

## **Extending the EITC to Noncustodial Parents: Potential Impacts and Design Considerations**

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## Executive Summary

The state of New York and the District of Columbia are the first jurisdictions to implement an innovative policy—an earned income tax credit (EITC) for low-income noncustodial parents who work and pay their child support in full. A similar tax credit was introduced by Senator Bayh and then-Senator Obama in 2007 (S. 1626). A noncustodial parent (NCP) EITC operates like the child-based EITC, which provides a refundable tax credit to low-income working families with children and encourages work. Under current federal income tax rules, low-income noncustodial parents are ineligible for the EITC benefits available to low-income families with children, even when they support their children through full payment of child support. While the EITC and child support have successfully removed many low-income working families from poverty, the combined effect of taxes and child support payments can impoverish noncustodial parents working at or near the minimum wage. NCP EITC policies work to reduce this disparity and to increase incentives for work and payment of child support.

We examine three policy scenarios for a national NCP EITC, which are based on the NCP credits adopted by New York and Washington, D.C. and proposed in S. 1626. Based on the NCP EITC policies examined here, we estimate that as many as 645,000 noncustodial parents (5 percent of all noncustodial parents) would be eligible for an NCP EITC, depending on the age and income criteria for the credit. On average, these policies would increase the annual incomes of eligible noncustodial parents by between \$500 and \$1,900—an increase of 6 to 12 percent in income after taxes and payment of child support. Estimated costs for an NCP EITC range from under \$100 million to \$1.1 billion (in 2004 dollars) depending on the policy option chosen.

We review several key design and implementation issues that should be considered when enacting an NCP EITC. Specifically, we note the following:

- Limiting an NCP EITC to those in the child support enforcement program, as is done in New York and Washington, D.C., would simplify the administration of an NCP EITC, but some people who pay the full amount of their child support order would not be eligible.
- New York and Washington, D.C. limit eligibility to noncustodial parents who pay at least the amount of current support due during the tax year. Requiring that each month's payment be made on time or that the noncustodial parent have no child support arrears could substantially reduce eligibility. Eligibility could be expanded by providing a partial credit to those paying some, but not all, of the amount due.
- Because many noncustodial parents are eligible for the child-based EITC, policymakers should consider whether these parents should be eligible for both a child-based EITC and an NCP EITC. In New York, noncustodial parents can only receive one credit.
- The interaction of the NCP EITC with federal and state tax intercept programs should be considered. If a noncustodial parent's tax refund is intercepted to pay child support arrears, as is done in New York and Washington, D.C., then custodial families and the government would benefit, but incentives to work and pay child support would be lower than if the credit were not intercepted.

- There are important steps that the government can take to encourage participation in an NCP EITC. If child support enforcement agencies pre-certify that noncustodial parents are eligible for the credit, then applications can be kept simple (for example, by not requiring Social Security numbers for the children) and noncustodial parents can be notified that they meet the child support criteria for the credit. Neither of these steps was taken in New York or Washington, D.C., but these steps would likely increase participation in an NCP EITC.

An NCP EITC provides an additional tool for encouraging child support payments by low-income noncustodial parents. Modifying and establishing child support orders that reflect the circumstances of low-income noncustodial parents would further reduce the likelihood that low-income noncustodial parents are impoverished as they work and pay child support. Custodial families would also benefit from the increased child support payments produced in response to the incentives generated by an NCP EITC.

## **I. Introduction**

In 2006, the state of New York and the District of Columbia became the first jurisdictions to implement an earned income tax credit (EITC) for low-income noncustodial parents who work and pay their child support in full. The Responsible Fatherhood and Healthy Families Act of 2007 (S. 1626), introduced by Senator Bayh and then-Senator Obama, would create a similar tax credit at the federal level. Under current federal income tax rules, low-income noncustodial parents are ineligible for the EITC benefits available to low-income families with children, even when they support their children through full payment of child support. While the EITC and child support have successfully removed many low-income working families from poverty, the combined effect of taxes and child support payments can impoverish noncustodial parents working at or near the minimum wage. Noncustodial parent (NCP) EITC policies work to reduce this disparity.

Like the EITC, an NCP EITC also increases work incentives by supplementing the incomes of low-wage workers. Because noncustodial parents must pay child support to be eligible, incentives to pay child support are increased, which can in turn produce more child support payments to custodial families. If an NCP EITC extends eligibility to noncustodial parents with child support arrears, then custodial families will also benefit when the noncustodial parent's tax refund is intercepted to repay arrears owed to the family.

We examine three policy scenarios for a national NCP EITC, which are based on the NCP credits adopted by New York and Washington, D.C. and proposed in S. 1626. Based on the NCP EITC policies examined here, we estimate that as many as 645,000 noncustodial parents would be eligible for an NCP EITC, depending on the age and income criteria for the credit. On average, an NCP EITC would increase the annual incomes of eligible noncustodial parents by between \$500 and \$1,900. Estimated costs for an NCP EITC range from under \$100 million to \$1.1 billion (in 2004 dollars) depending on the policy option chosen.

There are several key design and implementation issues that need to be considered when enacting an NCP EITC. One of these issues is whether the credit should be limited to those in the child support enforcement program or open to all with a child support order. Also, the definition of "full payment" has important implications for the administration of the credit and how many noncustodial parents would benefit. Another key issue is how dual-eligibility should be treated, as many noncustodial parents live with some of their children while living apart from others and thus could be eligible for both the child-based EITC and the NCP EITC. Also of interest is how the NCP EITC would interact with the tax offset program. Lastly, different strategies to encourage participation should be considered.

Below, we provide background and rationale for an NCP EITC, present alternative designs for an NCP EITC, and estimate their costs and effects. We then discuss key issues to consider when designing and implementing an NCP EITC.

