The Case for a Monthly Cost-of-Living Refund

How delivering the EITC as a monthly income boost would maximize real-time impacts for working families.

A monthly cost-of-living increase would maximize the impact of federal and state earned tax credits by giving families an income boost in real time.

EXECUTIVE SUMMARY

Many hard-working Americans struggle each month just to pay their rent, put food on the table, and provide basic necessities for their families. By replacing the Earned Income Tax Credit with a new, modernized Cost-of-Living Refund, we can give workers the option to receive a monthly electronic payment, providing earned tax credits throughout the year to give a boost to their income when they need help.

The federal Earned Income Tax Credit (EITC) is a popular, proven, and effective policy intervention that lifts more families out of poverty than food stamps, housing subsidies, and unemployment insurance combined. Because of its success, the EITC has garnered broad bipartisan support, and 30 states have implemented supplemental state credits.

Though the foundations of the EITC are strong, the decades-old policy is overdue for targeted upgrades that will better meet the needs of working people and a modern economy. Millions of Americans struggle each month to pay their rent, put food on the table, and provide basic necessities for their families. When families receive their state and federal EITC refunds at tax time, some are able to save – but more often than not, their refund goes to unpaid bills or debt accrued throughout the year. In its current structure as a lump-sum payment, the EITC does little to increase incomes in real time throughout the year as bills come in and emergencies come up.

The research is clear that annual lump-sum payments of EITCs cannot adequately meet the challenges working families all year long:

- Low-income families fall behind from month to month because of mounting bills or emergencies, and they need help more frequently than once a year to make ends meet;[1]
- Three in 10 families struggle with incomes that vary from month to month,[2] which makes families much more likely to turn to credit-based financial services like payday loans to get by;[3] and
- Too many working families are forced to use these high-interest debt traps to cover the basics: seven in 10 payday loan borrowers use them to cover regular monthly expenses like rent and utilities.[4]

One key modernization central to the broad EITC modernization and expansion known as the Cost-of-Living Refund is to allow families to choose to receive their federal and state EITC refunds each month as a sort of boost to their income, or to receive them annually during tax season as they do now. A monthly income boost is a simple and straightforward way to support families struggling throughout the year. It would not only help low-wage workers stretch their budgets each month, it would also help bridge the gap when workers face an illness or lose a job.

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[1] FINRA. "Financial Capability in the United States 2016". July 2016. Available at: http://bit.ly/FINRA2015.
[2] Board of Governors of the Federal Reserve System, "Report on the Economic Well-Being of U.S. Households in 2018." May 2019. Available at: http://bit.ly/fedreserve2019.
[3] Federal Deposit Insurance Corporation, "2017 FDIC National Survey of Unbanked and Underbanked Households." Appendix Table D.3. 2017. Available at: http://bit.ly/fdichh2017.
[4] The Pew Charitable Trusts. "Payday Lending in America: Who Borrows, Where They Borrow, and Why." July 2012. Available at: http://bit.ly/pewpayday2012.

Research suggests that providing earned tax credits monthly can benefit families by increasing financial security and providing a dependable alternative to harmful, high-interest debt. Experience shows that federal and state agencies can easily and efficiently administer monthly payments using much of the infrastructure they already have in place. According to our research, providing a periodic option for earned tax credits:

