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Using the Federal Income Tax System to Deliver Cash Assistance to Families: Policy Considerations

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SUMMARY

Using the Federal Income Tax System to Deliver Cash Assistance to Families: Policy Considerations

R47323

February 14, 2023

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The central purpose of the federal income tax system is to collect revenue to fund the federal government's activities. Nonetheless, the income tax system is also one of the largest sources of federal cash benefits to U.S. households (after Social Security) and remains the largest source of need-tested cash assistance for low- and moderate-income families with children. Policymakers often look to the federal income tax system to deliver cash benefits—especially to low- and moderate-income individuals and families.

Cash benefits in the tax code for low- and moderate-income families are generally structured as refundable tax credits. Refundable credits, unlike other tax benefits, are not limited by how much a family owes in income taxes. Hence, low- and moderate-income families—who tend to owe little or nothing in income taxes—can still receive these benefits as part of their annual tax refunds.

There are a variety of benefits and limitations of using the federal income tax system as the mechanism to provide cash assistance to families. Insofar as policymakers are interested in using the income tax system for this purpose, either on a temporary or permanent basis, they may wish to consider some of these issues as they develop their policies. This report examines seven issues that might inform the design of tax-based social benefit policies. Those issues are summarized in the table below.

Selected Policy Considerations

Issue	Policy Considerations
The Application for Tax Benefits Is the Federal Income Tax Return The federal income tax return (i.e., "the 1040")—while designed primarily to determine if households have paid all the income tax they owe for the year—also functions as an application for tax benefits.	Some information on the 1040 (i.e., various forms of income) can be accurately and efficiently verified, but other information (like some aspects of a child's eligibility for child benefits) are difficult or impossible for the Internal Revenue Service (IRS) to verify, absent an audit. In addition, the 1040 does not collect some parameters that policymakers may wish to use to administer tax benefits.
Not All Households File a Federal Income Tax Return The lowest-income households are generally not required to file federal income tax returns (although they can if they choose to). The IRS thus may lack information on nonfiling households who are eligible for a tax benefit.	Lack of information on low-income households may limit tax benefit programs' reach. Policymakers seeking to reach low-income households may consider requesting this information directly (e.g., via a "nonfiler" portal) or using other administrative data for outreach or administrative purposes. They may also consider whether a comparable nontax benefit administered by a different agency could better reach these populations in the short, medium, and/or long term.
Many Households Use Paid Preparers and Commercial Software Most families that receive cash assistance through the tax code pay for assistance in preparing and filing their returns—either using paid tax preparers or commercial software.	Private third-party intermediaries may make applying for and receiving tax benefits with complex rules easier for many households. But the associated fees reduce the amount of assistance families receive. And the high error rates of tax benefit claims on returns prepared by paid preparers—due in part to the complexity of tax benefit eligibility rules—may leave taxpayers and tax benefits more open to scrutiny.

Issue	Policy Considerations
Data Used to Administer Tax Benefits Are Generally Annual Data from a Prior Year Eligibility for and the amount of tax benefits a family receives in a given year are based on prior-year annual tax data. In other words, the IRS has information on a household's situation in the previous year, but not on its present situation. In addition, tax data generally do not include information about within-year fluctuations in income and family structure.	While the IRS has data on family structure, number of children, and various sources of income for the majority of U.S. households, these data are both retrospective and annual. Prior-year tax data may not reflect a household's current circumstances, especially if families experience income volatility or changes in family structure within the year and/or from year to year, so tax benefits may be less responsive to families' needs than other types of benefits.
Tax Benefits Are Usually Delivered Once a Year Generally, tax benefits are paid out once a year as a lump sum as part of a federal income tax refund. The IRS has demonstrated an ability to issue monthly payments by "advancing" credits before the applicable tax return is filed.	Insofar as tax benefits are "advanced," policymakers may consider if and to what extent those advanced amounts should be reconciled with the amounts allowed on applicable tax returns and the extent to which taxpayers would need to pay back overpayments of advanced tax benefits.
Some Households Do Not Have or Use Bank Accounts to Receive Tax Benefits Some Americans, especially lower-income Americans, may face difficulties receiving payments quickly and securely from the IRS if they do not have or do not use bank accounts to receive their tax refunds.	Direct deposit into a traditional bank account may provide the most secure and fastest receipt of tax benefits, but households that lack such accounts may struggle to receive their benefits. Moreover, some taxpayers use refund advanced products that direct tax refunds to temporary bank accounts, to which the IRS cannot deliver later payments. Policymakers may consider other options for benefit receipt, such as issuing prepaid cards.
Tax Benefits Can Be Reduced via Offset or Garnishment Actions A household's tax benefits (i.e., its tax refund) can be reduced by the federal government to collect certain debts or garnished by private creditors.	Collecting delinquent debts may benefit populations to whom the debts are owed. But collection activities can also impose significant financial hardship on those whose benefits are offset or garnished, especially if they are low income. Policymakers may consider the trade-offs between collecting certain past-due debts and the impact those offsets or garnishments will have on policy objectives for a particular tax benefit or population.

Contents

Introduction 1
Issue 1: The Application for Tax Benefits Is the Federal Income Tax Return 1
Verification of Data Provided on the 1040 2
Data Not Provided on the 1040 2
Policy Considerations 3
Refundable Tax Credits Are Not Taxable and Do Not Reduce the Amount of Other Need-Tested Federal Benefits 3
Case Study 1A | EITC Improper Payments and Verifying Where a Child Lives 4
Case Study 1B | Race, Ethnicity, and the Tax Code 4
Issue 2: Not All Households File a Federal Income Tax Return 5
Policy Considerations 7
Case Study 2A | Nonfiler Portals 8
Case Study 2B | Using Data from Other Programs to Administer Tax Benefits 9
Issue 3: Many Households Use Paid Preparers and Commercial Software 10
Policy Considerations 12
Case Study 3 | Volunteer Income Tax Assistance (VITA) 13
Issue 4: Data Used to Administer Tax Benefits Are Generally Annual Data from a Prior Year 13
Policy Considerations 15
Case Study 4 | Stimulus Checks Issued During the COVID-19 Pandemic 16
Issue 5: Tax Benefits Are Usually Delivered Once a Year 16
Policy Considerations 18
Case Study 5 | Advance Payments of the Fully Refundable Child Tax Credit 19
Issue 6: Some Households Do Not Have or Use Bank Accounts to Receive Tax Benefits 20
Policy Considerations 21
Case Study 6 | Refund Advance Products and Difficulties Receiving Stimulus Payments 23
Issue 7: Tax Benefits Can Be Reduced via Offset or Garnishment Actions 23
Offset 24
Garnishment 25
Policy Considerations 25
Case Study 7 | Protecting Stimulus Checks Enacted During the COVID-19 Pandemic from Offset and Garnishment 26
Conclusion 28

Contacts

Author Information 28

Introduction

The central purpose of the federal income tax is to collect revenue to fund the federal government's activities. Nonetheless, the income tax system is also one of the largest federal sources of cash benefits to households in the United States. In particular, the federal income tax system is the largest source of need-tested cash assistance for low- and moderate-income families with children.[1] Policymakers often look to the federal income tax system to deliver cash benefits, especially to low- and moderate-income individuals and families.[2] As one scholar commented, "the IRS is now one of the government's principal welfare agencies, on par with the Department of Health and Human Services (HHS) and the Social Security Administration."[3]

Cash assistance for low- and moderate-income families is generally structured in the tax code as refundable tax credits. Refundable credits, unlike other tax benefits, are not limited by how much a family owes in income taxes. Hence, low- and some moderate-income families—who tend to owe little or nothing in income taxes—can still receive these benefits as part of their annual tax refunds. This report will tend to focus on refundable credits as the primary mechanism for delivering assistance to families, although some of the issues discussed may apply to other types of tax benefits for families.

This report provides policymakers with a broad understanding of some of the benefits and limitations of using the tax code to provide cash assistance to families by examining seven issues common to most tax benefits.[4] Selected examples ("case studies") are provided throughout to illustrate some of these issues or examine certain topics more closely.[5]

Issue 1: The Application for Tax Benefits Is the Federal Income Tax Return

The federal income tax return functions as the application for tax benefits, although that is not its primary purpose. The federal individual income tax return's primary function is to reconcile how much households owe in income taxes annually and how much they have already paid during the year. A household that has overpaid its taxes—often when individuals have had too much withheld from their paychecks during the year—receives a refund after filing its Internal Revenue

[1] See CRS Report R46823, *Need-Tested Benefits: Who Receives Assistance?*, by Gene Falk, Karen E. Lynch, and Paul D. Romero; and Hilary Hoynes and Diane Schanzenbach, "Safety Net Investments in Children," *NBER Working Paper 24594*, May 2018, https://www.nber.org/papers/w24594.

[2] Congress provided three rounds of stimulus checks to low- and moderate-income individuals and families during the COVID-19 pandemic; see CRS Report R46415, *COVID-19 and Direct Payments: Overview and Resources*, coordinated by Margot L. Crandall-Hollick. It also expanded the child tax credit in 2021; see CRS Report R46900, *The Expanded Child Tax Credit for 2021: Frequently Asked Questions (FAQs)*, by Margot L. Crandall-Hollick. In addition, Congress has proposed redistributing the receipts from a proposed cap-and-trade program to households via the tax system; see CRS Report R40841, *Assisting Households with the Costs of a Cap-and-Trade Program: Options and Considerations for Congress*, by Jonathan L. Ramseur and Libby Perl.

[3] Kristin Hickman, "Pursuing a Single Mission (or Something Closer to It) for the IRS," *Columbia Journal of Tax Law*, vol. 169 (2016), p. 175.

[4] Other experts have examined how the federal income tax code is used to provide social benefits, including their differences with traditional spending programs. For example, see Frank Sammartino, Eric Toder, and Elaine Maag, *Providing Federal Assistance for Low-Income Families through the Tax System: A Primer*, Tax Policy Center, Discussion Paper No. 4, July 2002, https://www.taxpolicycenter.org/sites/default/files/alfresco/publication-pdfs/410526-Providing-Federal-Assistance-for-Low-Income-Families-through-the-Tax-System.PDF.

[5] Note that for ease of reading, the terms *family* and *household* are generally used interchangeably in this report and, unless otherwise specified, refer to all the individuals listed on a federal income tax return.

Service (IRS) Form 1040 (often simply called "the 1040"). In contrast, a household that has underpaid its taxes throughout the year owes a balance to the IRS.

When a household prepares its federal income tax return, it provides various pieces of information so that the IRS can administer the tax code, including tax benefits. This includes information on numerous types of income, some family relationships (spouse, children, other dependents), some expenses, and government issued identification numbers (IDs). A household generally also provides its mailing address for the previous year and, if it is owed a refund and has a bank account, may provide its bank information (e.g., the routing and account number associated with its bank account) to receive its refund via direct deposit. Tax data provided on other IRS forms—like information provided on W-2 wage statements for employees—are often insufficient to administer tax benefits that are designed for households, which are the focus of this report.

Verification of Data Provided on the 1040

When taxpayers provide information on their signed and filed tax returns, they acknowledge, under penalties of perjury, that the information provided is accurate and complete. Nonetheless, the IRS can independently verify the accuracy of some taxpayer-provided information, especially various sources of income. Broadly, the IRS verifies the accuracy of some tax data by comparing the information provided on the 1040 to information provided to the IRS by third parties, like employers, banks, financial institutions, universities, health insurers, and non-IRS government databases. As the Government Accountability Office (GAO) notes[6]

> misreporting [tax information] is much higher when little or no third-party information reporting exists than when substantial reporting exists. For items subject to substantial third-party information reporting, such as employers reporting wages on Form W-2, the IRS is able to use automated processes to identify and address noncompliance. Information reporting also produces indirect benefits by increasing taxpayers' incentive to comply, knowing that IRS collects the information, according to IRS officials.

However, the IRS cannot verify all information provided on the 1040 efficiently or accurately because it may not have relevant high-quality and timely third-party information. Lack of third-party information may be of particular concern to policymakers who are interested in tax benefits for families with children since many aspects of eligibility cannot be accurately or efficiently verified (see "Case Study 1A | EITC Improper Payments and Verifying Where a Child Lives").

Data Not Provided on the 1040

Information that could be necessary to administer a new tax benefit may not currently be collected on the 1040. For example, families do not currently report information regarding more nuanced relationships or activities that policymakers may wish to encourage or support—such as kinship care or unpaid caregiving. Other aspects of family life that are not necessary to administer federal tax law but may be of interest to policymakers when designing tax policies—such as a household's debt or wealth or demographic characteristics like race, gender, education level, or immigration status—are also not provided on the 1040.

Even if the IRS updated the form to request certain information from taxpayers, accurate third-party data that could be used to verify this information may not be available. There is not, for

[6] U.S. Government Accountability Office (GAO), *Tax Administration: Better Coordination Could Improve IRS's Use of Third-Party Information Reporting to Help Reduce the Tax Gaps*, GAO-21-102, December 15, 2020, p. 7, https://www.gao.gov/products/gao-21-102.

example, an existing database that provides accurate and timely information on individuals who provide unpaid caregiving or kinship care. Some taxpayers could see requests for information that is not necessary to administer tax law as overly intrusive. This could have unintended consequences, like discouraging participation in the tax system (see "Case Study 1B | Race, Ethnicity, and the Tax Code").