## **II. Background**

The federal EITC is the nation's largest antipoverty program, providing \$44.4 billion in benefits to 23 million low-income working families and individuals in 2006 (IRS 2008). A key attribute

of the federal EITC is that it is refundable—the credit first reduces a family’s tax liability (if any) to zero, and the remaining credit is then paid to the family. The federal EITC was enacted in 1975 to offset Social Security taxes for low-income families and to increase work incentives; it has been considerably expanded over the years. Childless workers and those whose children live elsewhere were initially ineligible for the EITC, but they became eligible for a small credit beginning in the 1994 tax year. In addition to the federal EITC, 23 states, the District of Columbia, and several local governments have EITCs.<sup>1</sup>

To receive the more generous “child-based” EITC, a taxpayer must have a “qualifying child” who resides with the taxpayer for more than half the year. Thus, noncustodial parents are ineligible for the EITC on behalf of children living elsewhere—even if they meet their child support obligation. In 2008, a taxpayer with two resident children could receive up to \$4,824 in EITC, compared with \$438 in “childless” EITC benefits for a taxpayer without resident children. With some exceptions, noncustodial parents are ineligible for other tax benefits on behalf of their nonresident children, including the dependent exemption, head-of-household filing status, child tax credit, and child and dependent care credit.

While the child-based EITC removes many low-income families from poverty (Holt 2006), the combined effect of child support payments and taxes can drive a low-wage noncustodial parent into poverty (Primus 2006; Wheaton and Sorensen 1997). Since 1989, the federal government has required that states have mandatory judicial guidelines for setting child support awards. However, states vary considerably in the definition of income, the amount of award levels, and the treatment of low-income noncustodial parents. In most states, child support awards are regressive, meaning that the higher the income of the noncustodial parent, the lower the percentage of income devoted to child support. Moreover, many states impute a minimum level of income to noncustodial parents when determining their child support award on the assumption that everyone should be able to work at least at a full-time year-round minimum-wage job. Thus, even though noncustodial parents’ income may be lower than this amount, their orders are not reduced. In a study of seven large states, half of noncustodial parents with child support orders and reported incomes under \$10,000 were required to pay at least 83 percent of their income in child support. Of those with reported income between \$10,000 and \$20,000, half were required to pay at least 22 percent of their income in child support (Sorensen, Sousa, and Schaner 2007).

A simple example illustrates how the current tax system and child support guidelines improve the incomes of low-income custodial families but can drive low-income noncustodial parents into poverty. In 2008, a full-time, full-year minimum-wage worker would earn \$12,775 for the year, which is equal to 74 percent of the poverty level for a single parent with two children and 114 percent of the poverty level for a single individual (table 1). A custodial parent with two children and earnings of \$12,775 would pay \$977 in payroll taxes, and would receive \$641 in refundable child tax credits and \$4,824 in EITC benefits. A noncustodial parent with the same earnings would pay \$1,360 in payroll and federal income taxes and receive \$8 in childless EITC benefits, resulting in after-tax income of \$11,423. A typical child support guideline would require noncustodial parents with two children to pay 25 percent of gross income on child

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<sup>1</sup> State Online Resource Center, “State EITC Basics: FAQs about State EITC,” <http://www.stateeitc.com/basics/index.asp>, accessed November 24, 2008.

support, for a total of \$3,194 for the year. Child support and federal taxes would thus increase the custodial family’s income to \$20,456 (118 percent of the poverty level for a single parent with two children) while reducing the noncustodial parent’s income to \$8,229 (73 percent of the poverty level for a single individual).

**Table 1: Impact of Federal Taxes and Child Support on Income and Poverty Status of Custodial and Noncustodial Parents with a Full-Time Job**

	Custodial Parent	Noncustodial Parent
Earnings (full-time minimum wage job)	\$12,775	\$12,775
As a Percent of Poverty	74%	114%
Payroll Tax	\$977	\$977
Federal Tax (before credits)	\$0	\$382
Refundable Child Tax Credit	\$641	\$0
Earned Income Tax Credit	\$4,824	\$8
Earnings Less Taxes, Plus Credits	\$17,263	\$11,423
As a Percent of Poverty	100%	102%
Child Support	\$3,194	(\$3,194)
Income after Taxes, Credits, and Child Support	\$20,456	\$8,229
As a Percent of Poverty	118%	73%

Note: This example reflects the 2008 minimum wage, tax rules, and poverty thresholds. The example assumes that there are two children who live with the custodial parent, and that the child support order is set to 25 percent of the noncustodial parent's gross income (earnings). The custodial family's poverty threshold is \$17,346, the threshold for a single adult with two children. The noncustodial parent's threshold is \$11,201, the amount for a single individual.

An NCP EITC could reduce the negative effects of the current tax system and child support guidelines on low-income noncustodial parents (Primus 2006; Sorensen 1999; Wheaton and Sorensen 1997). Another approach would be to change the treatment of low-income noncustodial parents in state child support guidelines. In combination, these two approaches could help ensure that orders for low-income noncustodial parents are set at an amount where full payment is possible, reduce the likelihood that noncustodial parents who work and pay support will be impoverished, and encourage work and child support payment among noncustodial parents. Custodial families would benefit from the increased child support payments produced in response to the incentives generated by these policies.<sup>2</sup>

<sup>2</sup> As discussed elsewhere, custodial families would also benefit in cases in which the noncustodial parent’s tax refund is intercepted to repay child support arrears owed to the family.

### III. Noncustodial Parent EITC Policies

Various approaches could be taken to constructing an NCP EITC.<sup>3</sup> The New York, D.C., and S. 1626 NCP EITCs all require the noncustodial parent to have paid all child support that accrued during the tax year.<sup>4</sup> Key differences among the credits include the eligible age range, the formula used to calculate the amount of the credit, and the income range in which the credit is available.<sup>5</sup> New York extends eligibility to all noncustodial parents age 18 and above, Washington, D.C. restricts eligibility to those age 18–30, and S. 1626 would restrict eligibility to those age 25–64 (the age range for the childless EITC).<sup>6</sup> S. 1626 would provide noncustodial parents in the income range of an expanded childless EITC with an amount equal to twice the amount of the credit available to adults without resident children. New York allows noncustodial parents to claim the greater of twice the existing federal childless EITC or two-thirds of the state EITC for a single taxpayer with one child. The District of Columbia relies solely on the District's child-based EITC when determining the credit and income range for its NCP EITC. In other words, noncustodial parents who pay their full child support are eligible for the same credit that is available to families with resident children (based on the number of noncustodial children).