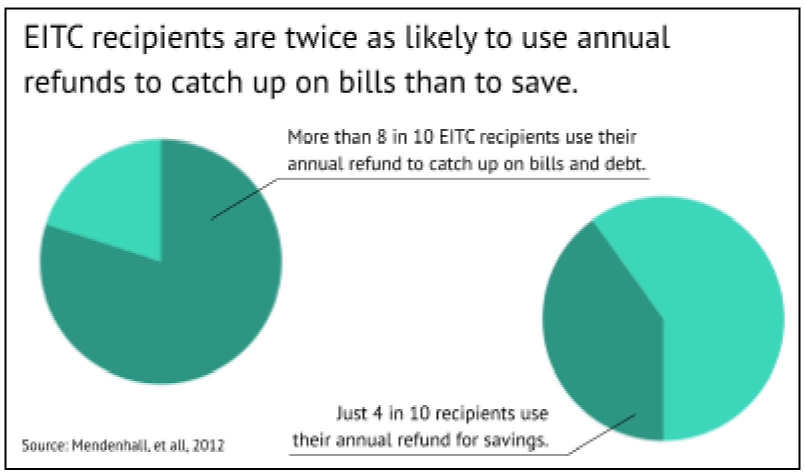
- Is administratively feasible, accurate, inexpensive, and efficient;[5]
- Can smooth incomes and increase household financial security throughout the year;
- Can help families avoid debt traps like payday loans;
- Has broad bipartisan support;[6] and
- Is strongly supported by the low-income households who are likely recipients.[7]

This report highlights the existing research supporting periodic payments of tax credits and provides best practices for providing a periodic payment option for the federal EITC and supplemental state credits.

EVERYDAY AMERICANS NEED HELP MAKING ENDS MEET THROUGHOUT THE YEAR

Most Americans want to be able to make ends meet and take care of their families. In a 2015 survey by the Pew Charitable Trusts, 92 percent of Americans said it was more important to them to have financial security than to move up the income ladder.[8] The research is equally clear that too many Americans grapple with financial precarity on a monthly basis. One recent national survey found that nearly half of Americans have trouble covering monthly expenses,[9] and another found that 39 percent of Americans lack enough funds to cover a $400 unforeseen expense.[10]

One-time refunds at tax time fall short of alleviating financial stress in real time. Under current law, a person becomes eligible for the EITC at the end of the year, based on her earnings throughout that year.[11] At the beginning of the next year, she files her taxes and reports the previous year's earnings to the IRS. If the IRS determines she is eligible for the EITC based on the previous year's income, she receives a lump-sum payment to refund tax payments she made throughout the previous year.[12]



[5] Bellisle & Marzahl (2015), http://bit.ly/chicagopilot.
[6] See House Budget Committee. "Expanding Opportunity in America." July 2014. Available at: bit.ly/GOP_HB. See also Economic Security Project Action, "Side-by-side Analysis of Cost-of-living Refund Policies." Available at: bit.ly/ESPfedCLR.
[7] Bellisle & Marzahl (2015), http://bit.ly/chicagopilot.
[8] The Pew Charitable Trusts. "Americans' Financial Security: Perception and Reality." March 2015. Available at: bit.ly/PewMarch2015.
[9] FINRA. "Financial Capability in the United States 2016". July 2016. Available at: bit.ly/FINRA2016.
[10] Board of Governors of the Federal Reserve System, "Report on the Economic Well-Being of U.S. Households in 2018." May 2019. Available at: http://bit.ly/fedreserve2019.
[11] The system is the same for state EITCs, if a person lives in a state that offers a state supplemental credit.
[12] Because the EITC is refundable, recipients often receive refunds in excess of the taxes they actually paid.

As Tax Policy Center notes: "Delivered as a lump sum after filing a tax return, the credit provides an opportunity to boost savings and purchase durable goods. But a lump-sum credit does not provide adequate assistance to low-income families who might struggle with regularly recurring expenses such as child care, rent, and groceries."[13]

Throughout the year, families get behind because of mounting bills or unexpected expenses. More often than not, families use much of their tax-time refunds to pay off these unpaid bills and debt they accrued throughout the year to meet the basics. And while annual tax refunds have a reputation for encouraging savings, the research suggests otherwise: a 2012 study found that 84 percent of EITC recipients used a significant portion of their tax refund to pay overdue bills and credit card debt, while only 39 percent were able to allocate their refund to savings.[14]

In a survey of tax filers in that same year, respondents cited the months leading up to tax refund time – November, December, and January – as the hardest months to make ends meet.[15] So while yearly tax refunds help at the time recipients get them, the research suggests that tax credits could do more to end cycles of unnecessary debt if they were paid out more regularly.