Policy Considerations

If families are preparing their returns and already providing information about their income and family composition for tax purposes, using the federal income tax return may be an efficient way for families to receive cash assistance. In the words of economist Bill Gale, the income tax (and the 1040) can provide "'one stop' shopping that enables people to receive, in one fell swoop, the benefits of numerous social policies and economic incentives."[7]

Refundable Tax Credits Are Not Taxable and Do Not Reduce the Amount of Other Need-Tested Federal Benefits

At the federal level, refundable tax credits for individuals are not considered taxable income. This is the case regardless of whether the credit is claimed on a tax return or issued as advance payments. In addition, refundable tax credits do not count as income, or as resources for a 12-month period, in determining eligibility for or the amount of assistance provided by any federal or federally funded need-tested public benefit program.[8]

The treatment of assistance provided under other benefit programs varies, depending on the particulars of each program and whether Congress has specifically addressed the treatment in law.

In contrast, to receive other forms of assistance, a household may need to fill out a separate application and have its eligibility information (including income) verified before a benefit is issued, sometimes with a face-to-face interview. This may improve compliance with a particular program's eligibility requirements, for example by helping administrators more accurately determine need. But it also may place more administrative burdens on applicants than filling a tax return, may increase overall program administration costs, and may result in increased social stigma compared to claiming tax benefits.[9] Conversely, while using tax returns as the application for tax benefits may be less burdensome to households and less costly for the government in terms of upfront administration costs, it may be an imperfect instrument for determining eligibility, which could contribute to households erroneously receiving these benefits.[10]

And some dispute how simple the process of using a tax return to apply for benefits actually is. For some families, preparing and filing a return may be complicated, especially in terms of understanding tax terminology and eligibility rules for tax benefits (e.g., what is a dependent for

[7] William G. Gale, *Are Taxes Complicated? Compared to What?*, Tax Policy Center, TaxVox Blog, April 15, 2022, https://www.taxpolicycenter.org/taxvox/are-taxes-complicated-compared-what.

[8] See Internal Revenue Code (IRC) §6409.

[9] For example, see Jennifer Sykes et al., "Dignity and Dreams: What the Earned Income Tax Credit (EITC) Means to Low-Income Families," *American Sociological Review*, vol. 80, no. 2 (August 2015), pp. 243-267.

[10] The IRS Taxpayer Advocate has argued that using tax returns as the "application" for the earned income tax credit (EITC) rather than a traditional screening process results in low cost with high participation as well as a higher risk of improper payments. "Current administration costs are less than 1% of benefits delivered. This is quite different from other non-tax benefits programs in which administrative costs related to determining eligibility can range as high as 20% of program expenditures." Written Statement of Nina E. Olson, National Taxpayer Advocate, in U.S. Congress, House Committee on Ways and Means, Subcommittee on Oversight, Improper Payments in the Administration of Refundable Credits, hearings, 112th Cong., 1st sess., May 25, 2011, p. 9, https://www.irs.gov/pub/tas/testimony-written-wm_oversight-improper_payments-5-25-2011.pdf.

tax purposes, what is adjusted gross income).[11] This can be especially true of child tax benefits claimed by more complex or dynamic families (e.g., multigenerational families or families where members move in and out of a household during the year). In these families, more than one adult may be able to claim a child for a given tax credit and family members may struggle with understanding who can claim the child for a particular benefit.[12] This may lead families to make mistakes when preparing their returns or turn to paid preparers for help, which could create new policy concerns including increased scrutiny of benefit recipients and reduced benefit amounts. It may also increase the opportunities for individuals to fraudulently claim tax benefits for which they are not eligible.

Case Study 1A | EITC Improper Payments and Verifying Where a Child Lives

The lack of accurate third-party data, especially those tied to children, makes certain tax benefits difficult for the IRS to administer. A prime example of this issue is the lack of accurate third-party data to verify that a child claimed by a taxpayer for the earned income tax credit (EITC) meets the residency test. Taxpayers state on their returns that the children they are claiming for the credit have lived with them for at least half of the calendar year. But as the National Taxpayer Advocate noted in a 2019 report:[13]

> the IRS cannot independently verify that a child meets all the current EITC qualifying child rules, especially the residency requirement, during filing season. There is no national, authoritative, and timely database that indicates where and with whom a child lives during a calendar year for the purposes of administering this tax benefit, making accurate verification of this requirement difficult. Nor do we believe U.S. taxpayers would tolerate the government creating such a database.

Notably, IRS research also indicates that taxpayers who claim children who do not meet the EITC's eligibility requirements are the largest source of improper payments of the credit in dollar terms, and the most common eligibility requirement that they fail to meet is the residency requirement.[14] (Improper claims may be intentional fraud or honest mistakes.) This suggests that tax benefits that rely on information that is difficult to verify independently could be more prone to erroneous claims, which could make the benefits (and their recipients) more prone to scrutiny. For example, returns with EITC claims tend to be audited more frequently than non-EITC returns.[15]

Case Study 1B | Race, Ethnicity, and the Tax Code

Some policymakers are interested in understanding the impact of tax provisions on families and individuals of different races and ethnicities.[16] While tax provisions are not explicitly designed to benefit individuals of certain

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[11] Gabriel Zucker, Cassandra Robertson, and Nina Olson, "Introduction: Problems with IRS Benefit Delivery and Goals of Reform," in *The IRS as a Benefits Administrator: An Agenda to Transform the Delivery of EIP, EITC, and CTC*, New America, New Practice Lab, March 24, 2021, https://www.newamerica.org/new-practice-lab/reports/the-irs-as-a-benefits-administrator/.

[12] For more information, see CRS Insight IN11634, *Child Tax Benefits and Children with Complex or Dynamic Living Arrangements*, by Patrick A. Landers and Margot L. Crandall-Hollick; and Elaine Maag, H. Elizabeth Peters, and Sara Edelstein, Increasing Family Complexity and Volatility: The Difficulty in Determining Child Tax Benefits, Tax Policy Center, March 3, 2016, https://www.taxpolicycenter.org/publications/increasing-family-complexity-and-volatility-difficulty-determining-child-tax-benefits/full.

[13] Taxpayer Advocate Service, *Earned Income Tax Credit: Making the EITC Work for Taxpayers and the Government*, Objectives Report to Congress FY2020, Volume 3, July 2019, p. 12.

[14] Internal Revenue Service (IRS), *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns*, Publication 5162, August 2014, http://www.irs.gov/pub/irs-soi/EITCComplianceStudyTY2006-2008.pdf.

[15] See CRS Insight IN11952, *Audits of EITC Returns: By the Numbers*, by Margot L. Crandall-Hollick.

[16] For example, see Letter from Richard E. Neal, Chairman of the Committee on Ways and Means, and Ayanna Pressley, Member of Congress, to The Honorable Steven T. Mnuchin, Secretary of the U.S. Department of the Treasury, July 31, 2020, https://waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/2020.07.31%20Letter%20to%20Treasury%20CARES-IRC%20FINAL.pdf. Also see Executive Order 13985, "Advancing Racial Equity and Support for Underserved Communities Through the Federal Government."

races or ethnicities, some researchers have found that "wealthy, more likely White and male, households may disproportionately benefit from certain tax provisions."[17]

Taxpayers do not directly report race and ethnicity data and some other demographic data on their federal income tax returns, making it difficult to accurately assess these policies' impacts by race and ethnicity. In a 2022 report, the Government Accountability Office (GAO) noted

> According to the Department of the Treasury, IRS cannot collect demographic data under current law unless such data are necessary for administering the tax code. As a result, analysts have limited ability to assess the effects of tax laws, including COVID-19-related tax relief provisions, by demographics such as households' race, ethnicity, and sex.

Many argue that asking for this information directly on tax forms could have drawbacks, including increasing the chances of confidential tax data being leaked and reducing voluntary taxpayer compliance.[18]

Due to the legal, administrative, and policy issues around directly asking taxpayers to provide their race/ethnicity data, researchers, including those at the Urban Institute,[19] Congressional Budget Office (CBO),[20] GAO,[21] and Treasury,[22] are exploring ways to model the impact of tax provisions by race and ethnicity using data matching and/or imputation. For example, a January 2023 Office of Tax Analysis (OTA) working paper used a novel method of imputing race and Hispanic origin—an extension of a technique called Bayesian Improved First Name Surname Geocoding (BIFSG)—to estimate the distribution of certain tax expenditures by race and ethnicity.[23]

Issue 2: Not All Households File a Federal Income Tax Return

Generally, households must file an annual income tax return, in order to receive tax benefits. And many households—including low-income households with workers—may file a federal income tax return to claim refunds of over-withheld income taxes and/or refundable tax credits.[24] But not

[17] GAO, *Tax Equity: Lack of Data Limits Ability to Analyze Effects of Tax Policies on Households by Demographic Characteristics*, GAO-22-104553, May 2022, p. 6, https://www.gao.gov/assets/gao-22-104553.pdf.

[18] According to GAO, "Most experts we interviewed did not favor this method [collecting demographic data on tax forms]. They cited concerns with public reaction and the potential for inadvertent consequences of IRS examiners having access to that information." GAO, *Tax Equity: Lack of Data Limits Ability to Analyze Effects of Tax Policies on Households by Demographic Characteristics*, GAO-22-104553, May 2022, p. 14, https://www.gao.gov/assets/gao-22-104553.pdf.

[19] See Tracy Gordon and Aravind Boddupalli, *New Data Tools and Methods Can Help Federal Policymakers Create More Equitable Tax Policy*, Tax Policy Center, March 22, 2021, https://www.taxpolicycenter.org/taxvox/new-data-tools-and-methods-can-help-federal-policymakers-create-more-equitable-tax-policy.

[20] U.S. Congressional Budget Office, *Analyzing How the Effects of Federal Policies May Differ by Race and Ethnicity*, May 6, 2022, https://www.cbo.gov/publication/58030.

[21] GAO, *Tax Equity: Lack of Data Limits Ability to Analyze Effects of Tax Policies on Households by Demographic Characteristics*, GAO-22-104553, May 2022, https://www.gao.gov/assets/gao-22-104553.pdf.

[22] Deputy Secretary Wally Adeyemo and Assistant Secretary for Tax Policy Lily Batchelder, *Advancing Equity Analysis in Tax Policy*, U.S. Department of the Treasury, December 14, 2021, https://home.treasury.gov/news/featured-stories/advancing-equity-analysis-in-tax-policy.

[23] Julie-Anne Cronin, Portia DeFilippes, and Robin Fisher, *Tax Expenditures by Race and Hispanic Ethnicity: An Application of the U.S. Treasury Department's Race and Hispanic Ethnicity Imputation*, Department of the Treasury, Office of Tax Analysis, Working Paper 122, January 2023, https://home.treasury.gov/system/files/131/WP-122.pdf.

[24] For example, IRS data for the 2022 filing season indicate that among households with adjusted gross income (AGI) between $1 and $25,000 who filed a 2021 federal income tax return (representing about 28% of all 2021 individual income tax returns during that period), the majority (about 60%) had no income tax liability *before* any tax credits. Hence, even though many low-income taxpayers have income low enough that they do not owe taxes, many still file. (Among the 40% who did have a precredit income tax liability, the average amount they owed precredit was about $550 per return.) Of note, once credits were applied, 84% of taxpayers in this income category were due an income tax

all households file tax returns, in many cases because their incomes are too low to require filing. Specifically, while any household *can file* a federal income tax return, generally only those that have sufficient income to owe income taxes—more than $13,850 for single taxpayers, $20,800 for single parents, and $27,700 for married couples in 2023 (i.e., the standard deduction amount in 2023)—*must file*.[25] Households with income below these levels generally would have no "taxable income" and owe no income tax (even before taking credits into account). Hence, from the perspective of revenue collection—the main purpose of the tax system—it makes little sense to require them to file given the burden and costs of doing so. The IRS estimates that it takes the average taxpayer nine hours to prepare and file an individual return, costing on average $160.[26] Accordingly, for households with no obligation to file a tax return, preparing and filing a federal income tax return may be a particularly intimidating application instrument. (Some individuals and households fail to file, even when they are required to do so, because they are attempting to evade paying the taxes they owe. Data suggest tax evaders are likely a small share of all nonfilers.[27])

Current estimates indicate that a small share of people in the United States are nonfilers, meaning they do not appear anywhere on an income tax return as either the primary filer, a spouse, or a dependent. The Tax Policy Center estimates that about 15 million households did not file an income tax return in 2019, while a 2014 report estimated the nonfiling population included about 30 million individuals.[28] A 2017 Congressional Budget Office (CBO) study of 2006 tax data estimated that approximately 17% of households in the United States did not file an income tax return. According to this study, nonfiling households represented 14% of the U.S. population. Put another way, about 86% of all individuals in the United States were included on a tax return as either the primary taxpayer, a spouse, or a dependent.[29] A 2014 report using 2011 tax data estimated about 10% of the U.S. population did not "appear" on a federal individual income tax return.[30]

The 2017 CBO study estimated that of all nonfilers, the largest share were unmarried adults under 65 years old without any dependents (37%), followed by adults 65 years or older (31%).[31]

refund. See Internal Revenue Service, *SOI Tax Stats - Filing Season Statistics*, Table 1. All Individual Returns: Selected Income Items, Adjustments, Credits, and Taxes, by Size of Adjusted Gross Income (Through Filing Season Cycle 47), 2022, https://www.irs.gov/statistics/filing-season-statistics.