To estimate the effects of these different policy designs at the national level, we adjust the New York and D.C. policies to reflect the higher levels of the federal EITC.<sup>7</sup> Our New York-based policy sets the NCP EITC equal to two-thirds of the federal EITC for a single taxpayer with one child, and our D.C.-based policy sets the NCP EITC equal to the full federal child-based EITC.<sup>8</sup> We choose this approach because we wish to apply the principle underlying the New York and D.C. policies—that an NCP EITC should approach or match the levels of the child-based EITC—to the federal EITC. Except where noted, our S. 1626-based estimates show the impact of the NCP EITC relative to current law and do not capture the broader EITC expansions proposed by S. 1626, which include an expanded childless EITC and marriage penalty relief.

Figure 1 illustrates the NCP EITC credits simulated here. Like the EITC, the NCP EITC amounts simulated here would increase with earnings up to the point at which the maximum credit is reached, remain at this maximum level as earnings continue to increase, and then phase out based on earnings or adjusted gross income (AGI), whichever is higher. For purposes of

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<sup>3</sup> The NCP EITC policies considered here are targeted to noncustodial parents who pay their child support in full, so estimated eligibility and costs are much lower than under most recently proposed broad expansions to the childless EITC. See Carasso and colleagues (2008) for discussion and estimates of various proposals to expand the childless EITC. Coan (2008) compares an NCP EITC with a childless worker and all-worker EITC expansion.

<sup>4</sup> S. 1626 is ambiguous in this regard. It states that noncustodial parents must have “paid child support during the taxable year in an amount not less than the amount of child support due during the taxable year.” This could be interpreted to mean that the noncustodial parent must pay all current support as well as any child support arrears from prior years before being eligible for the NCP EITC.

<sup>5</sup> Information about the New York and District of Columbia noncustodial parent EITC policies is obtained from the 2006 New York and DC tax forms and instructions, as well as New York Tax Law Subsection 606 (d-1) and District of Columbia Official Code (DC ST 1981 § 47-1806.4) (both downloaded on October 25, 2006).

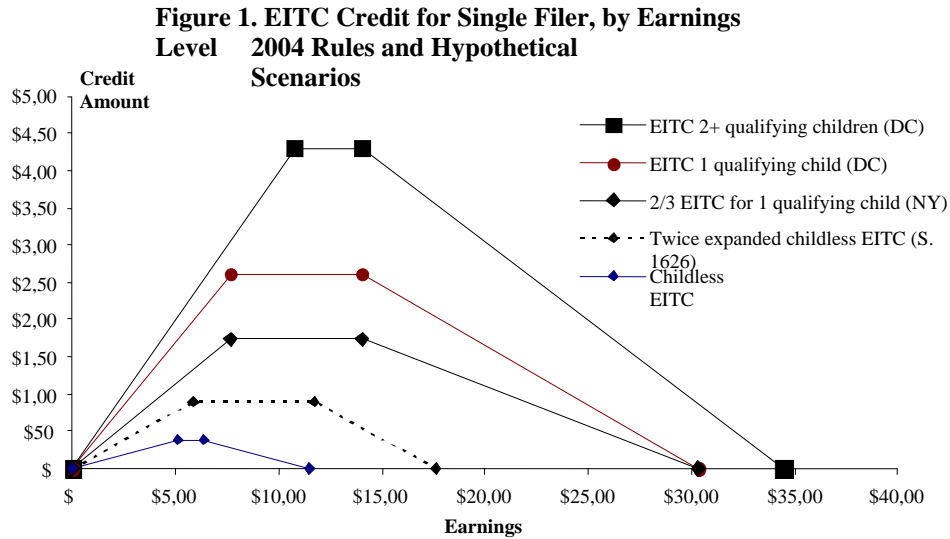
<sup>6</sup> The child-based EITC does not include age restrictions, except that parents who are themselves qualifying children for the EITC cannot claim the EITC. The same approach could be used for an NCP EITC.

<sup>7</sup> State and local EITCs are typically lower than the federal EITC. New York's EITC is equal to 30 percent of the federal EITC and Washington, D.C.'s, EITC is equal to 40 percent of the federal EITC.

<sup>8</sup> The New York-based scenario does not include an option for the noncustodial parent to claim twice the childless EITC, because 2/3 of the federal EITC for one child is always greater than twice the federal childless EITC.



comparison, figure 1 includes the childless EITC. In 2004 (the year of the data for our estimates), single taxpayers without resident children were eligible for a maximum credit of \$390, and the credit was completely phased out at \$11,490. Other than annual adjustments for inflation, there were no changes to the EITC between 2004 and 2008 that would affect the values for a single taxpayer shown in figure 1. Therefore, the values are equivalent to 2008 rules deflated to 2004



dollars.

*Notes:* The 2004 values shown here are equivalent to 2008 values deflated to 2004 dollars. The EITC phases out with earnings or with adjusted gross income, whichever is larger.

Under our specifications, the D.C.-based scenario provides the most generous credit, followed by the New York-based scenario, and then the S. 1626-based scenario. Specifically, if the NCP EITC is equal to the full child-based EITC, then a noncustodial parent would receive a maximum credit of \$2,604 (if one child—phasing out at \$30,338) or \$4,300 (if two or more children—phasing out at \$34,458).<sup>9</sup> If the NCP EITC is set to two-thirds of the EITC for a single filer with one child, the taxpayer would receive a maximum credit of \$1,736, and the phaseout would extend to \$30,338. Under S. 1626, a noncustodial parent would receive a maximum of \$897 in EITC benefits, and the phaseout would end at \$17,599.<sup>10</sup>

<sup>9</sup> Our estimates capture the higher beginning and end of the phaseout range for married taxpayers who file joint returns (the beginning and ending points are \$3,000 higher in 2008 dollars, deflated to 2004 dollars). The resulting end of the phaseout for married couples is \$20,265 under the S. 1626-based scenario, \$33,004 under the New York-based scenario and for noncustodial parents with one child under the D.C.-based scenario, and \$37,124 for noncustodial parents with two or more children under the D.C.-based scenario.