Families are forced to turn to debt traps like payday loans to cover the basics throughout the year. Widespread income volatility and uncertain monthly expenses exacerbate economic insecurity. In 2018, three in 10 adults had incomes that varied from month to month, and one in 10 reported struggling to pay their bills in the previous year because of uncertain income.[16] Too often, unreliable income and expenses force families to take on credit cards and high-interest payday loans to fill the gap from month to month. A 2017 FDIC survey found that households whose incomes vary somewhat or a lot from month to month are significantly more likely to use credit-based financial services, like payday loans, than those whose income is the same each month.[17] (See the box for more information on the impacts of payday loans in America.)

HIGH-RISK PAYDAY LOANS CREATE UNNECESSARY CYCLES OF DEBT

Despite the documented risk and long-term costs, millions of families are forced to turn to payday loans not only to get out of financial crises, but also for regular monthly expenses. Payday loans are notoriously risky and extremely expensive, with typical annual percentage rates (APR) exceeding 300 percent in most states and nearing 700 percent in others.

A 2012 Pew report on payday lending in America found:

- 12 million Americans take out payday loans every year.
- The average borrower borrows $375 eight times a year and pays $520 in interest.
- Seven in 10 borrowers use payday loans for regular, recurring expenses, such as rent, credit card bills, or utilities.

As with many other public policies, predatory financial services have disparate impacts based on race, age, disability status, and other factors. A 2017 FDIC national survey found that usage of payday loans and other credit-based financial services is higher than average among borrowers who:

- Are unbanked;
- Earn less than $50,000 a year;
- Do not have a college degree;
- Are under age 55 (particularly those under 25);
- Are Black, Hispanic, or identify as some other race;
- Have a disability; and
- Whose income varies somewhat or a lot from month to month.

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[13] Elaine Maag, et al. "Redesigning the EITC: Issues in Design, Eligibility, Delivery, and Administration." June 2019. Tax Policy Center, Urban Institute & Brookings Institution. Available at: "https://urbn.is/36kJDnX.

[14] Mendenhall, et al. "The Role of Earned Income Tax Credit in the Budgets of Low-Income Families." Social Service Review. September 2012. Available at: bit.ly/mendenhall2012.

[15] Stephen Holt. "Periodic Payment of the Earned Income Tax Credit Revisited." Brookings Institution Metropolitan Policy Program. December 2015. Available at: brook.gs/holt_2015.

[16] Board of Governors of the Federal Reserve System, "Report on the Economic Well-Being of U.S. Households in 2018." May 2019. Available at: http://bit.ly/fedreserve2019.

[17] Federal Deposit Insurance Corporation, "2017 FDIC National Survey of Unbanked and Underbanked Households." Appendix Table D.3. 2017. Available at: http://bit.ly/fdichh2017.

A MONTHLY PAYMENT OPTION WOULD GIVE FAMILIES FLEXIBILITY TO ADDRESS FINANCIAL NEEDS AS THEY ARISE

Offering a monthly option for earned tax credits at the federal and state levels lets recipients choose what payment structure works best for them, combining the best features of monthly and annual payments.[18] If both federal and state earned tax credits offered a monthly option, participants could elect to receive both credits monthly or annually, or some combination of both. For example, a taxpayer could choose to receive their state credit as an annual lump sum, and pair it with a monthly income boost through their federal credit. This would guarantee a monthly income boost to help in real time, while preserving the savings and debt-reduction assistance that annual lump-sum payments can provide.

Unlike annual refunds, a monthly option can offer a cushion when a family faces a mid-year crisis, like an illness or a job loss. Or it can help stretch monthly budgets to cover the basics. As one low-income Fresno woman said in a focus group, "That's the phone bill, or that's the electric." A dependable monthly cash infusion, even a small one, could also reduce the need for payday loans and other debt traps that keep a grip on families for months or even years at a time.

