receive the full amount in the escrow account, plus interest. Some families accumulate as much as \$10,000 in their escrow accounts; the average received by families that complete the program is nearly \$5,000. *For more information, see "The Family Self-Sufficiency Program" at: www.cbpp.org/4-12-01hou.htm.*



Saver's Tax Credit for 2004: Workers Can Save for Retirement And Reduce Income Taxes

The Saver's Tax Credit can reward workers who make contributions to a retirement plan or Individual Retirement Account (IRA). Workers can receive a tax credit worth up to 50 percent of a maximum \$2,000 contribution. Married workers may each make the maximum contribution. The Saver's Tax Credit, is referred to in IRS tax forms as the "Credit for Qualified Retirement Savings Contributions." This may be particularly valuable for workers in areas where matched-savings plans, such as Individual Development Accounts (IDAs), are not available or when saving for retirement is a higher priority for a family than the uses that may qualify for matched savings in an IDA.

The Saver's Tax Credit will reduce or eliminate a worker's income tax but, unlike the Earned Income Credit, workers who owe no income tax will not benefit from the Saver's Tax Credit. However, some moderate-income workers with children may see increased benefits from the EIC when they make contributions to a retirement account through pre-tax salary deductions and take advantage of the Saver's Tax Credit. Here's why:

- Generally, only taxable earned income is counted in figuring the EIC. Most EIC claimants who make contributions for retirement through pre-tax salary deductions are in the "phase-down" range of the EIC, where EIC amounts decrease as taxable income increases. Since the salary deductions made for retirement reduce the worker's taxable income, the worker will qualify for a larger EIC.

Example: Randy and Meg earned \$25,000 in 2004 and have two children attending college. They ordinarily would owe income tax of \$290 and would qualify for an EIC of \$2,202. However, during 2004 they made contributions of \$1,000 to Meg's retirement plan at work through pre-tax salary deductions. This reduces their taxable income to \$24,000, and reduces their income tax to \$190 — a \$100 savings. Since only their \$24,000 in taxable earnings is considered in calculating the EIC, they will qualify for a higher EIC of \$2,413, an increase of \$211. And, they can take the Saver's Tax Credit (in their case worth up to 50 percent of their \$1,000 contribution — as much as \$500 in reduced income tax), which eliminates their \$190 income tax. *Overall, by making the \$1,000 contribution to Meg's retirement account and taking the Saver's Tax Credit, the couple gets a tax benefit of \$501. (Their original income tax amount was reduced by \$100 and then the remaining \$190 was eliminated, for a total tax reduction of \$290. In addition, by reducing their taxable income, they were able to claim an EIC that was \$211 higher than it would have been had they not made the retirement plan contribution: \$290 + \$211 = \$501.)*

- Also, since the Saver's Tax Credit reduces or eliminates the income tax a worker may owe, if the worker also qualifies for the Child Tax Credit, less of the CTC will need to go toward reducing income tax liability and more will be available for a CTC refund to the worker.

Who Is Eligible to Claim the Saver's Tax Credit?

The credit may be claimed by taxpayers who:

- are age 18 or older,
- are not full-time students,
- are not claimed as a dependent on someone else's return; and
- have adjusted gross income in 2004 no higher than these amounts:
 - \$50,000 if married filing jointly
 - \$37,000 if filing as head of household
 - \$25,000 if filing single or married filing separately

What Retirement Contributions Qualify for the Saver's Tax Credit?

Contributions workers elect to make through salary reduction to a variety of employer-administered retirement plans are eligible for the credit, as are contributions to both traditional and Roth Individual Retirement Accounts (IRAs). Salary reduction contributions made to the following types of plans are eligible:

- a 401(k) plan, including a SIMPLE 401(k)
- a section 403(b) annuity
- an eligible deferred compensation plan of a state or local government (a "governmental 457 plan")
- a SIMPLE IRA plan
- a salary reduction SEP (Simplified Employee Pension)

Individuals entitled to deduct IRA contributions may still do so and also claim the Saver's Tax Credit. Voluntary after-tax contributions to a qualified retirement plan or 403(b) annuity also qualify for the Saver's Tax Credit.

How Is the Amount of the Saver's Tax Credit Figured?