[25] For details on 2021 filing requirements for most taxpayer, as well as exceptions, see IRS, *Dependents, Standard Deduction, and Filing Information for Use in Preparing 2021 Returns*, Publication 501, June 28, 2022, https://www.irs.gov/pub/irs-pdf/p501.pdf.

[26] IRS, *1040 (and 1040-SR Instructions) Tax Year 2021*, December 21, 2021, p. 107, https://www.irs.gov/pub/irs-pdf/i1040gi.pdf.

[27] Taxpayers who owe taxes but do not file are a relatively small contributor to the tax gap—about $39 billion of a gross tax gap of $496 billion, or 8%—according to IRS estimates. See IRS, *Tax Gap Estimates for Tax Years 2014-2016*, Publication 1415 (Rev. 8-2022), August 2022, https://www.irs.gov/pub/irs-pdf/p1415.pdf.

[28] Howard Gleckman and Elaine Maag, *Free File Is An Easy Way For Government To Get Coronavirus Payments To Non-Filers*, Tax Policy Center, March 30, 2020, https://www.taxpolicycenter.org/taxvox/free-file-easy-way-government-get-coronavirus-payments-non-filers; and James Cilke, *The Case of the Missing Strangers: What We Know and Don't Know About Non-Filers*, paper presented at the 107th Annual Conference of the National Tax Association, Santa Fe, NM, November 13-15, 2014, http://tinyurl.com/y7chw254.

[29] See Table 5 in Shannon Mok, *An Evaluation of Using Linked Survey and Administrative Data to Impute Nonfilers to the Population of Tax Return Filers*, CBO, Working Paper 2017-06, September 2017, p. 39.

[30] James Cilke, *The Case of the Missing Strangers: What We Know and Don't Know About Non-Filers*, paper presented at the 107th Annual Conference of the National Tax Association, Santa Fe, NM, November 13-15, 2014, http://tinyurl.com/y7chw254.

[31] See Table 10 in Shannon Mok, *An Evaluation of Using Linked Survey and Administrative Data to Impute Nonfilers*

Nonfiling households had lower incomes on average and were more likely to receive federal assistance than their tax-filing counterparts.[32] Overall, estimates indicate that nonfilers are a diverse group made up of low-income "students, older adults living on Social Security, people on public assistance or Supplemental Security Income," and working people with incomes below the filing requirement.[33] The 2014 study suggested that younger nonfilers were more likely to be male, while older nonfilers were more likely to be female. Broadly, these results are similar to older research on nonfilers done by the U.S. Treasury.[34]

Policy Considerations

The federal income tax system is not a universal system, with many nonparticipating households being very low income. This may complicate policymakers' goals to create near-universal programs and/or reach the lowest-income households. Policymakers may try to address this limitation in a variety of ways. For example, they may try to encourage nonparticipating households to manually provide information to the IRS, effectively having these households file income tax returns (see "Case Study 2A | Nonfiler Portals"). This solution, while broadening the information available to the tax system, would add to the administrative burden on low-income households. Policymakers could attempt to lower this burden with easier tax preparation and filing, including one-to-one outreach and support like "navigators."[35] Alternatively, policymakers could attempt to use data from other federal or state programs to either administer a tax program or conduct outreach to certain households (see "Case Study 2B | Using Data from Other Programs to Administer Tax Benefits"). This approach could reduce the administrative burden on individuals, but might lead to more errors in administering the program. Since take-up for many needs-tested benefits is not universal—and data suggest it is significantly lower than take-up of refundable tax credits—there may also be concerns that information from these programs would itself be inadequate to make tax-based aid universal.[36]

Alternatively, policymakers may consider designing tax-based assistance to target families most likely to file tax returns, while trying to reach the lowest-income households via an alternative policy mechanism, such as a more traditional cash assistance program. In considering whether to use an alternative system, policymakers may consider the tax benefit's structure and duration.

to the Population of Tax Return Filers, CBO, Working Paper 2017-06, September 2017, p. 44.

[32] See Table 6 and Table 7 in Shannon Mok, *An Evaluation of Using Linked Survey and Administrative Data to Impute Nonfilers to the Population of Tax Return Filers*, CBO, Working Paper 2017-06, September 2017, pp. 40-41.

[33] Howard Gleckman and Elaine Maag, *Free File Is An Easy Way For Government To Get Coronavirus Payments To Non-Filers*, Tax Policy Center, March 30, 2020, https://www.taxpolicycenter.org/taxvox/free-file-easy-way-government-get-coronavirus-payments-non-filers.

[34] Jim Cilke, *A Profile of Non-Filers*, U.S. Department of the Treasury, Office of Tax Analysis, July 1998, https://home.treasury.gov/system/files/131/WP-78.pdf.

[35] The New America Foundation's qualitative research indicates that there are a number of logistical barriers to getting nonfilers to file a return, including that many think that they are not allowed to file a return. This research was conducted in regard to the stimulus checks enacted during the COVID-19 pandemic, but may include lessons more broadly applicable to nonfilers. See Gabriel Zucker and Lindsey Wagner, *Talking to Non-Filers: Evidence from Qualitative Research with Families Who Don't Regularly File Taxes*, New America, July 16, 2021, https://www.newamerica.org/new-practice-lab/blog/talking-to-non-filers/. For an example of one-to-one outreach, see Fay Walker, Mary Bogle, and Elaine Maag, *Early Lessons on Increasing Participation in The Child Tax Credit*, Urban Institute, May 18, 2022, https://www.urban.org/research/publication/early-lessons-increasing-participation-child-tax-credit.

[36] See for example, Figure 1 on page 3 of Taxpayer Advocate Service, *Earned Income Tax Credit: Making the EITC Work for Taxpayers and the Government*, Objectives Report to Congress FY2020, Volume 3, July 2019.

Some argue that in the short and potentially medium term, the IRS may be best suited to deliver certain types of cash assistance quickly because the agency already possesses critical data on *most* U.S. households—including data on family structure, marital status, income, and where to send payments.[37] Others argue that in the longer term, with time to develop the appropriate infrastructure and data sharing, other agencies like the Social Security Administration (SSA) could be better suited than the IRS to provide certain forms of ongoing cash assistance to families.[38] Some may argue that *joint* administration of cash assistance programs between the IRS and another agency could succeed over the longer term. In such cases, policymakers may want to look at existing jointly administered programs like the health insurance premium assistance tax credit, which is administered by the IRS and the Department of Health and Human Services (HHS).

Case Study 2A | Nonfiler Portals

Nonfilers can receive tax benefits by manually providing information to the IRS that the IRS can then use to administer and issue the benefits. During the COVID-19 pandemic, the IRS developed "nonfiler portals" so low-income nonfilers could receive stimulus check payments and advance payments of the child credit. Unlike data from a different program that may be ill suited to administer a tax benefit (see Case Study 2B), the data from these nonfiler portals were used to effectively create a simplified income tax return and hence directly administer tax benefits.[39]

Unlike administrative data from other programs, nonfiler portals can request the exact information that the IRS needs to determine eligibility for and the amount of a payment. But because they require taxpayers to manually provide information, they may have limited benefit on their own—that is, without outreach and/or assistance—to households who historically do not interact with the tax system. Individuals may be confused by the tax terms used or struggle if they do not speak English as a first language, have limited access to a computer or the internet, or require additional assistance. One concern with some of the nonfiler portals initially deployed during the COVID-19 pandemic, for example, was that they were not available in Spanish and not mobile friendly. Code for America, a nonprofit organization, developed an alternative mobile-friendly nonfiler portal for families to receive the 2021 expanded child credit. The organization's evaluation of the child tax credit nonfiler portal was that combining certain outreach strategies with simplified filing using the portal was more successful than either strategy on its own.[40]

There is increased interest among some policymakers in simplifying income tax filing for some households, especially those with relatively simple tax situations.[41] Insofar as the federal government provides more social benefits through the tax code, nonfiler portals—and the simplified tax returns they generate—may be a tool to include nonfilers in the tax filing system. For example, policymakers may wish to integrate aspects of nonfiler

[37] See, for example, Elaine Maag, *Should IRS or Social Security Administer A Monthly Child Benefit?* Tax Policy Center, TaxVox Blog, February 17, 2021, https://www.taxpolicycenter.org/taxvox/should-irs-or-social-security-administer-monthly-child-benefit.

[38] See, for example, Sam Hammond and Elaine Maag, *Issues in Child Benefit Administration in the United States: Imagining the Next Stage of the Child Tax Credit*, Urban Institute, December 2021.

[39] Nina Olson, *What is this thing called … Portal?* Procedurally Taxing (blog), April 29, 2020, https://procedurallytaxing.com/what-is-this-thing-called-portal/.

[40] Code for America, *Lessons from Simplified Filing in 2021*, End of Filing Season GetCTC Report, January 2022, https://files.codeforamerica.org/2022/01/15163938/lessons-from-simplified-filing-in-2021-getctc-report-january-2022.pdf. Other research suggests that having "trusted messengers" or "navigators" could help families navigate the tax system and increase uptake of benefits. For example, a brief by researchers at the Tax Policy Center highlighted the potential benefits from having nurses inform low- and middle-income families about the child tax credit, making them aware of free resources to determine their eligibility, file their taxes, and claim tax benefits. For more information, see Nikhita Airi, Luisa Godinez-Puig, and Kim Rueben, *Trusted Messengers' Role in Helping new Mothers File Taxes*, Tax Policy Center, December 2022, https://www.taxpolicycenter.org/publications/trusted-messengers-role-helping-new-mothers-file-taxes/full.

[41] See, for example, Lucas Goodman et al., *Automatic Tax Filing: Simulating a Pre-Populated Form 1040*, National Bureau of Economic Research, Working Paper no. 30008, April 2022.

portals with partially or fully prepopulated returns, perhaps using data from IRS information returns or other federal programs, if feasible.

Case Study 2B | Using Data from Other Programs to Administer Tax Benefits

A 2017 CBO study on nonfilers suggests this population tends to participate in other benefit programs like Social Security, Medicare, Medicaid, and SNAP at higher rates than filing households.[42] Some might argue that data from these programs could be used by the IRS to "find" nonfilers, either to administer a benefit directly or for outreach purposes.

However, data from other benefit programs may be ill suited to directly administering a tax program, in particular because they may lack the relevant information to implement a tax provision. Data from other programs may use different eligibility rules, different measures of households and income, and different time periods (e.g., eligibility for tax benefits is typically determined on an annual basis, while eligibility for some nontax benefits is determined on a shorter time frame, such as a monthly basis).

In a 2015 study, Elaine Maag and colleagues from the Urban Institute examined whether SNAP administrative data could be used to administer a tax benefit, the EITC.[43] Maag et al. noted a significant overlap in the population eligible for SNAP and the EITC in Florida, where the study was conducted. However, the researchers found that "except in limited circumstances, the information that applicants report to SNAP is not detailed enough to conclusively verify eligibility [for the EITC]." More broadly, when discussing using SNAP data for tax benefit administration, Maag et al. noted that from the perspective of administering tax benefits, "data are likely to be cumbersome to work with and may not be available in a timely manner."

It is important to note that benefit programs themselves are not universal, so administrative data from federal or state benefits programs do not encompass the universe of nonfilers. In particular, adults aged 18 to 64 without disabilities and without children tend not to receive any need-tested benefits.[44]

Some have pointed out that most *individuals* in the United States are visible to the IRS because they are listed somewhere on a tax *information* return filed by a third party with the IRS. For example, even though low-income seniors may not file federal income tax returns due to their low incomes, they and the IRS are sent SSA-1099s, Social Security benefit statements. Similarly, many low-income nonfiling workers and the IRS are sent information returns like W-2s or 1099-NECs. In a 2014 paper, James Cilke estimated that[45]

> The IRS's Federal income tax reporting "touches" an estimated 99.5 percent of the U.S. resident population.... Approximately 90 percent of the U.S. population appears on a filed income tax return, while almost everybody else appears on one or more information returns filed with the IRS.

These studies suggest that data that may not be suitable for the administration of a tax provision could potentially be used for outreach to nonfilers. Indeed, during the rollout of stimulus checks during the COVID-19 pandemic, the Center on Budget and Policy Priorities (CBPP) advocated for using data from SNAP and Medicaid not to directly issue the payments, but rather for "aggressive state outreach" to nonfiling households, which CBPP estimated could reach 9 million of the estimated 12 million nonfiling households.[46]

Nonetheless, there may always remain some households—especially those comprised of working-age adults who do not receive any federal or state benefits, are not disabled, and do not work (or do not have a documented work record)—that will be difficult for any system to find.

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[42] See Tables 6 and 7 in Shannon Mok, *An Evaluation of Using Linked Survey and Administrative Data to Impute Nonfilers to the Population of Tax Return Filers*, CBO, Working Paper 2017-06, September 2017.

[43] Elaine Maag et al., *Using Supplemental Nutrition Assistance Program Data in Earned Income Tax Credit Administration: A Case Study of Florida SNAP Data Linked to IRS Tax Return Data*, Urban Institute, September 2015, https://www.urban.org/sites/default/files/publication/71686/2000438-using-snap-data-in-eitc-administration.pdf.

[44] See, for example, Figure 2 in CRS Report R46823, *Need-Tested Benefits: Who Receives Assistance?*, by Gene Falk, Karen E. Lynch, and Paul D. Romero.

[45] James Cilke, *The Case of the Missing Strangers: What we Know and Don't Know About Non-Filers*, paper presented at the 107th Annual Conference of the National Tax Association, Santa Fe, NM, November 13-15, 2014, http://tinyurl.com/y7chw254.