> **"That's the phone bill, or that's the electric."**
>
> –Potential CLR recipient in Fresno, CA on what a monthly refund would mean.

When it comes to the intricacies of how Americans make ends meet each month, nobody is in a better position to know what their family needs than they do themselves. Providing the greatest level of flexibility is one of the best ways to help people meet their own unique financial challenges.

HOW FREQUENTLY SHOULD PERIODIC PAYMENTS BE DISBURSED?

A commonly proposed alternative to monthly payments is to offer payments quarterly (every three months). The frequency of payments depends partly on how policymakers view the goal of the EITC. Both quarterly and monthly payments would have the benefit of increasing real-time financial security by spreading the credit across the year in more regular increments. Some research suggests that quarterly payments may be more successful to offset a small financial shock, since they are less likely to be absorbed into monthly budgets and spent in the normal course of the month.[19] Monthly payments may be better at helping families keep up with financial obligations throughout the year, because they match up better with the frequency of common expenses that low-income families incur, such as rent, child care, and utilities. While both structures have valuable features, we prefer monthly payments because they are more likely to meet the overarching goal of helping families make ends meet in real time.

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[18] An alternative to allowing the entire credit to be received monthly is to restrict the monthly option to a certain portion of the credit, which has the benefit of reducing the risk of overpayment. For example, the Worker Relief and Credit Reform Act of 2019 proposes offering monthly payment for 75 percent of a recipient's estimated federal EITC. See Worker Relief and Credit Reform Act of 2019, H.R. 5271, 116th Cong. (2019). Available at: bit.ly/HR_5271.

[19] See Sahm, et al. "Check in the Mail or More in the Paycheck: Does the Effectiveness of Fiscal Stimulus Depend on How It Is Delivered?" American Economic Journal: Economic Policy. August 2012. Available at: http://bit.ly/2O4xIUP.

EXPERIENCE SHOWS THAT MONTHLY PAYMENTS ARE FEASIBLE

Periodic payments through electronic payments and prepaid debit cards are administratively feasible. In an EITC periodic payment pilot conducted recently in Chicago, recipients were given half of their estimated 2014 EITC in four quarterly payments throughout the year. The pilot concluded that periodic payments are administratively feasible, noting that "[a]ll participants were able to provide initial bank account or prepaid debit card information to receive the payments electronically and keep the direct deposit information updated throughout the year."[20] (Read more about the Chicago pilot on the following page.)

There is precedent at the federal level for periodic payment of the EITC, which provides valuable lessons for policymakers to improve future proposals. From 1979 to 2010, the federal EITC offered a partial advance payment, called the Advanced Earned Income Tax Credit, which was paid during the year in installments tacked onto a recipient's paycheck. However, a series of flaws in the program meant few people chose it. First, there was little publicity about the advance credit option. It also required recipients to ask employers to provide the advance, creating stigma in the workplace as well as added complexity for employers administering the credit. In addition, several design flaws increased the risk of overpayment. The information used to estimate participants' income and credit ahead of time did not take into account earnings from multiple jobs, a spouse's earnings, or fluctuations in wages throughout the year, which put participants at risk of owing taxes in April if their credit was overestimated.[21] These are risks that smart design choices can safeguard against in future programs. Streamlining applications for the monthly option with normal state and federal tax filings wouldn't require employers to play a central role in administering the program, and credit estimates would be based on all household earnings reported to the IRS.

