To: Interested Parties
From: Center for Law and Social Policy (CLASP)
National Consumer Law Center (NCLC)
The Institute for College Access and Success (TICAS)
Date: February 10, 2022
Memo: Recommendation to Amend IRC § 6402 to Prohibit Offset of Refundable Tax Credits that Support Low-Income Workers and Families

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Recommendation: Amend IRC § 6402 to prohibit offset of the EITC and CTC.

Summary: The Earned Income Tax Credit (EITC) and the Child Tax Credit (CTC) are poised to lift record numbers of children and low-income workers out of poverty and to put money in the pockets of families unable to afford sufficient food or rent. But unless Congress acts, payments intended for millions of workers and children will instead be intercepted through the Treasury Offset Program (TOP) and redirected to government coffers, leaving millions in poverty.

Refundable tax credits support the financial stability of all families. However, none of the well documented benefits for low-income children and workers are realized if the government does not actually make EITC and CTC payments to families. Unfortunately, under current law, that's exactly what happens when low-income tax filers owe a debt (such as prior year taxes or past-due student loans) to the government: Rather than sending tax refunds attributable to the EITC and CTC to the intended recipient so they can spend them on their most urgent family needs, these funds are seized through the Treasury Offset Program and redirected to the collecting government agency.

Congress rightly acted to protect the portion of the CTC payments that were paid out in advance in 2021 (as well as economic impact payments paid separately from other tax refunds) from seizure through TOP to ensure that struggling families could use those payments to meet their most urgent needs—including food and shelter—rather than diverting them to cover debt owed to the Department of Education or other government agencies. But payments made in tax-season refunds are not similarly protected and will be subject to the offset program–a difference in treatment that is arbitrary and inequitable.

The Department of Treasury reports that in FY 2019, $802 million in federal tax debt was collected through federal tax refund offsets, along with $5.2 billion in federal non-tax debt and $2.5 billion in state debt. In FY 2020, $507 million in federal tax debt was collected, along with $3.5 billion in federal non-tax debt and $5.8 billion in state debts. This is true even though a moratorium on federal student loan debt repayment has been in place since March 2020. Prior to the temporary federal student loan payment pause, most money intercepted through federal tax refund offsets was directed to the Department of Education to collect on federal student loans that are in default because the borrower was unable to afford their payments.

The seizure of these critical family resources prioritizes collection of past-due debts owed to governments over the ability of families to meet their basic needs. As recognized by the National Taxpayer Advocate and the American Bar Association Section of Taxation, the current, unrestricted approach of the Treasury Offset Program is at odds with Congressional intent to avoid collections that would impose economic hardship and the anti-poverty purpose of the EITC. Looming offsets this tax season also threaten one of the Biden Administration's, and this Congress's, signature achievements: cutting childhood poverty nearly in half by expanding the CTC and making it fully refundable.

We therefore recommend that Congress and the Biden Administration pursue legislation amending the Internal Revenue Code to protect these refundable tax credit payments from offset. Such legislation should be readily administrable. As the National Taxpayer Advocate recently explained, programming to protect the portion of a tax refund attributable to the EITC "would be straightforward" and "easily administrable." Automating protection of these credits would also eliminate the current cumbersome process whereby taxpayers must discover and navigate how to file an exception to offset that the IRS must process on a case-by-case basis.

Alternative Recommendation: Amend IRC § 6402 to prohibit offset of refundable credits (including the EITC, CTC, CDCTC, and AOTC) for low-income tax filers.

Summary of Alternative: We strongly recommend a clean prohibition on offset of the EITC and CTC to best ensure that these funds reach the children and families they are designed to benefit. Should Congress choose not to protect these credits from offset entirely, we recommend that it at minimum protect refundable credits for taxpayers designated by the IRS as low-income. Consistent with IRS practice and the National Taxpayer Advocate's recommendations to Congress, we suggest defining low-income either as income below 250% of the federal poverty level (FPL) or income below the relevant IRS allowable living expenses (ALE), as identified through the automated algorithm recently developed by the Taxpayer Advocate Service (TAS) research.