[46] Chuck Marr et al., *Aggressive State Outreach Can Help Reach the 12 Million Non-Filers Eligible for Stimulus Payments*, Center on Budget and Policy Priorities, October 14, 2020, https://www.cbpp.org/research/federal-tax/aggressive-state-outreach-can-help-reach-the-12-million-non-filers-eligible#_ftn1.

Issue 3: Many Households Use Paid Preparers and Commercial Software

Most families that receive cash assistance through the tax code pay for assistance in preparing and filing their returns, using either paid tax preparers or commercial software. IRS data indicate that almost 53% of all 2018 tax returns were prepared by a paid preparer, with a similar share of low- and moderate-income households using paid preparers.[47] Other IRS research indicates that a significant proportion of low- and moderate-income taxpayers—about 4 in 10—self prepare their returns using commercial software (including software available through Free File).[48] This contrasts with the administration of nontax social benefit programs, which are typically administered using government-provided assistance.[49]

Paid preparers by definition and most commercial software companies charge fees for their services—in some cases very high fees—which ultimately reduces the amount of tax-based assistance families receive. According to one estimate, the fees charged by preparers averaged $400 for taxpayers eligible for the EITC, or about 16% of the average EITC amount.[50] These fees may vary widely from preparer to preparer. According to one GAO study of 19 paid preparers, "[t]he fees charged for tax preparation services varied widely across the 19 visits, sometimes between offices affiliated with the same chain. Often, paid preparers either did not provide an estimate of the fees upfront or the estimate was less than the actual fees charged."[51]

Research suggests that many taxpayers are willing to pay these fees, believing that doing so will ensure their compliance with the complex rules that govern these tax benefits while maximizing the benefits for which they are legally eligible.[52] The eligibility rules for family-related tax benefits like the EITC and the child credit are widely regarded as complex, especially those governing who can claim a child for a particular benefit. Low- and moderate-income families who have lower literacy rates, speak English as a second language, or have nontraditional or

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[47] For 2018 data, see IRS, *Table 22*, Statistics of Income Historical Tables, https://www.irs.gov/statistics/soi-tax-stats-historical-table-22; GAO, *Paid Tax Return Preparers: In a Limited Study, Preparers Made Significant Errors*, GAO-14-467T, April 8, 2014; and Taxpayer Advocate Service, *Earned Income Tax Credit: Making the EITC Work for Taxpayers and the Government*, Objectives Report to Congress FY2020, Volume 3, July 2019.

[48] For example, 41% of 2017 tax returns with an EITC claim were self prepared using commercial software and 2% were prepared using Free File. See Taxpayer Advocate Service, *Earned Income Tax Credit: Making the EITC Work for Taxpayers and the Government*, Objectives Report to Congress FY2020, Volume 3, July 2019, p. 24.

[49] The National Taxpayer Advocate argued, "The application process for social benefit programs administered outside the tax system typically includes government-provided assistance. Unlike those other programs, the IRS has essentially outsourced significant functions in the EITC claim and distribution process to the private sector." Taxpayer Advocate Service, *Earned Income Tax Credit: Making the EITC Work for Taxpayers and the Government*, Objectives Report to Congress FY2020, Volume 3, July 2019, p. 23.

[50] Gabriel Zucker, Cassandra Robertson, and Nina Olson, *The IRS as a Benefits Administrator: An Agenda to Transform the Delivery of EIP, EITC, and CTC*, New America, New Practice Lab, March 24, 2021, https://www.newamerica.org/new-practice-lab/reports/the-irs-as-a-benefits-administrator/; and Figure 5 in CRS Report R43805, *The Earned Income Tax Credit (EITC): How It Works and Who Receives It*, by Margot L. Crandall-Hollick, Gene Falk, and Conor F. Boyle.

[51] GAO, *Paid Tax Return Preparers: In a Limited Study, Preparers Made Significant Errors*, GAO-14-467T, April 8, 2014, p. 19, https://www.gao.gov/products/gao-14-467t.

[52] "The high U.S. [tax] preparer usage rate is in part a symptom of the complexity of the income tax system, as taxpayers want to be sure they comply with the law but also want to make sure they take advantage of all the tax breaks they legally qualify for." Leonard E. Burman and Joel Slemrod, *Tax in America: What Everyone Needs to Know*, second ed., vol. 217 (Oxford University Press, 2020).

complex family structures (e.g., where the child is not the biological child of the taxpayer claiming the credit) may find the eligibility rules for family tax benefits especially confusing.[53] Research suggests this complexity may be an important factor in driving low-income families to use paid preparers.[54]

While taxpayers may believe paid preparers help them accurately prepare their tax returns and receive all tax benefits for which they are eligible, the evidence indicates that is not necessarily the case. According to one GAO study, the most common errors on tax returns, including those prepared by paid preparers, are errors related to refundable tax credits, suggesting even paid preparers may struggle to navigate the eligibility rules of these tax benefits.[55]

Another study that examined erroneous EITC claims found that a large share of returns prepared by paid preparers included errors, including those returns prepared by attorneys, CPAs, and enrolled agents. The most common and costliest errors tended to occur among unregulated tax preparers, often called "unenrolled preparers."[56] The lowest frequency of errors and the least costly errors tended to occur among volunteers trained by the IRS to prepare the returns of low- and moderate-income families (see "Case Study 3 | Volunteer Income Tax Assistance (VITA)").

Moreover, since taxpayers are generally legally responsible for the accuracy of the information on their tax returns, the cost of these inaccuracies, as well as the cost of the services themselves, is ultimately borne by families. The high error rates may also increase scrutiny of taxpayers who claim family tax benefits like the EITC, contributing to, for example, higher audit rates.[57]

In lieu of paid preparers, taxpayers who self-prepare their returns may use commercial software, which itself is minimally regulated. This extends to the IRS's Free File program, which allows low- and moderate-income taxpayers to use free commercial software to prepare and file their income tax returns.[58] The IRS does not generally test any commercial software—including software offered via Free File—to ensure it will help taxpayers accurately prepare and file their returns.[59] The lack of regulation, oversight, and testing may contribute to the low usage of the Free File program.[60]

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[53] For more information, see Taxpayer Advocate Service, *Earned Income Tax Credit (EITC): The IRS's EITC Return Preparer Strategy Does Not Adequately Address the Role of Preparers in EITC Noncompliance*, 2015 Annual Report to Congress, Volume 1, p. 261, https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/ARC15_Volume1_MSP_24_EITC-Preparer-Strategy.pdf.

[54] Gabriel Zucker, Cassandra Robertson, and Nina Olson, *The IRS as a Benefits Administrator: An Agenda to Transform the Delivery of EIP, EITC, and CTC*, New America, New Practice Lab, March 24, 2021, https://www.newamerica.org/new-practice-lab/reports/the-irs-as-a-benefits-administrator/.

[55] GAO, *Tax Filing: 2021 Performance Underscores Need for IRS to Address Persistent Challenges*, GAO-22-104938, April 2022, p. 15.

[56] For more information on unenrolled preparers, see Taxpayer Advocate Service, *RETURN PREPARER OVERSIGHT: The IRS Lacks a Coordinated Approach to Its Oversight of Return Preparers and Does Not Analyze the Impact of Penalties Imposed on Preparers*, 2018 Annual Report to Congress, Volume 1, pp. 105-116.

[57] For more information on EITC audits, see CRS Insight IN11952, *Audits of EITC Returns: By the Numbers*, by Margot L. Crandall-Hollick.

[58] For more information on Free File, see CRS In Focus IF11808, *The Internal Revenue Service's Free File Program (FFP): Current Status and Policy Issues*, by Gary Guenther.

[59] Taxpayer Advocate Service, *Earned Income Tax Credit: Making the EITC Work for Taxpayers and the Government*, Objectives Report to Congress FY2020, Volume 3, July 2019, p. 25.

[60] See the series, "The TurboTax Trap: How the Tax Prep Industry Makes You Pay," *ProPublica*, https://www.propublica.org/series/the-turbotax-trap.

Policy Considerations

The use of paid preparers may be convenient for many taxpayers. But the fees charged by paid preparers effectively reduce the value of tax benefits, which may undercut policymakers' objectives. In addition, returns prepared by paid preparers can include errors for which taxpayers are ultimately responsible.

In response to concerns about the cost and accuracy of paid preparers, policymakers have proposed a variety of different reforms. These include instituting a "public option" government-provided alternative to commercial software.[61] Of note, the law commonly referred to as the Inflation Reduction Act (IRA; P.L. 117-169) includes a provision that provides the IRS with $15 million to study the cost and feasibility of creating a free direct e-file program (i.e., a public option).[62] Other proposals have included requiring "truth in lending" disclosures of tax preparation fees so that consumers can make better-informed decisions;[63] allowing the IRS to establish minimum competency standards for paid preparers;[64] and having the IRS use data it already possesses to send prefilled forms to taxpayers.[65] This final option, which has been the subject of recent congressional interest, may work best for low-income workers without children and with simple tax situations. For example, researchers found that "single individuals with no dependents, wage-only income, and income less than $100,000—[who] comprised 20 percent of all return filers ... had a roughly 80 percent success" with prefilled returns.[66] In other words, prefilled returns may not be an appropriate option for certain families, especially ones where the family's structure changes from year to year.

[61] See, for example, S. 912 in the 115th Congress, as introduced by Sen. Elizabeth Warren. For a discussion of this and similar legislation, see Dylan Matthews, "Elizabeth Warren has a great idea for making Tax Day less painful," *Vox*, April 14, 2018, https://www.vox.com/2016/4/13/11417676/elizabeth-warren-tax-return-free-filing-tax-day-intuit-hr-block-turbotax-automatic-simple.

[62] See CRS Insight IN11977, *IRS-Related Funding in the Inflation Reduction Act*, by Brendan McDermott.

[63] Taxpayer Advocate Service, *Earned Income Tax Credit: Making the EITC Work for Taxpayers and the Government*, Objectives Report to Congress FY2020, Volume 3, July 2019, pp. 30-31.

[64] National Taxpayer Advocate, "Legislative Recommendation #4 Authorize the IRS to Establish Minimum Competency Standards for Federal Tax Return Preparers," in *2022 Purple Book*, pp. 9-11, https://www.taxpayeradvocate.irs.gov/reports/2021-annual-report-to-congress/national-taxpayer-advocate-2022-purple-book/.

[65] Lucas Goodman et al., "Automatic Tax Filing: Simulating a Pre-Populated Form 1040," NBER Working Paper 30008, April 2022; and CRS Insight IN11992, *Prefilled Individual Income Tax Return Filing: What It Is and Policy Issues*, by Gary Guenther.

[66] Jonathan Curry, "Study: Pre-Filled Tax Returns Would Come With Tricky Trade-Offs," *Tax Notes Federal*, June 20, 2022.

Case Study 3 | Volunteer Income Tax Assistance (VITA)

The Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) programs provide free tax preparation and filing services to low-income taxpayers during tax filing season. According to the IRS, about 80,000 volunteers at 11,000 sites prepare about 3.5 million tax returns each year.[67] About $41 million was set aside for VITA/TCE funding in FY2022.[68]

The IRS does not directly run VITA/TCE sites, but rather provides grants to community organizations and nonprofits to operate sites. The IRS sets forth basic requirements of the sites, and "provides the sponsoring organization with limited administrative support, grant money, and periodic inspection. The sponsor organization recruits volunteers to run the site, trains the volunteers, provides equipment like laptops and printers (often paid for with IRS grants), and oversees the day-to-day operations. All sites also generally use the same tax preparation software (TaxSlayer), which is provided by the IRS."[69]

VITA volunteers must pass a minimum certification test in order to prepare returns, with higher-level certifications for some complex tax situations, like preparing returns for servicemembers.[70]

Research indicates that tax returns prepared by VITA volunteers are less prone to error than returns prepared by most other types of preparers. One IRS Taxpayer Advocate Report found that in FY2017, VITA/TCE sites had a 93% accuracy rate over all returns they prepared.[71] VITA volunteers were also less prone to errors when helping taxpayers file for refundable tax credits. For example, the most recent IRS study of EITC compliance found that 20%-26% of EITC returns prepared by VITA volunteers had an overclaim of the credit, compared to 35%-44% for EITC returns prepared by national tax return preparation firms. (The percentages of EITC returns with overclaims for other types of preparers were 42%-46% by enrolled agents, 47%-49% by accountants [CPAs], 35% by attorneys, and 49%-54% by unenrolled preparers.) The same study also indicated that the errors on VITA-prepared returns were also less costly compared to other types of preparers.[72]

Despite the accuracy and low cost of VITA tax preparation, it is one of the least used tax preparation methods. Although about 75% of individual taxpayers may be eligible to have their returns prepared by VITA/TCE,[73] only about 1%-3% of taxpayers use VITA sites. It is unclear what the major drivers of the comparatively low utilization rate of VITA are, but they could include insufficient funding, taxpayer preference for more convenient options, or belief that paid preparers will get them a bigger refund. One volunteer preparer noted that VITA/TCE are underfunded and staff are overworked, limiting their ability to meet demand.[74] The Taxpayer Advocate has also highlighted that the lack of a year-round presence and the fact that returns with common schedules (like those associated with gig work) are deemed "out of scope" for VITA volunteers may also discourage taxpayers from using VITA.[75]

Issue 4: Data Used to Administer Tax Benefits Are Generally Annual Data from a Prior Year

Like other provisions of the income tax, eligibility for and the amount of tax benefits a family receives in a given year are based on prior-year (i.e., lagged) annual tax data. As a result, the IRS

[67] Frank Nolden, *Tax Volunteers Support Taxpayers in Need*, IRS, https://www.irs.gov/about-irs/tax-volunteers-support-taxpayers-in-need, updated January 25, 2022. More recent data from FY2021, which include the impact of the COVID-19 pandemic, indicate that 52,874 volunteers at 8,874 sites prepared 1,977,465 returns with a 96.4% accuracy rate. IRS, "Table 9" in *Selected Taxpayer Assistance and Education Programs, by Type of Assistance or Program, Fiscal Year 2021*, IRS Databook: Service to Taxpayers, https://www.irs.gov/statistics/service-to-taxpayers.