Electronic periodic payments are inexpensive to administer. EITCs are generally very inexpensive to administer, with administrative costs at the federal level below one percent of total program cost.[22] State EITCs are similarly efficient, with existing state EITCs costing less than one percent of state revenue per year.[23] Fiscal estimates from states who have explored periodic payment options also suggest that providing periodic payments, especially using electronic payments, would maintain low administrative costs. For example, in Colorado, where a state EITC with periodic payment was proposed by initiative in 2018, the state estimated the administrative cost of an expanded state EITC that included a monthly option. It estimated that if 25 percent of refunds were on debit cards, the cost of debit card servicing would be only 0.2 percent of the cost of the state EITC, and its estimate treated the cost of electronic funds transfers as a minor expense.[24] While revenue agencies often argue that their computer systems are inadequate to administer periodic payments, states and the federal government administer other safety net programs on a periodic basis, so there is every reason to believe that with funding for implementation, the technical hurdles are surmountable.

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[20] Bellisle & Marzahl (2015), http://bit.ly/chicagopilot.
[21] Stephen Holt. "Periodic Payments of the Earned Income Tax Credit." Brookings Institution Metropolitan Policy Program. June 2008. Available at: https://brook.gs/2NT3T9A.
[22] Greenstein, Wancheck & Marr, "Reducing Overpayments in the Earned Income Tax Credit." Center on Budget and Policy Priorities. January 2019. Available at: http://bit.ly/315g1db.
[23] Erica Williams & Samantha Waxman, "States Can Adopt or Expand Earned Income Tax Credits to Build a Stronger Future Economy." Center on Budget and Policy Priorities. March 2019. Available at: http://bit.ly/2ObhxFp.
[24] Greg Sobetski. "Initiative # 134 Initial Fiscal Impact Statement." Colorado Legislative Council Staff. Available at: http://bit.ly/CO_134.

A PROVEN SUCCESS: THE CHICAGO PERIODIC PAYMENT PILOT

In 2015, the Center for Economic Progress released a report detailing a recent EITC periodic payment pilot in Chicago. Some participants were given half of their estimated 2014 EITC refund in four quarterly payments, while the control group received their EITC as normal, in one annual payment. The report concluded that:

- **Periodic payments improve financial stability.** Participants who received periodic payments experienced less stress meeting monthly expenses and had more disposable income to meet real-time needs throughout the year.
- **Periodic payments help people avoid payday loans and late fees.** Compared to the participants who received annual lump-sum payments, those who received periodic payments were half as likely to report having a payday loan, and they experienced a 45 percent reduction in payday loans throughout the study. They were also half as likely as the control group to have paid late fees in the prior two months.
- **Regular injections of cash are used mainly on necessities**. Researchers found that 86 percent of the funds paid periodically were used to pay bills, pay down or avoid debt, or cover necessities like groceries or transportation.
- **Periodic payments help people save money.** The share of participants planning to save a portion of their 2014 tax refund doubled from the year before, suggesting that periodic payments might improve recipients' capacity for saving at tax time. Thus, a state EITC paid monthly would allow recipients to save more of their federal EITC as a financial cushion.
- **Nearly all participants preferred periodic payments.** Perhaps most importantly, at the end of the study, nine in 10 recipients of periodic payments expressed a preference for the periodic payment model over a single lump sum. One remarked that it is "nice to have extra money to attend to and balance out monthly expenses and to be in a position to save for emergencies and rainy days." Half the people in the lump-sum control group were interested in a periodic payment alternative.[25]

A PERIODIC PAYMENT OPTION HAS BROAD POLITICAL AND PUBLIC SUPPORT

Providing an option for periodic payments has bipartisan support. The national discussion about the virtues of periodic payments of the EITC has been going on for some time, with support from both conservative and progressive thought leaders, and both Republicans and Democrats in Congress. Below is a partial list of recent proposals to include a periodic option:

- The American Enterprise Institute, in a 2017 paper, proposed to model EITC payment on the periodic payment option in the Affordable Care Act;[26]
- The Center for American Progress, in a 2014 report, argued for a provision in the EITC that would allow workers to receive a portion of their credit ahead of tax time through their paychecks;[27]

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[25] Bellisle & Marzahl (2015), http://bit.ly/chicagopilot.
[26] Angela Rachidi. "The American Safety Net: A Primer On Welfare Programs For Low-income Families." American Enterprise Institute. January 2017. Available at: http://bit.ly/2RwFr08.
[27] Vallas, et al. "Harnessing the EITC and Other Tax Credits to Promote Financial Stability and Economic Mobility." Center for American Progress. October 2014. Available at: https://ampr.gs/2RmH6FB.