If Congress elects to only protect low-income taxpayers from credit offset, we recommend including protection for all refundable credits aimed at supporting families and education, including the Child and Dependent Care Tax Credit (CDCTC) and the partially refundable American Opportunity Tax Credit (AOTC) in addition to the EITC and CTC, to ensure that low-income families and students receive the support they need to access child care and education. Notably, because the EITC is already limited to low-income filers, with the credit phasing out before 250% of FPL due to the eligibility formula, any low-income threshold would only be needed for determining eligibility for protection of the other refundable credits.

Further Explanation and Support for Recommendations:

1. **Government seizure of EITC and CTC diverts funds from low-income workers' and children's basic needs to government agencies, leaves in poverty families who would otherwise be lifted out, and undercuts documented benefits to recipients' and children's health and economic mobility.**

The EITC and CTC are designed to reduce poverty (especially childhood poverty), ensure low-income workers and families with children can meet basic needs, promote economic mobility, and increase economic activity in local communities. They have been extremely effective in doing so:

- In 2018, even before the expansion of the programs through the ARPA, the CTC and EITC lifted 10.6 million people out of poverty, over half of whom were children, and reduced the severity of poverty for another 17.5 million.
- In 2021, the expansion of the CTC was expected to further cut child poverty by more than 40%. The CTC monthly payments helped families afford necessities in 2021. Nearly half of Household Pulse Survey respondents reported spending their CTC monthly payments on food.
- An extensive body of research has documented the benefits of the EITC. The EITC has been found to have positive impacts on the health and employment of recipients and to positively impact recipients' children's well-being, including children's health, cognitive development, educational outcomes, and later employment rates.
- Like the EITC, the impact of the CTC on the wellbeing of low-income children appears to be wide ranging, with research suggesting that children whose families receive these benefits do better in school, have higher educational attainment, have better health outcomes, and earn more money as adults.

The EITC and CTC support the financial stability of all families, and are especially critical to families headed by women of color, who, due to longstanding systemic discrimination and barriers to opportunity, experience a persistent wage gap. Many women of color rely on the EITC to make ends meet: 21% of Black and Latina women and 23% of Native American women receive the EITC. And full refundability of the CTC has most significantly reduced child poverty among Black and Latino children, almost half of whom previously received less than the full credit because their families' income was too low.

Critically, none of these important benefits for low-income children and workers are realized if the government does not actually make EITC and CTC payments to families. Unfortunately, under current law, that's exactly what happens when low-income tax filers owe a debt (such as prior year taxes or past-due student loans) to the government: Rather than sending tax refunds attributable to the EITC and CTC to the intended recipient so they can spend them on their most urgent family needs, these funds are seized through the Treasury Offset Program and redirected to the collecting government agency. As Treasury Secretary Yellen recognized in recent remarks on the expanded CTC and EITC, actually delivering these payments to families is critical: While these programs have "produced a profound moral and economic achievement for America" the full scale of achievement will only be realized "when we finally get these benefits to the people who need them most."

2. **The main victims of EITC and CTC offsets are children.**

Most EITC funds, and all CTC funds, go to families with dependent children: Only families with dependent children are eligible for the CTC, so 100% of CTC payments made in tax refunds go to families with dependent children. EITC payments are heavily targeted to families with dependent children. The Congressional Research Service found "[a]s a result of the targeting of the benefit to families with children, 97% of all EITC dollars in 2018 went to families with children." While the American Rescue Plan temporarily expanded eligibility for the EITC to more low-income workers without children, the benefit continues to be much larger for families with children, and families with children continue to receive the vast majority of EITC payments.

Therefore, when CTC and EITC payments are withheld by the Treasury due to a tax filer's debt, children overwhelmingly pay the price. This is counter to the child-focused purpose of the CTC and EITC, and is unfair. Children are not responsible for, and cannot help, whether their parents or guardians are behind on federal taxes, student loans or other debts, and should not be punished through government seizure of payments meant to support children and alleviate childhood poverty. The IRS already recognizes that refunds should not be seized from "injured spouses" who are not liable for a debt. All the more so, funds should not be seized from children.