<sup>10</sup> A key element of S. 1626 is that it doubles an *expanded* childless EITC. If S. 1626 had proposed an NCP EITC that was simply twice the existing EITC, income eligibility would end at \$11,490 instead of \$17,599 and substantially fewer noncustodial parents would be found to meet the child support eligibility criteria.

#### IV. Noncustodial Parents: Earnings, Payment of Child Support, and EITC Eligibility

The estimates presented here are generated by the TRIM3 (Transfer Income Model Version 3) microsimulation model using data from the 2005 Annual Social and Economic Supplement to the Current Population Survey (ASEC).<sup>11</sup> The ASEC provides detailed demographic information and 2004 income data for a nationally representative sample of households. The ASEC does not identify noncustodial parents, so TRIM3 imputes noncustodial parent status and child support payment characteristics based on information obtained from the Survey of Income and Program Participation (SIPP), Current Population Survey Child Support Supplement, and child support enforcement administrative data. We model 2008 federal income tax rules, deflating the dollar amounts to 2004 levels for consistency with the 2004 income data.

We estimate that there were 11.9 million noncustodial parents in 2004 (table 2). Our estimates exclude institutionalized noncustodial parents and families in which the child lives with neither parent, but include all other noncustodial parents resident within the United States, including those for whom paternity has not been established or there is no child support order. We include noncustodial parents who have a case with the Child Support Enforcement (IV-D) Program, noncustodial parents who have private child support orders, and noncustodial parents who have had no involvement with the public or private child support system.

**Table 2: Estimated Earnings and Child Support Payment Status of Noncustodial Parents in 2004**

Earnings <sup>1</sup>	Noncustodial Parents (1000s) <sup>2</sup>	Percent Paying		
		No Child Support <sup>3</sup>	Some of Child Support Due	All of Child Support Due
<=0	1,655	84%	12%	4%
\$1-\$9,999	954	68%	27%	5%
\$10,000-\$19,999	1,461	62%	22%	16%
\$20,000-\$29,999	1,755	57%	18%	25%
\$30,000-\$39,999	1,398	52%	16%	32%
\$40,000+	4,692	49%	14%	37%
Subtotal \$1-\$29,999	4,170	61%	22%	17%
Total	11,915	58%	17%	25%

Source: TRIM3 Microsimulation Model Using Data from the 2005 ASEC.

<sup>1</sup> Earnings include earnings of a spouse, if present.

<sup>2</sup> Noncustodial parents represented here exclude institutionalized parents and cases in which the child lives with neither parent, but include all other noncustodial parents resident within the United States, including those for whom paternity has not been established or there is no child support order.

<sup>3</sup> The "no child support" column includes cases where paternity has not been established or there is no formal child support order, as well as cases where the noncustodial parent pays none of the support due.

<sup>11</sup> TRIM3 is developed and maintained by the Urban Institute under contract with the Office of the Assistant Secretary for Planning and Evaluation at the U.S. Department of Health and Human Services. Documentation of the TRIM3 model is available at <http://trim3.urban.org/T3Technical.php>. TRIM3 requires users to input assumptions and/or interpretations about economic behavior and the rules governing federal programs. Therefore, the conclusions presented here are attributable only to the authors of this report.

The NCP EITC policies considered here require full payment of child support due under a child support order, a requirement that the majority of noncustodial parents do not meet. Of the estimated 11.9 million noncustodial parents in 2004, 25 percent paid all child support due under a child support order during the year, and another 17 percent paid some of the support due. Those not paying any support include cases for which paternity has not been established or there is no child support order, as well as cases where an order has been established but the noncustodial parent does not pay any of the required child support. Full payment is less likely at lower earnings levels. Seventeen percent of noncustodial parents with earnings below \$30,000 and 5 percent of noncustodial parents with earnings below \$10,000 paid the full amount of child support due under a child support order.<sup>12</sup>

An NCP EITC might require that a noncustodial parent have a case with the IV-D program (as in New York and Washington, D.C.). However, our NCP EITC estimates include all noncustodial parents who pay their child support in full, including those who do not participate in the IV-D program. Most noncustodial parents who would be income and child support eligible for an NCP EITC participate in the IV-D program, and others might request IV-D services to become eligible for an NCP EITC requiring IV-D participation.<sup>13</sup>

Under current EITC rules, noncustodial parents may be eligible for the “childless” EITC or (if they have children living with them) the child-based EITC. However, they cannot receive the EITC on behalf of their children living elsewhere. We estimate that 19 percent of noncustodial parents are eligible for the EITC: 5 percent are eligible for the childless EITC, and 14 percent are eligible for the child-based EITC (table 3). In the earnings range most likely to be affected by the New York– and D.C.-based EITC scenarios (earnings under \$30,000), we estimate that 14 percent of noncustodial parents are eligible for the childless EITC and 31 percent are eligible for the child-based EITC.<sup>14</sup> At the lowest earnings level (\$1 to \$9,999), 46 percent of noncustodial parents are eligible for the childless EITC and 24 percent are eligible for the child-based EITC.<sup>15</sup>

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<sup>12</sup> Earnings include earnings of a spouse, where present.

<sup>13</sup> This issue is discussed in further detail in the section on NCP EITC design and implementation considerations.

<sup>14</sup> These results include all noncustodial parents. Of those who pay child support in full and have earnings under \$30,000, 5 percent are eligible for the childless EITC and 30 percent are eligible for the child-based EITC.

<sup>15</sup> About 30 percent of noncustodial parents with earnings below \$10,000 are ineligible for the EITC, primarily because they are outside the 25 to 64 age range for the childless EITC or have unearned income that raises them above the eligibility limit.