- The House Budget Committee, chaired by then-Speaker Paul Ryan, endorsed periodic payments in 2014 to improve simplicity and delivery of the EITC;[28]
- Several Democratic lawmakers and 2020 presidential candidates have recently proposed EITC expansions featuring a monthly payment option, including: Sen. Harris (LIFT Act); Sen. Booker (Rise Credit); Rep. Moore (WRCR Act), Rep. Tlaib (BOOST Act, endorsed by Sen. Sanders); Rep. Watson Coleman (EITC Modernization Act); Sec. Julian Castro (Working Families First Credit); Sen. Bennet; and Mayor Bloomberg.[29]

Recipients in a pilot overwhelmingly preferred periodic payments to lump sums. A recent experiment where recipients actually got periodic payments revealed that they strongly prefer it to the status quo. At the end of the Chicago periodic payment pilot described above, nine in ten recipients expressed a preference for the periodic payment model over a single lump sum. Most recipients also reported experiencing less stress in meeting monthly expenses.[30]

> **"It's nice to have extra money to attend to and balance out monthly expenses and to be in a position to save for emergencies and rainy days."**
>
> –Chicago pilot participant, on receiving quarterly EITC payments.

A majority of low-income people want a periodic payment option in the EITC. In a 2019 nationwide online poll of adults with self-reported income below $50,000, a majority indicated a preference for advance periodic payments, compared to a lump sum (see chart below).[31] A similar survey in Illinois in 2018 found a majority of survey respondents would prefer a periodic option. This preference has shown up in focus group research as well. In a series of California focus groups in 2017 conducted by David Binder Research, low-income voters showed deep concern about the rising cost of living, including housing and gas. Across all groups, especially women of color, participants felt that they were one bad break away from financial ruin, and that regular payments would help with cash flow, paying off debt, and items for their children.

BEST PRACTICES FOR IMPLEMENTING A PERIODIC PAYMENT OPTION

Make periodic payment the default. Evidence from the Chicago pilot shows that participants overwhelmingly prefer the periodic payment once they experience it. While only half of the control group participants were interested in a periodic option when asked at the outset of the pilot, 90 percent of participants who in fact received periodic payments said they would choose it again. Given this disparity, it is reasonable to create a small incentive for monthly payments while still giving recipients a choice: make monthly payments the default, and provide a simple election on the form (such as a checkbox) for recipients to choose a lump sum instead.[32]

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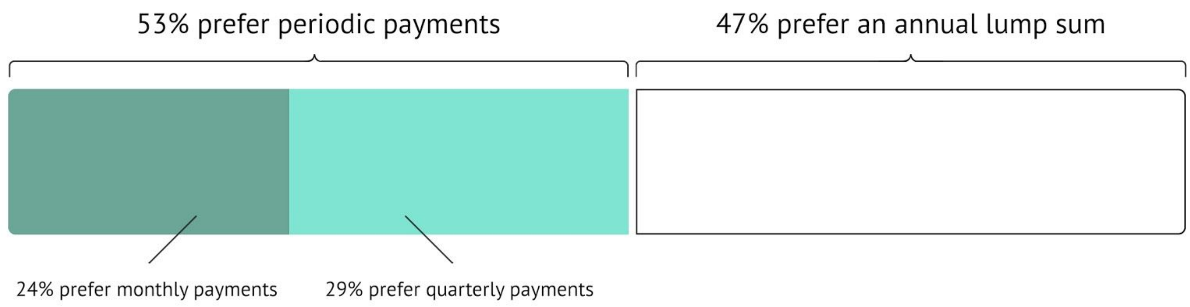
[28] House Budget Committee. "Expanding Opportunity in America." July 2014. Available at: http://bit.ly/GOP_HB.
[29] See Economic Security Project Action, "Side-by-side Analysis of Cost-of-living Refund Policies." Available at: bit.ly/ESPfedCLR. Mayor Buttigieg's plan to expand the EITC includes an option to advance up to $500 of the federal credit.
[30] Bellisle & Marzahl (2015), http://bit.ly/chicagopilot.
[31] Survey conducted by Economic Security Project Act, available at: bit.ly/Dec2019survey.
[32] Some have suggested that an alternative approach making monthly payment the default for state credits, and lump-sum the default for federal credits, or vice versa, could provide some value to recipients.