[68] See CRS In Focus IF11979, *Internal Revenue Service Appropriations, FY2022*, by Gary Guenther.

[69] Noah B. Metz, "Volunteer Income Tax Assistance During the Pandemic and Beyond," *Tax Notes*, vol. 169 (December 21, 2020), p. 1912.

[70] IRS, "Volunteer Training Certification," https://www.irs.gov/individuals/volunteer-training-certification (updated April 26, 2022).

[71] Taxpayer Advocate Service, *2017 Annual Report to Congress*, Volume 1, p. 129, https://www.taxpayeradvocate.irs.gov/reports/2017-annual-report-to-congress/full-report/.

[72] IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns*, Publication 5162 (8-2014) Catalog Number 66766H, August 2014, https://www.irs.gov/pub/irs-soi/EITCComplianceStudyTY2006-

has information on what a household's situation was in a prior year, but no information on its present situation, which may differ. In addition, tax data generally do not include information about within-year fluctuations in income and family structure.

When families apply for tax benefits that they will receive in that year, they provide their characteristics—for example, their income and number of children—for the prior year on their federal income tax returns. For example, taxpayers receive their 2021 EITCs—the EITCs that reflect their total annual earned income in 2021 and their family structures for 2021—after they file their 2021 income tax returns in 2022. Most taxpayers had until April 18, 2022, to file their 2021 returns, or until October 17, 2022, if they requested a filing extension. This lag in time provides taxpayers with flexibility to complete their income tax returns for the prior year, but also delays when the IRS receives the most recent complete annual tax information for the prior year.

In addition, the data collected for administering federal tax benefits are typically annual data—specifically, annual measures of taxpayers' marital status, income, and number of children. Tax filing status for a given year depends on whether a taxpayer is married or unmarried, and whether or not the taxpayer has dependents. In both cases, these aspects of a household's status might not be apparent until the end of the year. Marital (and hence filing) status is generally based on whether a taxpayer is married on the last day of the year.[76] For most tax benefits, dependent children must live with a taxpayer for more than six months out of the year to be considered a "qualifying child," which may only be clear at the end of the year for some households.[77]

Because tax benefits received in a given year are generally based on a family's characteristics for the prior year, they cannot reflect monthly or quarterly fluctuations in families' lives in real time (see "Case Study 4 | Stimulus Checks Issued During the COVID-19 Pandemic"). In other words, a tax benefit cannot immediately be provided to a family based solely on its current income in a given month for two reasons: no such tax data exist at that point (a W-2 has not been generated and a 2022 return will not be filed until 2023) and the IRS collects information on individuals' earned income on an annual basis, not a monthly basis. This is in contrast to other nontax forms of cash assistance, which may be more responsive to changes in families' circumstances:

> Spending programs typically reflect changes in income and living arrangements throughout the year, allowing them to be more responsive than tax credits to changes in circumstances. A person determines who else is in his or her assistance unit, applies for a benefit, is determined eligible, and then begins receiving that benefit, typically on a monthly basis.[78]

2008.pdf.

[73] Taxpayer Advocate Service, *2017 Annual Report to Congress,* Volume 1, p. 129, https://www.taxpayeradvocate.irs.gov/reports/2017-annual-report-to-congress/full-report/.

[74] Dylan Matthews, "The IRS has a big opportunity to fix the way Americans file taxes," *Vox*, April 13, 2022, https://www.vox.com/policy-and-politics/22596072/irs-turbotax-hr-block-free-file-tax-return.

[75] Taxpayer Advocate Service, *2017 Annual Report to Congress*, Volume 1, pp. 128-140, https://www.taxpayeradvocate.irs.gov/reports/2017-annual-report-to-congress/full-report/.

[76] For example, if a couple is married on December 31, 2020, they are generally considered married for all of 2020 on their 2020 income tax return. (There are exceptions to this general rule.) See IRS, *Publication 501 (2021), Dependents, Standard Deduction, and Filing Information*, https://www.irs.gov/publications/p501#en_US_2020_publink1000220722.

[77] For more information, see CRS Insight IN11634, *Child Tax Benefits and Children with Complex or Dynamic Living Arrangements*, by Patrick A. Landers and Margot L. Crandall-Hollick.

[78] Sam Hammond and Elaine Maag, *Issues in Child Benefit Administration in the United States: Imagining the Next Stage of the Child Tax Credit*, Urban Institute, December 2021, p. 7.

This lag in data may be of interest to policymakers in light of research on the changing structure of some families, with a greater share of families changing composition over the course of the year than in previous decades in ways that could complicate the administration of existing tax benefits.[79] It may also be of interest to policymakers designing tax benefits based on income, as income can change over time, and income volatility may be more common among individuals who move in and out of households.[80]

Policy Considerations

Characteristics of families—like their income and structure—can change from month to month and year to year, and those changes may not be captured by current tax data. Research suggests that moderate-income families, and poor families in particular, can experience significant variations in income from month to month.[81] To make the social benefits in the tax code more responsive to changes in families' situations, like income, the IRS would need more frequent and/or timely tax data to be provided by both individuals and employers. Gathering this information could necessitate taxpayers to manually update information about their family circumstances with the IRS (e.g., whether they had a qualifying child for a given month or if their marital status had changed). It could also necessitate workers and businesses regularly providing updates of workers' income. Improved technology (e.g., an IRS account accessible from a mobile device) could help lessen these burdens, although it is not clear to what extent.

Some experts caution against trying to make the tax system operate more like a traditional benefit system, as it would sacrifice some of the advantages of using the income tax system, including ease of use, reduced stigma, and low operational costs.[82] Absent creating an entirely new income tax system based on real-time monthly data, policymakers may want to consider weighing their policy goals against the limitations of the current income tax system.

[79] Elaine Maag, H. Elizabeth Peters, and Sara Edelstein, *Increasing Family Complexity and Volatility: The Difficulty in Determining Child Tax Benefits*, Tax Policy Center, March 3, 2016, https://www.taxpolicycenter.org/publications/increasing-family-complexity-and-volatility-difficulty-determining-child-tax-benefits/full.

[80] See Elaine Maag et al., *Income Volatility: New Research Results with Implications for Income Tax Filing and Liabilities*, Tax Policy Center, May 25, 2017, https://www.taxpolicycenter.org/publications/income-volatility-new-research-results-implications-income-tax-filing-and-liabilities/full.

[81] Anthony Hannagan and Jonathan Morduch, *Income Gains and Month-to-Month Income Volatility: Household Evidence from the U.S. Financial Diaries*, NYU Wagner Research Paper No. 26598833, U.S. Financial Diaries Working Paper, September 11, 2015.

[82] As the former National Taxpayer Advocate has written, "But if we want to administer them [benefits] through the tax system, then we have to understand how they fit into the greater scheme of the tax system, and we can't just impose a system that was created for a completely different purpose onto the tax system." Nina Olson, "Thinking Out Loud About the Advanced Child Tax Credit—Part I," Procedurally Taxing (blog), June 29, 2021, https://procedurallytaxing.com/thinking-out-loud-about-the-advanced-child-tax-credit-part-i/.

Case Study 4 | Stimulus Checks Issued During the COVID-19 Pandemic

During the COVID-19 pandemic, Congress enacted three rounds of stimulus checks. These payments were structured as temporary one-time refundable tax credits that were issued to households before they had to file their applicable returns. For example, the first payment enacted as part of the CARES Act (P.L. 116-136) equaled $1,200 per eligible individual ($2,400 for married taxpayers filing a joint tax return) plus an additional $500 per eligible child. The payment amount then phased down for higher-income taxpayers. These payments were structured as a new one-time refundable tax credit for 2020 that was advanced so that payments were received in 2020, as opposed to 2021 (when 2020 income tax returns were filed).

To facilitate implementation, the statute directed the Department of the Treasury to automatically issue these payments to households in 2020 if they had filed 2019 income tax returns, determining eligibility based on information on their 2019 returns. If a 2019 return had not been filed, the statute directed the Treasury to automatically issue payments based on 2018 return information. Eligible households who did not automatically receive the first payment (or who received less than they would have based on their income and family size as reported on their 2020 income tax returns) were eligible to receive the payment (or additional amount) as the recovery rebate credit when they filed their 2020 income tax returns. In contrast, if a household received more than it was eligible for, the difference did not need to be paid back. The second and third rounds of payments were structured similarly and based on prior-year tax return information, although the amounts and some eligibility rules differed.[83]

The fact that the stimulus check amounts and eligibility were based on older data led to concern that the benefits were being received by ineligible households, when in fact the households were often eligible based on the statute. For example, after enactment of the CARES Act, the *Washington Post* reported a story with the headline “The IRS sent $1,200 to a rich woman who doesn’t need it. Also, she’s British. And lives in London.”[84] Nevertheless, the woman in question lived in the United States on a work visa in 2018, filed a 2018 income tax return, and was, according the statute, eligible for the advance payment based on her 2018 return.

Issue 5: Tax Benefits Are Usually Delivered Once a Year

Generally, tax benefits are paid out once a year as a lump sum as part of a federal income tax refund. Research suggests that some households may value these annual lump sum payments as a form of forced savings that enables them to make large purchases. For example, some research has found that some households that receive the EITC use their annual tax refunds as a kind of forced savings that enables them to make large purchases.[85] But households may also use their refunds to pay for necessities or pay off debt. Hence, policymakers may be interested in paying out a tax benefit more frequently than once a year to help people meet their ongoing needs.

Some studies indicate that many low- and moderate-income families who receive refundable tax credits face financial hardship during the year and may take on debt to meet their basic needs or put off certain expenses (like out-of-pocket health care expenses) until they receive their tax refunds.[86] After they receive their refunds, some households have “an opportunity to catch up, but

83 See CRS Report R46415, *COVID-19 and Direct Payments: Overview and Resources*, coordinated by Margot L. Crandall-Hollick.

84 Michelle Singletary, “The IRS sent $1,200 to a rich woman who doesn’t need it. Also, she’s British. And lives in London.” *Washington Post*, May 1, 2020.

85 See, for example, Elaine Maag, William J. Congdon, and Eunice Yau, *The Earned Income Tax Credit: Program Outcomes, Payment Timing, and Next Steps for Research*, OPRE, MEF Associates, and the Urban Institute, February 2021, pp. 15-18.

86 Elaine Maag, Stephen Roll, and Jane Oliphant, *Delaying Tax Refunds for Earned Income Tax Credit and Additional Child Tax Credit Claimants*, The Tax Policy Center, December 7, 2016, p. 3; and JP Morgan Chase Institute, *Deferred Care: How Tax Refund Enable Healthcare Spending*, January 2018, https://bit.ly/3u68GtN.

then the cycle often repeats."[87] Some research on the child tax credit suggests that some low-income families prefer receiving regular monthly payments. According to a survey from the Urban Institute, "45 percent of nonelderly adults living with children who received the advanced child credit payments in 2021 preferred receiving the credit as a monthly payment, 28 percent reported no preference in payment timing, and 27 percent preferred a single payment as part of a tax refund."[88]

Under current law, most families receive refundable tax credits once a year as part of their annual tax refunds. And while some taxpayers may adjust how much is withheld from their paychecks throughout the year (i.e., they receive little to no refund at tax time because they have had "perfect withholding"), they cannot have negative withholding. In other words, they cannot adjust their tax withholding to receive the portion of the refundable credits that exceeds their income tax liability. Hence, many low-income families, who have little or no income tax liability, can only receive refundable tax credits once a year in their tax refunds.

However, policymakers have attempted to work around this aspect of tax benefits by issuing tax benefits *before* a taxpayer files the applicable tax return, which is often referred to as "advancing" the tax benefit. Several tax benefits have been paid out before the applicable federal income tax return is filed—notably the health insurance premium assistance tax credit; the 2021 expanded child tax credit; and, from 1979 through 2010, part of the EITC.

Crucially, when policymakers advance refundable tax credits, they have generally based the advance amounts on retrospective annual tax data to estimate current eligibility. For example, advance payments of the child credit issued in 2021 were based on an estimate of the 2021 credit using 2020 tax data on income and family structure. One issue that arises with advancing a benefit based on older data is if and how to reconcile what is received in advance with what can eventually be claimed on a tax return. This is often referred to as "reconciling" or "truing up" the advance payment. For example, if Congress decided that a $3,000 refundable tax credit were to be advanced in 2022 based on an estimate using 2021 data—perhaps as 12 monthly payments of $250—what would happen if a household was only ultimately eligible for a $2,000 credit when it filed its 2022 income tax return in 2023? Would the household need to pay back all or some of the $1,000 overpayment of the credit?

