Katrina Survivors
and the Earned Income Credit and Child Tax Credit

As a result of Hurricane Katrina in August 2005 — and later, Hurricanes Rita and Wilma — working families and individuals are dealing with devastating disruptions to their lives. Work and family situations have changed dramatically for people who have lost jobs and homes and may be separated from their families. As the tax filing season approaches, workers who have been anticipating receiving the Earned Income Credit and the Child Tax Credit will need this income boost more than they ever imagined. But, many will have questions about barriers they may face in filing their tax returns. Others who have lost income, and could now qualify for the credits for the first time, may not know about the opportunity to obtain these benefits. Still others, who have helped family members, friends and strangers, may now need the extra money the credits provide, but it may be unclear whether they qualify. Tax Credit Outreach Campaigns and free tax filing programs are likely to encounter workers with many concerns and questions.

In September 2005, Congress passed legislation, described below, concerning EIC and CTC claims by Katrina survivors. Discussions continue in Congress regarding whether the provisions of this new law will also be extended to survivors of Rita and Wilma. In addition, the IRS is preparing to issue more detailed guidance to the public, Volunteer Income Tax Assistance (VITA) programs and commercial tax preparers on the tax-related measures passed by Congress and how the IRS intends to address tax filing barriers hurricane survivors may face. *As new information becomes available, the Center on Budget and Policy Priorities will share it with organizations in our Outreach Campaign network and will post information at our website, www.cbpp.org.*

Katrina Tax Relief Act Can Boost EIC and CTC Benefits for Katrina Survivors

The Katrina Emergency Tax Relief Act passed by Congress in September 2005 offers a tax credit filing option to individuals who were living in a county designated a federal disaster area when the hurricane struck or who had evacuated just before. If their 2005 earned income is *lower* than their 2004 earned income, such individuals can choose to use the 2004 amount when figuring their Earned Income Credit (EIC) and their Child Tax Credit (CTC) refund. This choice will enable many low- and moderate-income workers whose 2005 income is reduced because of Katrina-related reasons to get a larger tax refund.

Who qualifies? Tax filers entitled to make this choice are those who, on August 25, 2005, were residents of any area designated to receive federal assistance because of Katrina, or who had evacuated before that date. *(For a list of the counties affected by Katrina see the listing at the Federal Emergency Management Agency website: www.fema.gov/news/disasters.fema.)*

The choice will not increase income tax. The decision to use his or her 2004 income for EIC and CTC purposes will not affect the amount of income tax the worker owes for 2005. His or her income tax will be based on 2005 earned income, and will be lower than if the tax had been calculated based on the higher 2004 income. Thus, workers whose income in 2005 was lower than in 2004 can get a ***higher tax refund*** based on the 2004 income, while maintaining a ***lower tax liability*** based on their 2005 income.

THE CENTER ON BUDGET AND POLICY PRIORITIES

820 First Street, NE, Suite 510 • Washington, DC 20002 • 202.408.1080 • Fax 202.408.1056 • center@cbpp.org • www.cbpp.org

The choice can increase EIC and CTC benefits for many families. Choosing to use a higher income earned in 2004 to figure the 2005 EIC may provide a larger credit. For example:

> Emily is a single mother with two children who earned $12,000 in 2004 but, because she became unemployed as a result of Katrina, earned only $7,000 in 2005. If Emily uses her 2005 earned income to figure her EIC, she will qualify for $2,800. However, if she uses her higher 2004 earned income, she can get an EIC worth $4,400. To claim the CTC in 2005, a worker's earned income must exceed $11,000. Since Emily's 2004 earned income exceeds this threshold, she is also able to claim an added $150 through the CTC refund. If she used her 2005 income, she would not qualify for a CTC refund. (Note: Regardless of which year's income Emily uses, her receipt of unemployment benefits does not affect her tax credits, since at these income levels, unemployment benefits are not counted.)

But, choosing the higher income is not always best. Since the EIC begins to decrease as income rises above $14,370 ($16,370 for married workers), some families will be better off calculating their EIC based on their lower 2005 income rather than their higher 2004 income. For example:

> Francine is a single worker with two children who earned $25,000 in 2004, but whose income fell to $15,000 in 2005 because of Katrina. Using the higher 2004 income, Francine would qualify for an EIC worth only $2,161, but using her post-Katrina income, she would qualify for an EIC worth significantly more: $4,267.
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> If Francine uses the higher 2004 income, she would qualify for a CTC refund worth $1,190, which is almost twice the CTC refund for which she qualifies using her lower post-Katrina income ($600). However, calculating both credits based on her 2004 income yields a total refund of $4,351 ($2,161 [EIC], plus $1,190 [CTC]). Using the 2005 income, the total refund is more: $4,867 ($4,267 [EIC], plus $600 [CTC]). Thus, the best overall choice is to use the 2005 income.

Workers should consider both options before deciding. As the example above illustrates, it will be wise to calculate the credits using each year's income to see which amount provides the best overall tax benefit. Although higher earned income is often an advantage in figuring the CTC refund, in many cases a worker will not gain enough through a higher CTC to outweigh having received a lower EIC. Under the Katrina Emergency Tax Relief Act, the earned income amount a worker chooses to use must be used in figuring *both* the EIC and CTC. The tax preparation software used by VITA sites can easily calculate the best option.

Workers without children may benefit from using their lower 2005 income. Since workers between the ages of 25 and 64 who are not raising children qualify for the EIC if their income is below $11,750 ($13,750 if married), such workers may find it advantageous to use their lower 2005 earned income, as opposed to their higher 2004 earned income, to claim the EIC.

Flexible enforcement of rules. A second element of the new legislation gives IRS the authority to adjust how it applies tax law regarding issues such as residency requirements so that tax filers don't lose tax credits or filing status due to dislocation and separation of family members caused by the hurricane or relief payments received by the family. The IRS will issue more specific guidance regarding this.

Documenting earnings. The IRS is also addressing concerns that employees may not receive W-2s from their employers (or 1099s documenting income from other institutions) when needed to file their tax returns. This may occur because the place of employment was destroyed and the W-2s could not be issued, or because the W-2s did not catch up to employees relocated because of the hurricane. The IRS will provide at its website a secure way for workers interested in the option to use 2004 earned income to determine the amount shown on their 2004 tax return.