In a recent nationwide survey, a majority of lower-income respondents preferred periodic payment over annual lump sum



Source: Economic Security Project, bit.ly/Dec2019survey

Mandate electronic payments by direct deposit or prepaid debit cards. It is essential that monthly payments be made available primarily by electronic payments, to reduce administrative costs and to prevent recipients from losing a substantial amount each month in check-cashing fees. Most recipients will use direct deposit, and prepaid debit cards should be available as an option for unbanked recipients. Many states have existing contracts with debit card vendors for other social programs. To reduce administrative costs, set a minimum amount to be eligible for monthly payments.

Make periodic payments available to all EITC recipients. To reach the largest population possible of those in need, periodic payments should be available to all recipients. A more limited (and complex) approach would be to restrict eligibility initially to those who have received a credit in a specified number of previous years to increase the likelihood of actual eligibility and narrow the participant universe. . While this could reduce the risk of overpayment, it excludes otherwise eligible recipients who would benefit from periodic payment, and undermines one of the strongest benefits of the monthly payment option: contemporaneous financial support to meet real-time needs.

Provide real-time payment, based on the current tax year. Typically, the EITC is paid out in a lump sum based on the previous year's income. That is, payment is delayed until the year following the tax year during which workers earned the credit. This is a simple approach, but it does not respond to financial needs as they arise. For periodic payments, the preferred approach is to disburse the credit during the tax year in which claimants earn the credit, rather than waiting until tax time the following year. This helps families when they actually need funds. While it requires advance prediction of annual income to determine eligibility, the research shows that households can do this with accuracy.[33] Additionally, many of the recent federal proposals to expand the EITC are substantially simpler, which would make prediction of credit estimates easier.[34]

Include safeguards to reduce the risk of overpayment. One of the shortcomings of previous attempts to implement advance periodic payments is that previous designs failed to adequately account for the risk of overpayment. One safeguard is to make only a portion of the credit available for periodic payments, so that any overpayment can be drawn from the remaining balance at the end of the year. Several current and recent proposals promote this version of the monthly option. Programs can also include safe-harbor provisions to

[33] Bellisle & Marzahl (2015), http://bit.ly/chicagopilot.
[34] See Economic Security Project Action, "Side-by-side Analysis of Cost-of-living Refund Policies." Available at: bit.ly/ESPfedCLR.

ensure that good-faith claimants don't face large penalties for unexpected changes in circumstances, such as a mid-year raise. The public popularity of the Affordable Care Act advance premium tax credit, which can result in overpayment at the end of the year, indicates that the existence of some overpayment in a program is not a fatal flaw.[35]

For state credits, advocates should work with their Congressional delegation and across state agencies to ensure these payments do not penalize recipients of other safety net programs. Generally, tax refunds are not treated as income for the purposes of eligibility for other safety net programs. But federal law is ambiguous and sometimes inconsistent on this topic as it relates to periodic payments. It's important that state policies are explicitly designed to avoid the unintended consequence of jeopardizing a worker's participation in other safety net programs through periodic payments.

[35] Internal Revenue Service. "The Premium Tax Credit - The Basics." Available at: http://bit.ly/2U3xqS8.