3. **The National Taxpayer Advocate recommended prohibiting offset of the EITC to further Congressional intent behind the antipoverty program and to refrain from taking collection actions that will impose economic hardships on taxpayers.**

In the National Taxpayer Advocate 2022 Purple Book, legislative recommendation #17 is to amend the Internal Revenue Code to prohibit offset of the EITC portion of a tax refund. This recommendation is well-reasoned. As the Taxpayer Advocate explained, "Congress created the EITC to provide financial support for low-income individuals and families, enhance workforce participation, and reduce poverty," and offsetting the EITC would cause "economic hardship" and often leave the taxpayer unable to pay his or her basic living expenses.

Further, offsets of the EITC impact families who are not only low-income as determined by the means-testing formula, but also demonstrably struggling to pay their necessary expenses, as shown by their past-due debt to the IRS or another government agency. Yet using this robust collection power directly undermines the anti-poverty purpose of the EITC program and causes economic hardship by seizing funds the taxpayer almost surely needs to pay for basic living expenses for themselves and their children, such as rent, heat, food, diapers, medicine, and transportation to work.

This recommendation to exempt the EITC from offset is also echoed by the American Bar Association Section of Taxation, which explained that:

> "[T]he EITC is designed for taxpayers whom Congress already has recognized are in hardship situations and need additional help to lift them, and especially their children, out of poverty. Waiving EITC-based refunds across the board would recognize the public benefit nature of those refunds and greatly assist families in need. By contrast, applying EITC-based refunds to satisfy tax obligations could punish the children the EITC seeks to lift out of poverty, by denying them opportunities for better food, housing, and other basic necessities . . . ."

The ABA further identified that protecting the EITC from offset would be consistent with the way that similar anti-poverty disbursements are treated, ending the anomalous treatment of this benefit, and would be consistent with treatment of the EITC in other contexts.

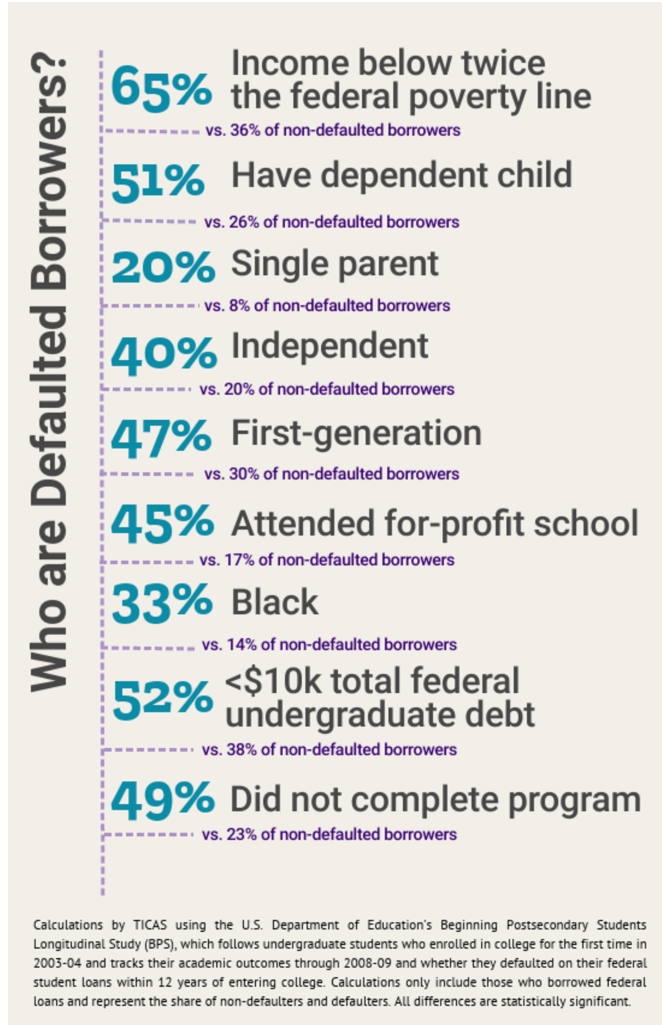
4. **The same rationale supports prohibiting offset of refundable tax credits for collection for other agencies, at minimum for low-income families.**

Although the National Taxpayer Advocate's purview is limited to collection of federal tax debts, the same concern with protecting against collection actions that impose economic hardships on taxpayers applies to the collection of other debts through the Treasury Offset Program. Although protecting against EITC and CTC offset for collection of federal tax debts is important, it would only address a small subset of offsets of these payments, as most dollars collected through federal tax refund offsets go toward other government debts. Other past-due government debts collected through the program include federal non-tax debts including student loans, some state non-tax debts such as unemployment overpayments and old child support orders, and state tax debts.