**Table 3: Estimated EITC Eligibility of Noncustodial Parents**

Earnings <sup>1</sup>	Noncustodial Parents (1000s) <sup>2</sup>	Percent of Noncustodial Parents who are:			
		Ineligible for EITC	Eligible for EITC		
			Total	Childless	Child-Based
<=0	1,655	100%	0%	0%	0%
\$1-\$9,999	954	30%	70%	46%	24%
\$10,000-\$19,999	1,461	58%	42%	10%	31%
\$20,000-\$29,999	1,755	65%	35%	0%	35%
\$30,000-\$39,999	1,398	76%	24%	0%	24%
\$40,000+	4,692	100%	0%	0%	0%
Subtotal \$1-\$29,999	4,170	55%	45%	14%	31%
Total	11,915	81%	19%	5%	14%

Source: TRIM3 Microsimulation Model Using Data from the 2005 ASEC. EITC eligibility is estimated on 2004 income using 2008 rules deflated to 2004 dollars.

<sup>1</sup> Earnings include earnings of a spouse, if present.

<sup>2</sup> Noncustodial parents represented here exclude institutionalized parents and cases in which the child lives with neither parent, but include all other noncustodial parents resident within the United States, including those for whom paternity has not been established or there is no child support order.

## V. Estimated Impact of Different NCP EITCs

Holding the eligible age range constant, the S. 1626-based NCP EITC policy (which is equal to twice an expanded childless EITC) would cost the least, reach the smallest number of noncustodial parents, and yield the smallest average increase in EITC benefits. If all noncustodial parents age 18 or older who paid their full child support were eligible, then an estimated 162,000 noncustodial parents would qualify for an average \$541 increase in EITC benefits for a total \$87 million in additional benefits (table 4).<sup>16</sup> As illustrated in figure 1, the New York- and D.C.-based scenarios extend NCP EITC eligibility higher up into the earnings range than the S. 1626-based policy, increasing the number of eligible noncustodial parents to 521,000 under the New York-based scenario (which sets the NCP EITC equal to two-thirds the child-based EITC for one qualifying child) and 645,000 under the D.C.-based scenario (which provides the same benefit level as the child-based EITC). Eligible noncustodial parents would qualify for an average \$894 increase in benefits under the New York-based scenario and \$1,732 increase in benefits under the D.C.-based scenario. The total estimated costs of the New York- and D.C.-based scenarios are \$466 million and \$1.1 billion, respectively.

<sup>16</sup> The S. 1626-based NCP EITC estimates presented here show the effect of the S. 1626 NCP EITC relative to 2008 EITC rules (deflated to 2004 dollars and modeled on 2004 data). Therefore, for noncustodial parents eligible for the NCP EITC, the costs and benefits reflect the combined effects of extending the childless EITC *and* doubling it for noncustodial parents who pay their support in full. Estimated costs and benefits are lower if the S. 1626 NCP EITC is considered as an add-on to other EITC provisions of S. 1626 (rather than as a stand-alone policy, as shown here). For example, we estimate that the total cost of the EITC provisions in S. 1626 is \$2,760 million (in 2004 dollars), of which \$39 million represents the incremental effect of adding an NCP EITC (for 25- to 64-year-olds) to the other provisions of S. 1626 (compared with \$70 million if the same NCP EITC is implemented as a stand-alone policy).

**Table 4. Tax Units Eligible for the NCP EITC, Under Three Alternative Scenarios, by Eligible Age Range (All results are shown in 2004 dollars)**

NCP EITC Scenario	Tax Units Eligible for NCP EITC (thousands)	Average After-Tax Income (Before EITC) <sup>1</sup>	Average Annual Child Support Paid	Average EITC			Average Percent Increase in Income after Child Support, Taxes, & EITC	Estimated Cost (millions)
				Under Current Rules	Under Modeled Scenario	Average Increase		
<b><i>Twice the Expanded Childless EITC (based on S.1626)</i></b>								
18+	162	11,854	2,821	44	585	541	6%	87
18-30	36	11,739	2,488	21	646	625	7%	23
25-64 <sup>2</sup>	136	11,990	2,991	53	566	513	6%	70
<b><i>2/3 EITC for Single Filer/One Child (based on NY policy)</i></b>								
18+ <sup>2</sup>	521	18,773	3,807	14	908	894	6%	466
18-30	115	17,712	3,046	7	979	972	7%	112
25-64	485	19,161	3,919	15	871	856	6%	415
<b><i>Full Qualifying Child EITC (based on DC policy)</i></b>								
18+	645	20,354	4,080	94	1,826	1,732	11%	1,117
18-30 <sup>2</sup>	131	18,723	3,310	101	1,985	1,884	12%	246
25-64	604	20,675	4,194	96	1,792	1,696	10%	1,025

Source: TRIM3 Microsimulation Model Using Data from the 2005 ASEC. Taxes and EITC eligibility are estimated on 2004 income using 2008 rules deflated to 2004 dollars.

<sup>1</sup> After-tax income is equal to cash income, less the employee share of payroll taxes, less federal income taxes (excluding the EITC).

<sup>2</sup> Indicates the actual eligible age range for the policy on which this scenario is based.

Imposing an age limit would reduce the eligibility and costs of an NCP EITC, especially if it is limited to noncustodial parents between the ages of 18 and 30. Restricting the D.C.-based scenario, for example, to those between 18 and 30 (rather than 18 and older) would reduce the number of noncustodial parents eligible for the credit from 645,000 to 131,000 and would reduce the cost from \$1.1 billion to \$246 million. This is because most noncustodial parents are over 30 years old and an even higher percentage of noncustodial parents who pay their full child support are over 30. Restricting eligibility to those age 25 to 64 would also reduce eligibility and costs, but by a relatively modest amount (i.e., around 10 to 20 percent).

The NCP EITC policies examined here would increase the annual incomes of eligible noncustodial parents by between \$500 and \$1,900 on average, depending on the policy and eligible age range. This represents an increase of between 6 and 12 percent in average income after taxes and payment of child support. The highest dollar and percentage increases in income

occur under the D.C.-based scenario. The New York–based scenario increases the average dollar amount of income by more than the S. 1626-based scenario, but both have similar effects on the percentage of income. This occurs because the New York–based scenario has a larger eligible income range than the S. 1626-based scenario.