Reconciling estimated payments with what a household is actually eligible for ensures that households receive the correct amounts of a credit. Reconciling may also discourage taxpayers from strategically deciding when to report information to the IRS to receive a larger benefit. However, reconciliation—depending on how it is designed—could dissuade people from spending the money they receive via the tax system for fear they might need to pay it back. It could also result in additional hardship for low- and moderate-income households who spend assistance for which they are ultimately not eligible and then need to pay it back. The need to reconcile may be common—especially if the eligibility for and amount of a tax benefit are based in part on factors that are likely to change from year to year, like income.[89] For example, a 2023

[87] Steve Holt, *Periodic Payment of the Earned Income Tax Credit Revisited*, Brookings Institution Metropolitan Policy Program, December 2015.

[88] Elaine Maag and Michael Karpman, *Many Adults with Low Income Prefer Monthly Child Tax Credit Payments*, Urban Institute, July 27, 2022, https://www.taxpolicycenter.org/publications/many-adults-lower-income-prefer-monthly-child-tax-credit-payments.

[89] The economist Kathryn Ann Edwards discussed the impact of income volatility and benefit program broadly in Kathryn Anne Edwards, "America's Endangered Solution to Child Poverty," *Bloomberg Tax*, February 8, 2022, https://news.bloombergtax.com/tax-insights-and-commentary/americas-endangered-solution-to-child-poverty-kathryn-edwards. Other studies include Anthony Hannagan and Jonathan Morduch, *Income Gains and Month-to-Month Income*

study by researchers at the Tax Policy Center found that among low-income families with children eligible to receive the EITC in one year, 39% would have been eligible for an EITC that was at least $500 smaller in the subsequent year. According to their estimates, more than half of these families (22% of all low-income families with children) would have been eligible for a credit that was at least $2,000 less than the credit in the previous year. The researchers estimated that when families experienced declines of $2,000 or more from one year to the next, the most common factor driving these declines was a change in income.[90] Hence, advancing the EITC—currently delivered as a lump sum annually—could create financial hardships for many low-income families.

Similarly, an older study of the health insurance premium assistance tax credit found that overpayments of the advance of the credit (which is advanced monthly to health insurers) were common. Among households that received the advance of the health insurance premium tax credit, 57% had an overpayment of the advance on their 2015 returns.[91] These overpayments generally need to be paid back, although there are protections for lower-income households and repayment was waived with 2020 tax returns due to concerns about economic hardship from the COVID-19 pandemic. Research suggests the majority of households who repay the premium tax credit do so in the form of a reduced refund.[92] However, while "repayment protection" may benefit taxpayers, it can increase a tax benefit's overall budgetary score and lead to concerns about program integrity.

Policy Considerations

The IRS has demonstrated that it can issue tax benefits outside of the normal filing season. Doing so, however, generally requires policymakers to consider whether and how to reconcile advance payments with what a household is actually eligible for when it files a return. Policymakers have used various approaches for reconciliation when designing tax benefits. Some benefits have not required any reconciliation (the three rounds of stimulus check enacted during the COVID-19 pandemic, and the premium assistance tax credit in 2020). Other benefits have only been partially paid out in advance (the advanced EITC and the advance of the 2021 child tax credit) to reduce the amount that may need to be paid back with reconciliation. Finally, some benefits have included provisions limiting how much low- and moderate-income taxpayers must repay if they received overpayments from the advanced credit (the premium assistance tax credit and 2021 child tax credit).

Volatility: Household Evidence from the U.S. Financial Diaries, NYU Wagner Research Paper No. 2659883, U.S. Financial Diaries Working Paper, September 13, 2015; Robert Moffitt and Sisi Zhang, "Income Volatility and the PSID: Past Research and New Results," *AEA Papers and Proceedings*, vol. 108 (May 2018); and Karen Dynan, Douglas Elmendorf, and Daniel Sichel, "The Evolution of Household Income Volatility," *The B.E. Journal of Economic Analysis & Policy*, vol. 12, no. 2 (December 18, 2012).

[90] The authors note that "In some cases, drops in the EITC from one year to the next can be dramatic. Among low-income families [with children], about 22 percent see a drop of at least $2,000 and another 11 percent see a drop of between $1,000 and $2,000 (figure 3). Drops of at least $2,000 are caused by income increasing 64 percent of the time, children decreasing 20 percent of the time, and income decreasing 16 percent of the time." Elaine Maag, Nikhita Airi, and Lillian Hunter, *Understanding Yearly Changes in Family Structure and Income and Their Impact on Tax Credits, Tax Policy Center*, February 1, 2023, pp. 8-10, https://www.taxpolicycenter.org/publications/understanding-yearly-changes-family-structure-and-income-and-their-impact-tax-credits/full.

[91] Letter from John A. Koskinen, Commissioner of the Internal Revenue Service, to Members of Congress, January 9, 2017, https://www.irs.gov/pub/newsroom/commissionerletteracafilingseason.pdf.

[92] Leonard Burman, Gordon Mermin, and Elena Ramirez, *Tax Refunds and Affordable Care Act Reconciliation*, Tax Policy Center, April 1, 2015.

A tax benefit's design may help reduce the discrepancy between an advance benefit and the benefit received on a tax return. For example, if a parameter once used to calculate eligibility for an amount of a tax benefit no longer affects eligibility or amount, taxpayers will not need to reconcile or true up the benefit based on annual changes in this factor. This can occur, for example, if older income data are not used to *estimate* eligibility but instead used to *determine* eligibility (as was the case with the temporary "income lookbacks" for the EITC enacted as part of P.L. 116-260 and P.L. 117-2).[93] Discrepancies are also likely to be reduced when income, if below certain levels, does not affect the amount of the benefit, like the "fully refundable" child credit in 2021 (see "Case Study 5 | Advance Payments of the Fully Refundable Child Tax Credit"). As these examples highlight, in addition to considering whether and to what extent to limit repayment of advanced benefits, policymakers may also consider using program design to improve ease of administration.

Case Study 5 | Advance Payments of the Fully Refundable Child Tax Credit

The American Rescue Plan Act (ARPA; P.L. 117-2) temporarily expanded the child credit for many taxpayers and modified its administration. Among other changes, the law made the credit fully refundable for 2021 only.

Fully Refundable

In the context of the ARPA-expanded child credit, full refundability meant the credit was the same amount per child for low- and moderate-income taxpayers, irrespective of their incomes. Specifically, if an unmarried parent had income in 2021 under $112,500 ($150,000 for married parents), the credit amount did not vary based on income. Whether the family had $0, $20,000, $50,000, or $100,000 of income, the credit amount was the same for a given number of children. (Higher-income taxpayers were subject to a phaseout of the credit based on their income.) By making the child credit fully refundable for 2021, ARPA temporarily eliminated the prior-law formula used to phase in the credit for lower-income taxpayers based on income. Under the prior-law formula, a taxpayer with more than $2,500 of earned income was eligible to receive a partial benefit from the credit.

While many studies examined the impact of full refundability on poverty, full refundability also eliminated the chance that low- and some moderate-income taxpayers would need to repay advance payments of the child credit due to changes in income. To understand this, it is important to first understand how the 2021 credit was advanced.

Advance Payments

The advance payments of the 2021 child credit were based on estimates of the credit taxpayers were eligible to claim on their 2021 income tax returns. In order to estimate taxpayers' 2021 child credits, the IRS was directed by the statute to use data from 2020 income tax returns, or if those were not available, data from 2019 income tax returns. Since up to half of the 2021 credit could be issued in advance, the IRS generally calculated 50% of the estimated 2021 credit amount and then issued that in monthly payments. For example, if a married couple filing jointly listed $75,000 of income and two young children on a 2020 return—and those children were also young in 2021 (i.e., 0-5 years old)—the IRS would have estimated their 2021 credit to be $7,200. The IRS would have issued half of that amount—$3,600—in six monthly payments of $600, beginning July 15, 2021, and ending December 15, 2021.

When taxpayers filed their 2021 returns (in 2022), they first calculated the total amounts of the 2021 child credit for which they were eligible (based on the number and ages of qualifying children, income, and marital status for 2021). Then, taxpayers subtracted from their total 2021 credits the sum of advanced child credit payments they received during calendar year 2021. For example, if an unmarried taxpayer had two young children (and filed as a head of household) in 2021 (like they did in 2020), but their 2021 income had actually fallen to $40,000, they would still be eligible for a total child credit for 2021 of $7,200. Since they would have received half of their total 2021 credit in advance payments in calendar year 2021 ($3,600), they would ultimately claim the remaining half ($3,600) on their 2021 return. As long as this unmarried parent's income was below $112,500 in both 2020 and 2021, their credit amount would not change even if their income did. (If their income had instead risen to $350,000 in 2021, they would not have been eligible for any credit in 2021, and would have needed to repay the

93 See CRS Report R44825, *The Earned Income Tax Credit (EITC): Legislative History*, by Margot L. Crandall-Hollick.

$3,600 in advance payments they had received.) Full refundability effectively removed income as a factor that would lead to low- and some moderate-income taxpayers needing to repay the advance payments of the credit.

The Treasury Inspector General for Tax Administration (TIGTA) found that the IRS issued 98% of advance child credit amounts correctly based on the 2020 data used to determine these payment amounts.[94] According to this analysis, errors tended to occur when the IRS advanced a credit for a child that was not ultimately a qualifying child based on 2020 or 2019 tax data. For example, a taxpayer may have claimed a child incorrectly in 2020 as a dependent, and the IRS may have erroneously issued an advance payment based on this information.

Notably, other factors, including changes in the number of eligible children from year to year, could have resulted in overpayments of the advance credit compared to what taxpayers were ultimately eligible to claim based on 2021 tax data. In these cases, Congress enacted repayment protection in the form of a safe harbor.[95]

Issue 6: Some Households Do Not Have or Use Bank Accounts to Receive Tax Benefits

Some Americans, especially lower-income Americans, may face difficulties receiving payments quickly from the IRS because they do not have bank accounts or do not use a bank account to receive their tax refunds. Most U.S. consumers choose to open a bank account because it is a safe and secure way to store money.[96] However, some U.S. households—often those with low incomes, lack of credit histories, or credit histories marked with missed debt payments—do not use banking services. According to the FDIC's 2021 survey on how America banks, 4.5% of households in the United States were *unbanked*, meaning that these households did not have a bank account.[97] Compared with the general U.S. population, unbanked consumers are more likely to have lower incomes, have less formal education, be of a racial or ethnic minority, and be disabled.[98]

Households may not open a bank account for a number of reasons. In the FDIC survey, unbanked households' most reported answers for why they did not have bank accounts were because they did not have enough money, were concerned about privacy, did not trust banks, and wanted to avoid high and unpredictable bank fees.[99] In the past two decades, the availability of free or low-cost checking accounts has reportedly diminished, and fees associated with checking accounts have grown.[100] Some bank accounts require minimum account balances to avoid certain maintenance or service fees.[101] For consumers living paycheck to paycheck, maintaining bank

[94] Treasury Inspector General for Tax Administration, *American Rescue Plane Act: Accuracy of Advance Child Tax Credit Periodic Payments*, Report Number 2022-47-070, September 21, 2022.

[95] For more information on the safe harbor, see Appendix D in CRS Report R46900, *The Expanded Child Tax Credit for 2021: Frequently Asked Questions (FAQs)*, by Margot L. Crandall-Hollick.

[96] In this report, *bank accounts* refer to checking, savings, and other accounts at all depository institutions, including banks and credit unions.

[97] Federal Deposit Insurance Corporation (FDIC), *2021 FDIC National Survey of Unbanked and Underbanked Households: Executive Summary*, November 2022, p. 1, https://www.fdic.gov/analysis/household-survey/2021execsum.pdf. (Hereinafter "FDIC, *National Survey of Unbanked and Underbanked Households*.")

[98] FDIC, *National Survey of Unbanked and Underbanked Households*, p. 1-2.

[99] FDIC, *National Survey of Unbanked and Underbanked Households*, p. 3.

[100] Consumer Financial Protection Bureau (CFPB), *CFPB Study of Overdraft Programs: A White Paper of Initial Data Findings*, June 2013, pp. 15-17, https://files.consumerfinance.gov/f/201306_cfpb_whitepaper_overdraft-practices.pdf; and FDIC, *FDIC Quarterly Banking Profile: Quarterly Income Time-Series Data*, 2022, https://www.fdic.gov/bank/analytical/qbp/.

[101] The most common fees that checking account consumers incur are overdraft and nonsufficient fund fees. Overdraft services can help consumers pay bills on time, but fees can be costly, particularly if used repeatedly. For more

account minimums and avoiding account overdrafts might be difficult, leading to unaffordable account fees.[102] At least some of these consumers may be served better by alternative financial providers if their products are less expensive, faster, and more convenient for some consumers.[103]

Households with bank accounts can elect to receive tax refunds via direct deposit. Direct deposit, usually to a bank account, is generally a faster and more secure way to receive payments than a paper check. For 2019 income tax returns, 87% of tax refunds were delivered by direct deposit, and the rest were delivered by mailing paper checks.[104] Some unbanked households may receive their tax refunds as paper checks, even though some of these households may prefer a faster and more reliable way to receive direct payments from the IRS.

The IRS does not send all direct deposits to permanent bank accounts. For consumers using refund advance products, a paid preparer establishes a virtual bank account solely to receive a given tax refund, and the account cannot be used later for delivering other payments (see "Case Study 6 | Refund Advance Products and Difficulties Receiving Stimulus Payments"). For all of these reasons, the IRS may not have some Americans' bank account information and, therefore, may not be able to deliver direct payments quickly.