Prior to the temporary federal student loan payment pause, most money intercepted through federal tax refund offsets was directed to the Department of Education to collect on federal student loans that are in default because the borrower was unable to afford their payments. (Full data available here.) That is likely to be the case again after the payment pause ends in 2022, though Education Secretary Cardona stated just this week that "The Child Tax Credit should be accessible, no matter your student loan repayment status." Once a borrower falls behind and into default, the full balance of the student loan comes immediately due, and the government can, among other things, seize thousands of dollars at a time from a tax refund—even if the borrower is only behind by a few hundred dollars, and even if their low income should make them eligible for a $0/month income-driven repayment plan.

Although there is no public data showing how much of the money seized from student loan borrowers through tax refund offsets is attributable to EITC and CTC payments, the number of borrowers at risk of offset and likely eligible for these credits is in the millions. Over 8 million Americans are in default on their federal student loans, and available data suggests roughly half [of those borrowers have dependent children](), and thus stand to experience offset of the CTC and potentially the EITC once collection is resumed.

People with student loans in default are overwhelmingly from low-income, low-wealth families and are disproportionately people of color and first-generation college students. Many—roughly 20%—are single parents whose families may be most in need of CTC and EITC support. Most borrowers who default are struggling with unaffordable student loan debt but never received the promised benefits of education. (Infographic on Who Are Defaulted Borrowers from TICAS, Casualties of College Debt: What Data Show and Experts Say About Who Defaults and Why (2019).)



5. **Congress Protected Advance CTC Payments from Offset and Can and Should Extend that Protection to CTC Payments Issued in Tax Refunds**

Congress rightly acted to protect the portion of the CTC payments that were paid out in advance in 2021 (as well as economic impact payments (EIPs, or stimulus payments, paid separately from other tax refunds) from seizure through the Treasury Offset Program. *See* Section 9611(e)(3) of the American Rescue Plan Act. This protection ensured that struggling families could use advance CTC payments and EIPs to meet their most urgent needs--including food and shelter--rather than having the funds confiscated by the Department of Education and other agencies to collect on government debts.

Unfortunately, perhaps due to misplaced concerns about whether the IRS could properly administer a protection from offset for specific credits, Congress did not protect these same payments from offset when they are paid out as part of a tax-season income tax refund, rather than in a separate payment. The National Taxpayer Advocate has since informed Congress in its 2022 Purple Book that programming to protect the portion of a tax refund attributable to the EITC "would be straightforward, rendering it easily administrable," and elsewhere stated that the IRS can and did create programming to prevent offset of refunds generated by other specific credits. Thus, any such administrative concerns are now unwarranted.

Protecting CTC payments paid in advance monthly installments but not those paid in tax refunds is arbitrary, unjustified, and inequitable. With administrative concerns addressed, there are no principled reasons for failing to protect payments in tax refunds while protecting advance payments. As the National Taxpayer Advocate recognized when it similarly appeared that people who received full Economic Impact Payments (EIPs) in advance would be protected from offset, while those who did not receive full EIPs in advance would be subject to offset when they claimed it on their tax returns, "This disparate result undermines public confidence in the fairness of the tax system" and is "unfair." Further, failing to protect payments in tax refunds disproportionately harms those families that did not receive advance payments, including families who were not required to file taxes in recent years because their incomes were too low, residents of Puerto Rico, and those with new dependents in 2021 (as the IRS never opened the update portal to allow parents to add dependents). Congress can and should act now to extend its current protections of advanced CTC payments to payments issued in tax refunds.