The credit can range from 10 percent to 50 percent of the worker's contribution to retirement, based upon the worker's adjusted gross income for the tax year. In the example of Randy and Meg above, their taxable income of \$24,000 as married joint filers qualifies them for a credit worth 50 percent of their \$1,000 contribution.

How do Workers Claim the Saver's Tax Credit?

Workers must complete IRS Form 8880, "Credit for Qualified Retirement Savings Contributions," enter the amount of the credit on Form 1040 or 1040A, and attach Form 8880 to their tax return. Form 8880 may be downloaded from the IRS website at: www.irs.gov/formspubs. *For additional information, see IRS Announcement 2001-106, pg. 416, "Saver's Tax Credit for Contributions by Individuals to Employer Retirement Plans and IRAs" at: www.irs.gov/pub/irs-irbs/irb01-44.pdf*



Roth IRAs: A Flexible Approach to Building Assets

Many workers who wish to save for retirement, homeownership, or other purposes may find that the Roth Individual Retirement Account (IRA) is an attractive way to save that offers important advantages. It can be an effective alternative for workers unable to obtain an Individual Development Account.

In a regular savings account, the interest earned on the account counts as taxable income. The interest earned in a Roth IRA, in contrast, is normally *not* taxable. In fact, all funds in a Roth IRA may be withdrawn tax-free so long as the account is at least five years old and:

- the worker has reached age 59^{1/2}; **or**
- the worker, or the worker's spouse, child, or grandchild is using IRA funds for a first-time home purchase (up to \$10,000 toward each purchase); **or**
- the worker is using IRA funds for higher education expenses; **or**
- the worker is disabled.

Roth IRAs also have several advantages over traditional IRAs. Most notably, withdrawals from traditional IRAs are taxable, while withdrawals from Roth IRAs aren't.

In addition, traditional IRAs have substantial penalties for withdrawal before age 59^{1/2}. (While there are exceptions, any early withdrawals still count as taxable income.) Traditional IRAs also require holders to begin withdrawals at age 70^{1/2}, while Roth IRAs have no mandatory withdrawals at any age and also allow contributions after age 70^{1/2}.

The main benefit of traditional IRAs is that workers can deduct the contributions to these accounts from their income, reducing their income tax liability. Roth IRAs do not provide this benefit. However, many low- and moderate-income workers — such as those who qualify for the EIC — don't need this tax advantage, either because they don't earn enough to owe income taxes or because they do owe income taxes but don't need an additional deduction.

While some workers may feel they don't earn enough to put any money aside for retirement, their EIC or CTC refund may provide enough funds to establish a Roth IRA. Minimum deposits to start a Roth IRA can be as low as \$100 to \$500. Roth IRAs can be established as bank certificates of deposit and other investment products. In 2004, workers can contribute up to \$3,000 to a Roth IRA; this limit rises to \$4,000 in 2005. These limits are \$500 higher for workers over age 50.

Community Action Program Provides Roth IRA Counseling

The Community Action Program of Tulsa County (CAPTC) in Oklahoma offers participants in its IDA program the option to start an IRA that also serves as an IDA and thus can receive matched contributions. IRAs are the second most popular savings vehicle chosen by IDA participants. CAPTC provides IDA participants interested in this option with a two-hour seminar covering the kinds of IRAs available, the advantages of Roth IRAs, how to start an IRA, and the choices for investing the funds in an IRA. *For more information, contact Dick Jackson, CAPTC, (918) 747-0167.*

Examples of Earned Income for the Earned Income Credit



Earned Income

Includes:

Taxable Earned Income:

- Wages, salaries, and tips
- Union strike benefits
- Long-term disability benefits received prior to minimum retirement age
- Net earnings from self-employment
- Gross income received as a statutory employee
- **Exception:** Military combat pay is non-taxable earned income, up to the highest pay level for enlisted personnel. Under a rule change beginning in 2004, such combat pay is counted to determine eligibility for the CTC. Military personnel may choose to count their non-taxable combat pay in determining eligibility for the EIC, if it is advantageous to do so.

If investment income exceeds \$2,650, the EIC may not be claimed. Investment income includes taxable interest, tax-exempt interest, and capital gain distributions.