Table 5 shows the distribution of eligible noncustodial parents and NCP EITC benefits by earnings level. Nearly all the noncustodial parents eligible for the S. 1626-based NCP EITC have earnings below \$20,000, and most (79 percent) have earnings between \$10,000 and \$19,999.<sup>17</sup> Because eligibility under the New York– and D.C.-based scenarios extends further up the income range, over half of noncustodial parents eligible under these scenarios have earnings above \$20,000. Virtually all of eligible benefits accrue to noncustodial parents with earnings less than \$20,000 under the S. 1626-based policy, compared with 62 percent and 50 percent, respectively, under the New York– and D.C.-based scenarios.

**Table 5: Distribution of NCP EITC Eligibility and Benefits Under Three Scenarios  
(Assuming Eligibility Extends to Noncustodial Parents Aged 18 and Above)**

NCP EITC Scenario (Age 18+ Eligible)	Noncustodial Parents (thousands)			Benefits (millions of 2004 dollars)		
	Twice Expanded Childless EITC ("S.1626")	2/3 EITC Single Filer/One Child ("NY")	Full Qualifying Child EITC ("DC")	Twice Expanded Childless EITC ("S.1626")	2/3 EITC Single Filer/One Child ("NY")	Full Qualifying Child EITC ("DC")
Total	162	521	645	\$87	\$466	\$1,117
Earnings Level <sup>1</sup>						
\$1 - \$9,999	19%	6%	5%	21%	8%	6%
\$10,000 - \$19,999	79%	31%	26%	79%	54%	44%
\$20,000 - \$29,999	2%	56%	51%	0%	37%	45%
\$30,000 - \$39,999	0%	6%	18%	0%	1%	5%

Source: TRIM3 Microsimulation Model Using Data from the 2005 ASEC. EITC eligibility is estimated on 2004 income using 2008 rules deflated to 2004 dollars.

<sup>1</sup> Earnings include earnings of a spouse, if present.

The numbers presented here are estimates of eligibility. The number of noncustodial parents claiming the NCP EITC could be substantially smaller. Our estimates do not capture all nuances regarding eligibility,<sup>18</sup> and they do not capture the additional work and child support payments that might be generated in response to the incentives produced by the credit. Finally, the estimates assume full compliance with tax rules. IRS compliance studies show that a common source of EITC error involves claiming children who fail to meet residency

<sup>17</sup> Eligibility under the S. 1626-based scenario extends to \$17,599 for single individuals and \$20,265 for married couples.

<sup>18</sup> In particular, we do not require child support to be paid through a government agency (as would likely be required) and we do not capture noncustodial parents whose children live with someone other than the other parent (such as a grandparent).

requirements.<sup>19</sup> Under an NCP EITC, noncustodial parents who inappropriately claim the child-based EITC on behalf of children living elsewhere might continue to do so (so there would be no increase in EITC costs for these noncustodial parents) or they might switch from the child-based EITC to the NCP EITC (which could reduce EITC costs if the NCP EITC is smaller than the child-based EITC).

## **VI. NCP EITC Design and Implementation Considerations**

As demonstrated above, the age and income eligibility criteria along with the benefit level for an NCP EITC substantially influence the number of noncustodial parents eligible for an NCP EITC and the potential cost of the credit. Policies focused on narrow age ranges (such as 18–30) are much less expensive than identical policies that would extend eligibility to a broader age range. Policies that base eligibility on the current or an expanded childless EITC will reach fewer noncustodial parents than those that extend eligibility into the income ranges covered by the child-based EITC—not just because more noncustodial parents fall into the broader income range covered by the child-based EITC but also because those with higher incomes are more likely to pay their child support in full.

Besides determining the eligibility criteria regarding age and income, and the benefit level for the NCP EITC, several other issues should be considered when designing an NCP EITC.

### ***A. Eligibility of Non-IV-D Noncustodial Parents***

As noted earlier, New York and Washington, D.C., require that noncustodial parents pay child support on behalf of a IV-D case to be eligible for the NCP EITC.<sup>20</sup> The IV-D program is operated by state and local governments with oversight from the federal government. The program provides child support enforcement services to current and former welfare families free of charge, and to other families for a small fee. In fiscal year 2006, the IV-D program collected about \$24 billion in child support for IV-D cases (Office of Child Support Enforcement [OCSE] 2009).

Because New York and Washington, D.C., limit eligibility for the NCP EITC to noncustodial parents with a IV-D case, the IV-D programs in these jurisdictions can certify which noncustodial parents meet the child support eligibility criteria for the NCP EITC. All state IV-D programs track amounts paid and owed as part of their child support enforcement functions, and data regarding IV-D orders and payments are subject to federal audit. The New York and Washington, D.C., IV-D programs inform their respective tax departments regarding which noncustodial parents meet the child support eligibility criteria for the NCP EITC. The tax departments then restrict the NCP EITC to noncustodial parents who are certified by the IV-D program as child support eligible for the credit. In this way, the child support eligibility criteria

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<sup>19</sup> The IRS estimates that in 1999, at least 1.2 million taxpayers receiving the child-based EITC were ineligible because the child did not meet the criteria for a qualifying child (IRS 2002). The most common qualifying child error was the failure of the child to meet residency requirements.

<sup>20</sup> As stated elsewhere, our estimates do not apply this restriction.

for the NCP EITC are “pre-audited,” reducing the potential for erroneous claims for the NCP EITC by noncustodial parents who, in fact, do not meet the child support eligibility criteria.

Most noncustodial parents who would be income and child support eligible for an NCP EITC already participate in the IV-D program. Precise numbers are not available, but an estimated 84 percent of custodial families who receive child support and have incomes below 200 percent of the poverty level participate in the IV-D program.<sup>21</sup> Noncustodial parents who do not currently participate in the IV-D program might request IV-D services in order to become eligible for an NCP EITC requiring IV-D participation.

In contrast to the New York and D.C. policies, S. 1626 states that noncustodial parents must pay support through a “State agency responsible for administering the State plan under part D of title IV of the Social Security Act.” This could be interpreted to mean that noncustodial parents do not necessarily have to pay on behalf of a IV-D case; they simply have to make payments through a state IV-D agency. In addition to enforcing child support for IV-D cases, state IV-D programs operate state disbursement units (SDUs) that disburse IV-D child support collections as well as private (non-IV-D) child support collections made through automatic wage withholding (Roberts 2000). In fiscal year 2006, the IV-D program disbursed \$3.6 billion in private child support collections through SDUs (OCSE 2009). States may vary in the amount and reliability of data regarding non-IV-D child support orders. Such issues should be taken into consideration when considering whether to extend an NCP EITC to private cases making payments through an SDU.