Fast and easy delivery of direct payments—particularly for nonfilers, unbanked consumers, or those without account information at the IRS—may be especially valuable. Individuals in these groups may be more likely to be low income or liquidity constrained (colloquially, living "paycheck to paycheck") and may need access to their payments quickly, especially during economic downturns or periods of financial hardship.[105]

Policy Considerations

Some of the lowest-income and most vulnerable populations may struggle to receive cash assistance provided through the tax code because they do not have bank accounts. This issue represents a potential barrier to certain populations receiving the benefits for which they are eligible. Policymakers may wish to consider alternative delivery mechanisms for tax benefits that

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information, see Trevor Bakker et al., *Data Point: Checking Account Overdraft*, CFPB, July 2014, p. 5, https://files.consumerfinance.gov/f/201407_cfpb_report_data-point_overdrafts.pdf.

[102] In addition, unpaid fees can lead to involuntary account closures, making it more difficult to obtain a bank account in the future.

[103] For example, although check cashing, money orders, and other nonbank transaction products might charge high fees, some consumers may incur higher or less predictable fees with a checking account. In addition, such alternative financial products might allow consumers to access cash more quickly, which might be valuable for consumers with tight budgets and little liquid savings or credit to manage financial shocks or other expenses. Lastly, nonbank stores often are open longer hours than banks, including evenings and weekends, which might be more convenient for working households. Moreover, these nonbank stores might also be more likely to cater to a local ethnic or racial community, for example, by hiring staff who speak a native language and live in the local community. Although consumers may find benefits in using alternative financial products substitutes, these products may not always have all of the benefits of bank accounts, such as FDIC insurance or other consumer protections. For more information, see Lisa Servon, *The Unbanking of America: How the New Middle Class Survives* (New York, NY: Houghton Mifflin Harcourt, 2017).

[104] Approximately 115 million of 158 million total returns were due tax refunds (73%), and of these 100 million were received as direct deposit (87%) See IRS, *SOI Tax Stats—Historic Table 2*, https://www.irs.gov/statistics/soi-tax-stats-historic-table-2.

[105] For more information on access to checking accounts and financial inclusion policy issues, see CRS In Focus IF11631, *Financial Inclusion: Access to Bank Accounts*, by Cheryl R. Cooper; and CRS Report R45979, *Financial Inclusion and Credit Access Policy Issues*, by Cheryl R. Cooper.

could be accessible to unbanked families. Other government benefit programs like Social Security have used prepaid cards as an alternative delivery method.

General-purpose prepaid cards may be considered an alternative to a traditional checking account, and they can be obtained through a bank, at retail stores, or online.[106] Prepaid card use is more prevalent among unbanked households.[107] For this reason, prepaid cards may be an alternative way for the government to reach unbanked consumers for direct payments. Indeed, a growing number of government programs are using general-purpose prepaid cards to distribute benefits to unbanked and other consumers, including Social Security payments using the Direct Express card.[108] The Treasury Department has experimented with prepaid cards for receiving tax refunds in the past,[109] and it provided some stimulus payments issued during the COVID-19 pandemic by mailing prepaid cards. However, reports suggest some people experienced confusion when receiving these unsolicited prepaid cards from the federal government,[110] and had questions about how to avoid fees when using these government-provided cards.[111] In addition, the Treasury Department needs up-to-date household addresses to successfully mail prepaid cards to taxpayers; as previously discussed, the information on federal income tax returns is lagged by one year and so may not be current.

Prepaid cards can be used in payment networks, such as Visa or MasterCard. They generally have features similar to debit and checking accounts, such as the ability to pay bills electronically, get cash at an ATM, make purchases at stores or online, and receive direct deposits. Prepaid cards often have a monthly maintenance fee and other particular service fees, such as fees for using an ATM or reloading cash.

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[106] For more information on prepaid cards, see CRS Report R43364, *Recent Trends in Consumer Retail Payment Services Delivered by Depository Institutions*, by Darryl E. Getter.

[107] FDIC, *National Survey of Unbanked and Underbanked Households*, p. 4.

[108] For more information on the Direct Express program, see U.S. Department of the Treasury, Bureau of the Fiscal Service, "Direct Express," https://www.fiscal.treasury.gov/directexpress/.

[109] For more information, see U.S. Department of the Treasury, "Treasury Launches Pilot Program of Prepaid Debit and Payroll Cards for Fast, Safe and Convenient Tax Refunds," press release, January 13, 2011, https://www.treasury.gov/press-center/press-releases/pages/tg1021.aspx; and Caroline Ratcliffe, William Congdon, and Signe-Mary McKernan, *Prepaid Cards at Tax Time and Beyond: Findings from the MyAccountCard Pilot*, Urban Institute, March 2014, https://www.urban.org/sites/default/files/publication/22476/413082-Prepaid-Cards-at-Tax-Time-and-Beyond-Findings-from-the-MyAccountCard-Pilot.PDF.

[110] Michelle Singletary, "Stimulus prepaid debit card is causing a lot of confusion," *Washington Post,* June 1, 2020, https://www.washingtonpost.com/business/2020/06/01/faq-stimulus-debit-card/.

[111] CFPB, "How to Use Your Economic Impact Payment Prepaid Debit Card without Paying a Fee," June 1, 2020, https://www.consumerfinance.gov/about-us/blog/economic-impact-payment-prepaid-card/.

Case Study 6 | Refund Advance Products and Difficulties Receiving Stimulus Payments

Refund advance products, such as refund anticipation checks (RACs) and refund anticipation loans (RALs), are common in the United States. A RAC is an agreement to pay tax preparation fees when a consumer receives a tax refund, for an additional fee (rather than when a tax preparer files a consumer's taxes). According to the IRS, with 2019 tax returns, over 21 million people used RACs (19% of households receiving a tax refund).[112] According to the Consumer Financial Protection Bureau (CFPB), RAC fees typically range from $30 to $50.[113] In contrast, a RAL is a credit product where a consumer receives an advance on an anticipated tax refund. Consumers can be charged interest and fees on these loans.[114] According to the FDIC, 1.0% of households used a RAL during 2021.[115] Lower-income and minority consumers were more likely to use refund advance products.[116]

When consumers use RACs or RALs, a virtual bank account is usually established solely for the transition. Tax refunds are deposited into this account, so fees, loans, or other amounts owed can be deducted before the consumer receives the remaining refund. Often, these temporary accounts are prepaid card accounts.[117] Because these accounts are temporary, future tax benefits cannot be directed to them. For this reason, these consumers faced difficulties quickly receiving stimulus checks issued during the COVID-19 pandemic from the IRS (these payments were advances of a one-time refundable credit based on older tax data, including information about RACs provided on older tax returns). This problem may be especially important for these consumers, since use of refund advance products suggests either a lack of funds to pay tax preparation fees or a desire for quick access to tax refunds. Therefore, this issue may limit rapid payment of tax benefits to those who may be most cash constrained, and for whom fast payments would be most valuable.

Issue 7: Tax Benefits Can Be Reduced via Offset or Garnishment Actions

A household's tax benefits may be reduced to collect past-due debts owed to the federal government, state or local government, or private creditors. This generally occurs by one of two mechanisms: offset or garnishment.

112 IRS, *SOI Tax Stats—Historic Table 2*, https://www.irs.gov/statistics/soi-tax-stats-historic-table-2. According to the GAO, "IRS data on tax-time financial products for 2016-2018 do not accurately reflect product use and the IRS has not updated reporting guidance to tax preparers. IRS data for 2008-2016 and information from industry participants and a consumer advocacy group's reports suggest that trends in the market for tax-time financial products include the decline of refund anticipation loans and that refund transfers became the most used product. Industry data also indicate that product fees for refund transfers increased in 2018; multiple other fees can be associated with tax-time products. New tax-time products and product features continue to be introduced." See GAO, *Tax Refund Products: Product Mix Has Evolved and IRS Should Improve Data Quality*, GAO-19-269, April 2019, p. 10, https://www.gao.gov/assets/700/698292.pdf.

113 Laura Udis, "Tax Refund Tips: Understanding Refund Advance Loans and Checks," CFPB, February 13, 2018, https://www.consumerfinance.gov/about-us/blog/tax-refund-tips-understanding-refund-advance-loans-and-checks/.

114 Laura Udis, "Tax Refund Tips: Understanding Refund Advance Loans and Checks," CFPB, February 13, 2018, https://www.consumerfinance.gov/about-us/blog/tax-refund-tips-understanding-refund-advance-loans-and-checks/.

115 FDIC, *National Survey of Unbanked and Underbanked Households*, p. 66, https://www.fdic.gov/analysis/household-survey/2021report.pdf.

116 GAO, *Tax Refund Products: Product Mix Has Evolved and IRS Should Improve Data Quality*, GAO-19-269, April 2019, pp. 23-27, https://www.gao.gov/assets/700/698292.pdf.

117 H&R Block, "0% Interest Tax Refund Advance Loan: Frequently Asked Questions," https://www.hrblock.com/offers/refund-advance/.

Offset

Various payments made by the federal government, including tax refunds, may be reduced before they are issued—or offset—to collect certain debts. In effect, a payment (e.g., a tax refund) is reduced to pay these debts before it is issued to a household, providing a mechanism by which the federal government can collect these delinquent debts.[118]

Tax refunds—including the portion of refunds from refundable tax credits—are subject to general offset rules.[119] Under these rules, the Treasury's offsets (reduces) tax refunds to collect past-due federal and state income taxes, certain past-due child support debts collected by child support enforcement agencies, nontax debts owed to federal agencies, and state unemployment compensation debts.[120] In addition, reductions of nontax federal payments for federal tax debts are done through the Federal Payment Levy Program (FPLP) in conjunction with Treasury.[121] Outside of offset procedures and FPLP, the IRS may reduce tax refunds for federal tax debts.[122]

At the end of FY2020, the U.S. Treasury reported collecting about $10 billion in unpaid nontax debts by offsetting tax refunds. Of that amount, $5 billion was for state child support debt, $3.5 billion was for federal nontax debt (e.g., student loans), $503 million was for state income tax debt, and $225 million was for state unemployment compensation debt.[123] Current data on how much tax refunds were offset for past-due federal tax debts are unavailable, but according to a report from the Treasury Inspector General for Tax Administration, in 2013, "more than $6.8 billion in individual refunds were offset to pay outstanding individual and business tax debts."[124]

Offset mechanisms generally apply to other payments issued by the federal government, and are not unique to tax benefits. However, there are limitations or protections of certain payments from offset actions. For example, veterans' pensions from the Department of Veteran Affairs (VA) and Supplemental Security Income (SSI) are not subject to offset.[125]

[118] IRS, *Topic No. 203 Reduced Refund*, May 18, 2021, https://www.irs.gov/taxtopics/tc203.

[119] See IRC §6402.

[120] 31 C.F.R. §258.8, 42 C.F.R. §664, 31 C.F.R. §285.2, 31 C.F.R. §285.8, respectively.

[121] See IRS, *Federal Payment Levy Program*, last updated March 3, 2022, https://www.irs.gov/businesses/small-businesses-self-employed/federal-payment-levy-program.

[122] Past-due nontax debts that can be collected via offset are generally more than 120 days past due, and federal agencies are generally required to notify the U.S. Treasury of these debts. U.S. Department of the Treasury, Bureau of the Fiscal Service, *Treasury Offset Program (TOP): Frequently Asked Questions for Federal Agencies*, https://fiscal.treasury.gov/top/faqs-for-federal-agencies.html.

[123] See Figures 24 and 25 in U.S. Department of the Treasury, "U.S. Government Non-Tax Receivable and Debt Collection Activities of Federal Agencies," in *Fiscal Year 2020 Report to Congress*, August 2021. By comparison, about $470 million of federal nontax debt was collected via administrative offset, and $507 million of federal tax debt was collected by offsetting federal payments (excluding refunds) via the FPLP. The collection of state child support debt in 2020 was nearly three times the amount in FY2020 as in the previous four fiscal years, when it averaged between $1.7 billion and $1.9 billion. This could be due in part to rules that allowed the first COVID-related stimulus payment to be offset for past-due child support.

[124] Treasury Inspector General for Tax Administration, *Revising Tax Debt Identification Programming and Correcting Procedural Errors Could Improve the Tax Refund Offset Program*, 2016-4-028, March 13, 2016, p. 1.

[125] For a list of payments exempt from offset, see U.S. Department of the Treasury, *Treasury Offset Program: Payments Exempt from Offset by Disbursing Officials*, May 16, 2022, https://fiscal.treasury.gov/files/dms/dmexmpt.pdf.

Garnishment

Garnishment of tax refunds generally refers to debt collection actions *after* a refund has been issued and deposited in a household's bank account. Garnishment may be used to collect debts to governments as well as private creditors. While the mechanics and legal authority for garnishment actions differ from offset—and may vary from state to state—they both have the effect of reducing the amount of a tax refund.

Payments from the federal government that are considered "federal benefit payments"—including Social Security benefits, SSI benefits, veterans' benefits, civil service and federal retirement and disability benefits, servicemember pay, military annuities, and survivor benefits—are generally protected from garnishment for certain types of delinquent debt.[126] Federal tax refunds are not considered federal benefits payments and are generally not protected from garnishment actions under current law. Data on the types of delinquent debts collected via garnishment from federal tax refunds are not publicly available.