6. Protecting Refundable Credits from Offset Entirely or for Filers Below 250% of FPL Should Be Readily Administrable

In recommending that Congress amend IRC § 6402(a) to prohibit offset of the EITC portion of a taxpayer's refund to satisfy prior-year tax liabilities, the National Taxpayer Advocate stated that "Programming [to protect the portion of a tax refund attributable to the EITC] would be straightforward, rendering it easily administrable." Although the NTA did not address the other credits, the same programming approach should apply, and thus protection of the portion of a tax refund attributable to the CTC, CDCTC or AOTC should also be straightforward and easily administrable.

Should Congress elect to protect tax refunds only for those earning below 250% of the federal poverty level, this too should be readily administrable, and should improve upon current procedures to protect against Treasury collection actions that cause economic hardship. The Taxpayer Advocate applauded the recommendation by the American Bar Association Section of Taxation in 2021 to automatically bypass tax refund offsets entirely based on economic hardship for individuals earning under 250% of FPL, noting that "an automated approach would be a win-win, proposition, reducing the need for taxpayers to contact the IRS to request [protection from offset] and reducing the burden on the IRS (and TAS) to process large numbers of [such] requests on a case-by-case basis."

As both the Taxpayer Advocate and ABA Section observed, although there is a procedure to request protection of a refund from offset based on economic hardship ("Offset Bypass Refund" or "OBR"), the procedure is "obscure and difficult to navigate," and thus underutilized. The Office of Management and Budget's 2021 report on racial equity in government programs notes that administrative burdens "do not fall equally on all entities and individuals, leading to disproportionate underutilization of critical services and programs, as well as unequal costs of access, often by the people and communities who need them the most."

By contrast, using 250% of FPL as a threshold for identifying when offset is likely to cause economic hardship to low-income taxpayers—and applying it automatically, without requiring taxpayers to apply for relief—is consistent with other IRS practices and is readily administrable. As the National Taxpayer Advocate explained in the 2020 Purple Book (recommendation 28), “Both the law and IRS procedures use the measure of 250 percent of the federal poverty level as a proxy for ‘low income’” and the IRS has already adopted that 250% threshold to “implement[] a ‘low income filter’ to exclude taxpayers with incomes below 250 percent of the federal poverty level from the automated levy program,” ensuring such filers are automatically protected from levy.

Similarly, should Congress elect to protect tax refunds only for those earning below the relevant IRS allowable living expenses (ALE)—which would identify people whose income is insufficient to meet necessary expenses based on a combination of national and local expense standards by family size—this should also be readily administrable provided that Congress approves of an automated approach, such as the automated ALE algorithm recently developed by TAS Research. As the National Taxpayer Advocate recently explained in the Purple Book, this algorithm has already been developed and, if approved, could be used to place a “‘low-income’ indicator” on accounts of all taxpayers identified as having incomes below their ALE. This, in turn, could presumably be used to automatically screen off such accounts from tax refund offset altogether, or from offset of refundable tax credits at minimum.

7. **Offsetting Refundable Credits Such at the CDCTC and AOTC That Are Based on Previous Spending on Child Care and Education Creates Hardship for Low-Income Taxpayers**

Should Congress elect to protect only low-income taxpayers from credit offset, such as those with incomes below 250% of FPL, we recommend including protection of all refundable credits intended to support families and education to avoid offsets that cause hardship to low-income families. This includes the Child and Dependent Care Tax Credit (CDCTC) and the American Opportunity Tax Credit (AOTC), which are only available to taxpayers who have already spent funds on child care or higher education. Protecting these credits for low-income taxpayers would further congressional intent to avoid Treasury collection actions that cause economic hardship and to support low-income families’ access to child care and education.

The American Rescue Plan made the CDCTC fully refundable for the first time, making the credit fairer by allowing low-income working families to receive the full value of the credit towards their eligible child care expenses, regardless of how much they owe on their 2021 taxes. The ARP expanded the CDCTC to up to $4,000 for one child and $8,000 for two or more children, helping working families pay for child care. However, to receive this credit, families must have paid for their child care up front. If a family incurred this expense in the expectation of receiving the tax credit, having it offset could create significant hardship. Similarly, the partially refundable American Opportunity Tax Credit (AOTC) requires taxpayers to have incurred higher education expenses in advance, and subsequently seizing that offset from low-income people when they file their taxes creates hardship.