### ***B. Definition of “Full Payment”***

Our estimates assume that a noncustodial parent would meet the “child support eligibility” requirements for an NCP EITC if he or she pays at least as much child support during the year as accrues during the year. This is the definition of full payment used by New York and Washington, D.C. Under this definition, the noncustodial parent can have arrears that accrued in prior years, as long as an amount equal to the current year’s support has been paid. Payments can include current support and/or arrears—as long as the total equals or exceeds the amount of current support due during the year.

Alternative definitions of full payment—such as requiring that each month’s child support be paid in full and on time—would increase administrative complexity and reduce the number of noncustodial parents eligible for the NCP EITC. Many noncustodial parents who pay child support have arrears, so denying the NCP EITC to noncustodial parents with arrears would also reduce eligibility.<sup>22</sup>

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<sup>21</sup> Over all income ranges, an estimated 74 percent of custodial families who receive support participate in the IV-D program (Hong et al. forthcoming).

<sup>22</sup> There are no published national data on the extent to which noncustodial parents who pay their current support orders in full have arrears. A study of nine large states (Sorensen et al. 2007) shows that most noncustodial parents with a child support order have arrears, but that arrears are less common among those who pay their current support in full. The study finds that 94 percent of child support obligors with reported incomes of \$1 to \$10,000 and 75 percent of those with reported incomes above \$10,000 have child support arrears. Among those who paid at least some support during the year, 80 percent had arrears. Less than half of those paying their full order for the calendar



On the other hand, an NCP EITC does not have to be limited to those who pay their full child support. Many low-income noncustodial parents face employment barriers and job instability that can make full payment difficult to achieve. Noncustodial parents with multiple children (and thus higher child support orders) may find it more difficult to make full payment than noncustodial parents with one child and similar earnings. Allowing noncustodial parents who pay partial support to receive at least some benefit from an NCP EITC would extend the benefits and incentives of an NCP EITC to a broader population (Mincy 2008; Primus 2006).

Administrative timing issues should also be considered when developing an NCP EITC. In New York, noncustodial parents whose employers did not report 2006 child support payment information until 2007 were initially denied the credit.<sup>23</sup> Those who appealed the decision were later able to claim the credit (Sorensen forthcoming). Policymakers could consider possible measures to reduce these problems, such as requiring full payment for a period other than the tax year or excluding amounts due from the final paycheck when determining whether full payment has been made.

### *C. Interaction with the Child-Based EITC*

In designing an NCP EITC, it is important to bear in mind that some noncustodial families have resident children (such as those from a current relationship) and are eligible for the child-based EITC. We estimate that nationally, 31 percent of noncustodial parents who have earnings under \$30,000 are eligible for the child-based EITC.<sup>24</sup>

Our estimates assume that noncustodial parents would claim the higher of the current EITC and the NCP EITC, but could not claim both credits. In most cases, noncustodial parents who are eligible for the child-based EITC will receive a higher benefit from the child-based EITC than the S. 1626, New York-, or D.C.-based NCP EITC and so are assumed to claim the child-based EITC and are not counted as eligible for the NCP EITC.<sup>25</sup> This assumption is consistent with New York's approach and produces the same results as S. 1626 (which extends eligibility only to noncustodial parents who are ineligible for the child-based EITC), although it may not reflect D.C.'s policy.<sup>26</sup>

### *D. NCP EITC and Tax Intercepts*

Part of the rationale for the EITC is to encourage low-wage work and the payment of child support by increasing the amount of income that low-wage noncustodial parents are able to retain. However, if the NCP EITC is intercepted to pay child support arrears, then this incentive

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year had arrears, but the median reported income of the full payers was \$30,579—so many would be outside the income range of an NCP EITC.

<sup>23</sup> Wage withholding by employers is a common method of child support enforcement. Nationally, more than two-thirds of child support collections are made through wage withholding (OCSE 2009).

<sup>24</sup> Earnings include earnings of a spouse, where present.

<sup>25</sup> The only exception to this rule is under the D.C.-based scenario, where noncustodial parents with one resident child and two nonresident children would receive a higher benefit by claiming the NCP EITC. In this case, we count the noncustodial parent as eligible for the NCP EITC.

<sup>26</sup> The 2006 D.C. tax forms and instructions do not appear to prevent a noncustodial parent from receiving both the child-based and NCP EITC. However, D.C. law indicates that the NCP EITC is available only to taxpayers who are ineligible for the federal EITC (and would therefore be ineligible for the standard D.C. EITC).

will be reduced. State and federal tax systems typically intercept tax refunds owed to noncustodial parents who have child support arrears and either forward the refund to the custodial family or return it to the government in order to repay child support that has been “assigned” by the custodial parent to the government as a condition for receiving welfare assistance.<sup>27</sup> Unless federal or state policies specifically exempt the NCP EITC from the tax intercept or the credit is only available to noncustodial parents without arrears, then some amount would be intercepted to repay arrears.

If a noncustodial parent is aware that the NCP EITC will be intercepted, then he or she may have little incentive to increase work effort or child support payments in order to qualify for the credit. This is particularly true if the intercepted credit would go to the government rather than to the custodial family. However, for noncustodial parents who pay child support, an intercepted NCP EITC would reduce the arrears owed. For noncustodial parents with low or moderate arrears, the intercepted NCP EITC could eventually repay the child support arrears owed to the government and custodial family, and the noncustodial parent would begin to receive the financial benefits of the credit. The intercepted credit could even help a noncustodial parent become eligible for the credit in the next year, if it is counted as a child support “payment” when determining eligibility for the next year’s NCP EITC.