Policy Considerations

The collection of past-due debts via offset and garnishment helps to ensure that individuals and organizations that owe money to the federal government and other creditors ultimately pay these debts. The repayment of these debts may also have positive benefits for populations who are owed the debts. For example, collections of past-due child support may benefit families seeking support from a noncustodial parent.[127] But collection activities can also impose significant burdens on those whose benefits are offset or garnished, especially if they are low income or facing a financial hardship.

Policymakers may wish to reduce financial hardship for some recipients of tax benefits, for example by limiting offset or garnishment activities for those whose income is below a certain threshold, who receive certain tax benefits (like the EITC), or who face another hardship, like unemployment. Some tax refunds may be partially protected from offset for past-due federal tax debts under existing IRS practices. For example, the IRS can provide relief to taxpayers facing hardship by issuing an Offset Bypass Refund (OBR), which effectively allows the taxpayer to receive at least a partial refund to address current financial hardships. The National Taxpayer Advocate's research suggests that only a small share of eligible taxpayers may receive an OBR prior to their refunds being issued and recommends making "OBRs systematically available to taxpayers whose refunds include allowable EITC claims."[128] In other cases, a spouse who files jointly may be able to protect part of their refund from offset for a past-due debt owed by their spouse if they are not legally responsible for the debt as an "injured spouse."[129]

Alternatively, policymakers may exempt payments entirely from offset and garnishment activities, as they did with the second round of stimulus payments enacted during the COVID-19

[126] For more information on federal benefit payments that are protected from garnishment, see U.S. Department of the Treasury, Bureau of Fiscal Service, *Guidelines for Garnishment of Accounts Containing Federal Benefit Payments*, March 2020, p. 16, https://www.fiscal.treasury.gov/files/eft/garnishment-guideline.pdf.

[127] For an overview of the Child Support Enforcement program, see CRS In Focus, *The Child Support Enforcement (CSE) Program*, by Jessica Tollestrup.

[128] National Taxpayer Advocate, *Most Serious Problem #10 COLLECTION: IRS Collections Policies and Procedures Negatively Impact Low-Income Taxpayers*, Annual Report to Congress 2021, p. 175, https://www.taxpayeradvocate.irs.gov/reports/2021-annual-report-to-congress/.

[129] See Taxpayer Advocate Service, *Injured Spouse*, February 11, 2022, https://www.taxpayeradvocate.irs.gov/get-help/issues-errors/injured-spouse/.

pandemic, or they may limit offset and garnishment activities for certain types of delinquent federal debts. For example, some view offsetting the refunds of EITC recipients for certain debts—including student loans—as at odds with the credit's goal of ensuring those who work are not in poverty.[130]

When determining whether and/or to what extent to protect tax benefits from offset and garnishment, policymakers may weigh the benefits of collecting certain past-due debts against any hardship such collections could impose on debtors. How should Congress or the IRS prioritize the collection of certain debts over others? What would the impact be on other creditors if they are not repaid and what could the impacts be on borrowers if they think a debt may not need to be repaid? Can limitations on debt collection action be targeted to vulnerable households, so that households with sufficient means to repay their debts without falling into financial hardship do pay?

Historically, the federal government has limited debt collection activities on certain federal benefits among households that may be facing financial hardship. For example, the federal government has limited debt collection actions on programs for low-income populations like SSI, protected portions of tax refunds as part of the IRS's OBR program, and limited debt collection activities on stimulus checks (see "Case Study 7 | Protecting Stimulus Checks Enacted During the COVID-19 Pandemic from Offset and Garnishment").

Case Study 7 | Protecting Stimulus Checks Enacted During the COVID-19 Pandemic from Offset and Garnishment

During the COVID-19 pandemic, Congress approved three rounds of stimulus checks that were each structured as a temporary one-time refundable tax credit advanced using older tax data. (Note that the IRS referred to the advance payments as economic impact payments, while they were colloquially referred to as "stimulus checks." Any additional amount claimed on a federal income tax return was referred to as the recovery rebate credit.) Advocates for these payments often discussed them as a way to provide financial relief to households affected by the economic downturn associated with the COVID-19 pandemic and provide economic stimulus. As such, some viewed a reduction in these amounts, including through garnishment actions, as undermining the payments' policy objectives.[131]

Because these payments were structured as refundable tax credits, they would have been subject to the general administrative offset rules under which Treasury offsets (reduces) tax refunds to collect past-due federal and state income taxes, certain past-due child support debts collected by child support enforcement agencies, nontax debts owed to federal agencies, and state unemployment compensation debts.

130 Some researchers argued, "In recognition of the EITC's role as a critical anti-poverty program and the CTC's role as child assistance, both should be exempted from offset, like Social Security benefits.... As a rule of thumb, exempting 85 percent of EITC/CTC from all debt offset—with the possibility for more generous exemptions in the case of extreme hardship—would bring EITC and CTC offsets roughly in line with standard policy for Social Security offsets." Gabriel Zucker, Cassandra Robertson, and Nina Olson, "1.9 Offset Exemption (for EITC, CTC)," in *The IRS as a Benefits Administrator: An Agenda to Transform the Delivery of EIP, EITC, and CTC*, New America, New Practice Lab, March 24, 2021, https://www.newamerica.org/new-practice-lab/reports/the-irs-as-a-benefits-administrator/.

The National Taxpayer Advocate has proposed that a portion of the EITC received in a refund be protected from offset for any debt. For example, see National Taxpayer Advocate, "Legislative Recommendation #2, Tax Reform: Restructure the Earned Income Tax Credit and Related Family Status Provisions to Improve Compliance and minimize Taxpayer Burden," in *2016 Annual Report to Congress*, Volume 1, pp. 325-357. Also see Persis Yu, *Voices of Despair: How Seizing the EITC is Leaving Student Loan Borrowers Homeless and Hopeless During a Pandemic*, National Consumer Law Center, July 2020, https://bit.ly/voices-despair-eitc.

131 Pamela Foohey, Dalié Jiménez, and Chris Odindet, "Time is Running Out to Protect Americans' Relief Payments from Debt Collectors," Harvard Law Review Blog, April 7, 2020. Lauren Saunders and Margot Saunders, *Protecting Against Creditor Seizure of Stimulus Checks*, National Consumer Law Center, May 6, 2020, https://library.nclc.org/protecting-against-creditor-seizure-stimulus-checks; and Emily Flitter and Alan Rappeport, "Some Banks Keep Customers' Stimulus Checks if Accounts Are Overdrawn," *New York Times*, April 16, 2020, https://www.nytimes.com/2020/04/16/business/stimulus-paychecks-garnish-banks.html.

However, Congress created special rules for the payments. The CARES Act (P.L. 116-136) exempted the first round of payments from these offsets except to satisfy past-due child support.

After the first round of payments were approved, the board of directors of the National Child Support Enforcement Association (NCSEA) adopted a resolution urging Congress to exempt future payments from offset for past-due child support collected by child support enforcement agencies. NCSEA's board of directors urged Congress to

> exclude any future COVID-19 related relief payments from offset for past-due child support until Congress determines that parents who owe past-due support have enough employment opportunities to be self-sufficient without a relief payment.

They also noted that

> Most state and tribal child support programs understood the purpose of the payment was to provide immediate and necessary relief to individuals who may have been impacted by the COVID-19 pandemic. They preferred that the payment be paid to each parent without being offset for past-due support, as the self-sufficiency of both parents was the immediate focus.

The Consolidated Appropriations Act, 2021 (P.L. 116-260), and American Rescue Plan Act (ARPA; P.L. 117-2) exempted the second and third rounds of direct payments from offset, including offsets for past-due child support.

The treatment was different for amounts that individuals received as the recovery rebate credit on their tax returns. None of the acts provided offset protections for the recovery rebate credit. Notably, the CARES Act, as originally enacted, did provide such protections, except for past-due child support; however, the Consolidated Appropriations Act, 2021 amended the CARES Act to remove them, apparently due to administrative concerns raised by the IRS.[132] Thus, all recovery rebate credits were subject to offset under the general rules. However, the IRS announced that it would not reduce the recovery rebate credits claimed on 2020 and 2021 tax returns to satisfy past-due federal tax debts.[133]

Separate from the issue of Treasury offset was the question of whether stimulus checks would be subject to garnishment and other collection actions by private creditors and debt collectors. The Consolidated Appropriations Act, 2021, shielded the second round of direct payments from garnishment and other collection actions.[134] The CARES Act and ARPA did not include such protections for the first and third rounds of payments. Some states took actions to protect the payments from these collection actions,[135] and other federal laws might have provided limited protection in specific circumstances (e.g., for nursing home residents).[136]

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[132] Taxpayer Advocate Service, "NTA Blog: Update on Offset of Recovery Rebate Credits: The IRS Has Agreed to Exercise Its Discretion to Stop Offsets of Federal Tax Debts," April 15, 2022, https://www.taxpayeradvocate.irs.gov/news/nta-blog-update-on-offset-of-recovery-rebate-credits-the-irs-has-agreed-to-exercise-its-discretion-to-stop-offsets-of-federal-tax-debts/.

[133] See IRS, "Q F2: Back taxes: Will the credit be applied to back taxes I owe?" (added January 13, 2022), in "2021 Recovery Rebate Credit—Topic F: Receiving the Credit on a 2021 Tax Return," https://www.irs.gov/newsroom/2021-recovery-rebate-credit-topic-f-receiving-the-credit-on-a-2021-tax-return; and IRS, "Q E2: Back taxes: Will the credit be applied to back taxes I owe?" (updated December 10, 2021), in "2020 Recovery Rebate Credit—Topic E: Receiving the Credit on a 2020 Tax Return," https://www.irs.gov/newsroom/2020-recovery-rebate-credit-topic-e-receiving-the-credit-on-a-2020-tax-return.

[134] See CRS Insight IN11605, *COVID-19 and Direct Payments: Comparison of First and Second Round of "Stimulus Checks" to the Third Round in the American Rescue Plan Act of 2021 (ARPA; P.L. 117-2)*, by Margot L. Crandall-Hollick. This may have been a result of the rules under which the law that included the second payments was considered. The laws creating the first and third stimulus checks were considered under reconciliation, whereas the law creating the second payment was not.

[135] Lori J. Sommerfield and John L. Culhane, "Protection of federal stimulus payments from creditors," Ballard Spahr LLP, April 15, 2021, https://www.consumerfinancemonitor.com/2021/04/15/protection-of-federal-stimulus-payments-from-creditors/.

[136] Centers for Medicare and Medicaid Services, "Nursing Home Residents' Right to retain Federal Economic Incentive Payments," July 11, 2020, https://www.cms.gov/newsroom/press-releases/nursing-home-residents-right-retain-federal-economic-incentive-payments.

Conclusion

The federal income tax is a near universal system that can be used to provide cash assistance to low- and moderate-income families. However, this report identifies a variety of issues with providing assistance through the tax code that policymakers may wish to address so that tax benefits achieve their policy objectives. Some of these issues may be unique to the tax system—like the benefits and limitations of using the income tax return as the application for benefits. Others—like how to deliver benefits to unbanked households—may apply to other types of assistance provided outside the tax code.

These are not the only issues Congress may consider when developing tax benefits for low- and moderate-income families. Congress may consider, for example, whether the culture of the IRS—an agency that has historically focused on compliance with and enforcement of tax law and less on benefits administration—lends itself to being the appropriate agency to issue benefits.[137] Should the IRS embrace its role as a benefits administrator, as has been done by revenue agencies in other countries, or does that impede its central goal of collecting revenue?[138]

Another factor Congress may consider is whether tax benefits are more sustainable and politically popular than other types of cash assistance.[139] Given recent history, policymakers may also want to consider whether debating tax legislation under the budget reconciliation process in the Senate affects their ability to address certain aspects of tax benefit administration.[140] By considering these issues as they create new or modify existing tax-based cash assistance, policymakers may be able to increase the likelihood that their policies achieve their intended goals.

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[137] According to the former IRS Taxpayer Advocate, "To date, the IRS has treated these programs [refundable tax credits] in the same way it treats other tax administration programs, which is to say, from an enforcement-oriented perspective. Its emphasis has been on using remote correspondence examinations, pre-refund fraud detection filters, and automated summary assessment authorities (math errors), sprinkled sporadically with some outreach efforts (see the annual EITC day events)." Nina Olson, "Thinking Out Loud about the Advanced Child Tax Credit—Part 3: the Family and Worker Benefit Unit," Procedurally Taxing (blog), July 1, 2021, https://procedurallytaxing.com/thinking-out-loud-about-the-advanced-child-tax-credit-part-3-the-family-and-worker-benefit-unit/.

[138] For a summary of how Canada, Australia, and the United Kingdom administer their child benefits through the tax code, see Samuel Hammond and David Koggan, *Administering a Child Benefit Through the Tax Code: Lessons for the IRS from Abroad*, Niskanen Center, May 27, 2021, https://www.niskanencenter.org/administering-a-child-benefit-through-the-tax-code-lessons-for-the-irs-from-abroad/.

[139] According to some experts, "Benefits delivered through the tax code are, at least for now, more popular than those delivered through the transfer system." Sam Hammond and Elaine Maag, *Issues in Child Benefit Administration in the United States: Imagining the Next Stage of the Child Tax Credit*, Urban Institute, December 2021, p. 23.

[140] See CRS Report R41408, *Rules and Practices Governing Consideration of Revenue Legislation in the House and Senate*, by Megan S. Lynch.

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