Note: Information taken from IRS Publication 596

Does not include:

- Interest and dividends
- Social security and railroad retirement benefits
- Welfare benefits
- Workfare payments
- Pensions or annuities
- Veterans' benefits (including VA rehabilitation payments)
- Workers' compensation benefits
- Alimony and Child Support
- Non-taxable foster care payments
- Unemployment compensation (insurance)
- Earnings for work performed while an inmate at a penal institution
- Taxable scholarship or fellowship grants that are not reported on Form W-2

Nontaxable earned income:

- Salary deferrals (for example: under a 401(k) plan)
- Military basic housing and subsistence allowances
- Meals or lodging provided by an employer for the convenience of the employer
- Housing allowance or rental value of a parsonage for the clergy
- Excludable dependent care benefits
- Salary reductions such as under a cafeteria plan
- Anything else of value you get from an employer for services you performed even if it is not taxable

EIC Benefits for Tax Year 2004 at Various Income Levels

This is not a tax table. Do not use this table to complete income tax returns.

2004 household income	Workers not raising a child		Workers raising one child		Workers raising two or more children		
	Is Worker Married?	Not Married	Married	Not Married	Married	Not Married	Married
\$ 500		\$40	\$40	\$179	\$179	\$210	\$210
1,000		78	78	349	349	410	410
1,500		117	117	519	519	610	610
2,000		155	155	689	689	810	810
2,500		193	193	859	859	1,010	1,010
3,000		231	231	1,029	1,029	1,210	1,210
3,500		270	270	1,199	1,199	1,410	1,410
4,000		308	308	1,369	1,369	1,610	1,610
4,500		346	346	1,539	1,539	1,810	1,810
5,000		383	383	1,709	1,709	2,010	2,010
5,500		390	390	1,879	1,879	2,210	2,210
6,000		390	390	2,049	2,049	2,410	2,410
6,500		383	390	2,219	2,219	2,610	2,610
7,000		344	390	2,389	2,389	2,810	2,810
7,500		306	383	2,550	2,550	3,010	3,010
8,000		268	344	2,604	2,604	3,210	3,210
8,500		230	306	2,604	2,604	3,410	3,410
9,000		191	268	2,604	2,604	3,610	3,610
9,500		153	230	2,604	2,604	3,810	3,810
10,000		115	191	2,604	2,604	4,010	4,010
10,500		77	153	2,604	2,604	4,200	4,200
11,000		38	115	2,604	2,604	4,300	4,300
11,500		0	77	2,604	2,604	4,300	4,300
12,000		0	38	2,604	2,604	4,300	4,300
12,500		0	0	2,604	2,604	4,300	4,300
13,000		0	0	2,604	2,604	4,300	4,300
13,500		0	0	2,604	2,604	4,300	4,300
14,000		0	0	2,604	2,604	4,300	4,300
14,500		0	0	2,532	2,604	4,209	4,300
15,000		0	0	2,453	2,604	4,104	4,300
15,500		0	0	2,373	2,532	3,999	4,209
16,000		0	0	2,293	2,453	3,893	4,104
16,500		0	0	2,213	2,373	3,788	3,999
17,000		0	0	2,133	2,293	3,683	3,893
17,500		0	0	2,053	2,213	3,577	3,788
18,000		0	0	1,973	2,133	3,472	3,683
18,500		0	0	1,893	2,053	3,367	3,577
19,000		0	0	1,813	1,973	3,262	3,472
19,500		0	0	1,733	1,893	3,156	3,367
20,000		0	0	1,654	1,813	3,050	3,262
20,500		0	0	1,574	1,733	2,946	3,156
21,000		0	0	1,494	1,654	2,840	3,051
21,500		0	0	1,414	1,574	2,735	2,946
22,000		0	0	1,334	1,494	2,630	2,840
23,000		0	0	1,174	1,334	2,419	2,630
24,000		0	0	1,014	1,174	2,209	2,419
25,000		0	0	855	1,014	1,998	2,209
26,000		0	0	645	855	1,787	1,998
27,000		0	0	535	645	1,577	1,787
28,000		0	0	375	535	1,366	1,577
29,000		0	0	215	375	1,156	1,366
30,000		0	0	56	215	945	1,156
31,000		0	0	0	56	734	945
32,000		0	0	0	0	524	734
33,000		0	0	0	0	313	524
34,000		0	0	0	0	103	313
35,000		0	0	0	0	0	103

Center on Budget & Policy Priorities
820 First Street, NE
Suite 510
Washington, DC 20002
202.408.1080
202.408.1056 fax