#### ***E. Other Tax Implications***

An NCP EITC would require new administrative procedures to notify the IRS (or state revenue department) of noncustodial parents who meet the child support criteria for eligibility. The new credit would represent a departure from efforts to standardize the definition of a qualifying child for tax-related purposes. The new credit could affect tax-related marriage penalties and bonuses, although the net effect of the changes is unknown.<sup>28</sup>

#### ***F. Encouraging Participation***

Not all persons eligible for the EITC claim it. The Government Accountability Office (GAO, formerly the General Accounting Office) estimates that 86 percent of those eligible for the child-based EITC claim the credit, compared with 43 percent of those eligible for the childless EITC (GAO 2001). The lower participation rate for the childless EITC is likely attributable to the smaller size of the credit and the fact that a larger percentage of those eligible have incomes below the required filing threshold. NCP EITC participation rates are likely to be highest for policies that offer large benefits, extend furthest up into the income range, and have the simplest application procedures.

Notifying noncustodial parents that they meet child support eligibility requirements and keeping application procedures as simple as possible can help encourage participation in an NCP

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<sup>27</sup> About 58 percent of child support obtained from federal tax intercepts in 2006 was forwarded to custodial families, with the remainder going to the government (OCSE 2009).

<sup>28</sup> An NCP EITC could contribute to marriage penalties because the noncustodial parent would no longer be eligible for the NCP EITC once married to the custodial parent. However, the additional income from an NCP EITC might increase marriageability of the noncustodial parent to another partner, because the noncustodial parent would continue to receive the credit once married as long as the additional income from the new spouse did not cause the noncustodial parent to become ineligible (Coan 2008).

EITC. While New York does extensive outreach about the NCP EITC, it does not send letters to noncustodial parents informing them that they meet the child support eligibility requirements for the NCP EITC (Sorensen forthcoming). Notifying noncustodial parents that they meet the child support eligibility criteria for the NCP EITC may increase their participation rate. In addition, both New York and Washington, D.C., require that noncustodial parents supply information about their nonresident children's Social Security numbers on their NCP EITC tax form.<sup>29</sup> This requirement was cited as a significant barrier for claiming the credit in New York since many noncustodial parents do not know the Social Security numbers of their nonresident children (Sorensen forthcoming). Given that child support eligibility is independently verified by the child support agency, such information may be unnecessary, and if so, could be dropped. If sufficient data are available on a standard tax form to determine eligibility, another way to increase participation would be for states or the federal government to automatically assign the NCP EITC to those who are income eligible and have been identified as paying their child support in full.<sup>30</sup>

## VII. Conclusions

While the EITC and child support have successfully removed many low-income working families from poverty, the combined effect of taxes and child support payments can impoverish noncustodial parents working at or near the minimum wage. NCP EITC policies, such as those provided in New York and the District of Columbia, work to reduce this disparity and to increase incentives for work and payment of child support. An NCP EITC thus works side by side with the child-based EITC, so that both low-income noncustodial and low-income custodial parents are encouraged to work and support their children. Custodial families would also benefit from the increased child support payments produced in response to the incentives generated by an NCP EITC.

We examine three options for an NCP EITC, based on credits proposed in S. 1626 and adopted by New York and Washington, D.C., which range from a credit equal to twice an expanded childless EITC to the full child-based EITC. We estimate that as many as 645,000 noncustodial parents would be eligible for an NCP EITC, depending on the policy option selected. On average, these policies would increase the annual incomes of eligible noncustodial parents by between \$500 and \$1,900—an increase of 6 to 12 percent in income after taxes and payment of child support. The total estimated costs of the NCP EITC policies examined here range from under \$100 million to \$1.1 billion (2004 dollars), depending on the eligible age range and NCP EITC formula for the policy in question. Not all those eligible would claim the credit, so actual costs would be lower. However, if the incentives generated by the credit cause more noncustodial parents to pay their child support in full, then costs would increase.

We have reviewed several key design and implementation issues that should be considered when enacting an NCP EITC. We summarize these findings here.

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<sup>29</sup> The Washington, D.C., NCP EITC form (Schedule N) goes even further and requires the name and Social Security number of the custodial parent.

<sup>30</sup> Before mid-1992, the IRS automatically assigned the EITC to those who appeared eligible but did not claim the credit (Scholz 1993–94). The IRS currently calculates the EITC for taxpayers upon request, but requires the taxpayer to submit Schedule EIC if claiming resident children.

- Limiting an NCP EITC to those in the child support enforcement program, as is done in New York and Washington, D.C., can simplify administration, but some people who pay the full amount of their child support order will not be eligible.
- New York and Washington, D.C. limit eligibility to noncustodial parents who pay at least the amount of current support due during the tax year. Requiring that each month's payment be made on time or that the noncustodial parent have no child support arrears could substantially reduce eligibility. Eligibility could be expanded by providing a partial credit to those paying some, but not all, of the amount due.
- Because many noncustodial parents are eligible for the child-based EITC, policymakers should consider whether these parents should be eligible for both a child-based EITC and an NCP EITC. In New York, noncustodial parents can only receive one credit.
- The interaction of the NCP EITC with federal and state tax intercept programs should also be considered. If a noncustodial parent's tax refund is intercepted to pay child support arrears, then custodial families and the government would benefit, but incentives to work and pay child support would be lower than if the noncustodial parent received the full credit.
- There are important steps that the government can take to encourage participation in an NCP EITC. If child support agencies pre-certify noncustodial parents for the credit, then applications can be kept simple (for example, by not requiring Social Security numbers for the children) and noncustodial parents can be notified that they meet the child support criteria for the credit. Neither of these steps were taken in New York or Washington, D.C., but they would likely increase participation in an NCP EITC.

An NCP EITC provides an additional tool for encouraging child support payments by low-income noncustodial parents. Combining an NCP EITC with employment and training programs for unemployed noncustodial parents, as New York does, would complement an NCP EITC by helping noncustodial parents find work. Modifying child support orders when necessary to ensure that they are realistic would further reduce the likelihood that low-income noncustodial parents will be impoverished as they work and pay child support, and would encourage work and child support payment among other low-income noncustodial parents. All of these policies are likely to benefit custodial families because of the increased child support payments that they produce.

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