Monthly EITC Payments

Recommendations for California

February 2019

Monthly payment of the EITC helps make ends meet. Instead of a lump sum, households receive distributions throughout the year, raising their income and smoothing volatility.

OVERVIEW

As more states and local jurisdictions consider modernizing their earned income tax credits, many are considering innovative ideas to get cash into working Americans' wallets consistently throughout the year. ESP advocates for monthly payment of the EITC to better help families make ends meet. Instead of waiting all year to receive their EITC at tax time, families would receive distributions throughout the year, raising their income every month and smoothing volatility.

After deciding to pursue periodic payment of the EITC, California policymakers will face several additional policy and implementation questions that will need to be resolved before the program can be launched. This memo summarizes some of the most important questions to consider.

KEY POLICY QUESTIONS AND RECOMMENDATIONS:

1. *Should the program provide real-time disbursement or delayed payment?*

Typically, EITC is paid out in a lump sum based on the previous year's income. Disbursing the EITC during the tax year in which claimants earn the credit (the current tax year, rather than waiting until tax time the following year) helps families when they actually need funds, but requires advance prediction of annual income to determine eligibility. Delayed payment (paying out the credit starting at tax time the next year and spread out over the following 12 months) does not require prediction, but does not respond to financial needs as they arise.

> **Recommendation**: ***Under California's current EITC structure*, provide a deferred credit, but also provide a reasonable rate of interest to claimants.** Given California's existing EITC structure, with a steep phase-in and phase-out, and with the largest credits concentrated among extremely low-income filers, it is difficult for filers to predict their credit accurately, making real-time payments challenging. Therefore, at this time, deferred payments are recommended. To encourage and enable claimants to select monthly payments, the state should provide reasonable interest on the amount of credit owed, including perhaps a subsidized interest rate. However, when California changes its EITC structure, it should then reconsider moving to real-time payments, which are superior in providing help when it is needed.

2. *What agency should administer payments?*
Policymakers could delegate responsibility for the program to tax agencies or to agencies that run existing benefit programs and may have existing infrastructure for monthly payments.

> Recommendation: **Consider delegating administration to the Franchise Tax Board.** It collects income data necessary to calculate EITC benefits and eligibility, and largely has payment infrastructure in place.

3. *How should payments be distributed?*
Payments could be offered by debit card, direct deposit, check, or added to paychecks by adjusting withholding.

> Recommendation: **Mandate electronic payments, by direct deposit or debit cards only.** Check cashing and predatory loan companies prey on financially vulnerable Americans, and payments by check increase their opportunity to do so. Dispersal through a paycheck line item may go unnoticed and burdens employers with administering a program. Paying by direct deposit or debit cards ensures that those who need these payments actually recognize and receive them, provided that debit cards do not charge significant fees.

4. *Should periodic payments be made monthly or quarterly?*
Monthly payments provide more consistent assistance and additional flexibility, but quarterly payments provide larger sums.

> Recommendation: **Make periodic payments monthly.** Monthly payment makes sense for the simple reason that a significant portion of expenses for low- and middle-income families are monthly or more frequent (e.g., rent, child care, utility bills). Monthly payments also give recipients the flexibility to save a small amount at a time and build up a savings cushion.

5. *Should monthly payments be optional or mandatory for the recipient?*
A universal system of monthly payments may be simpler to administer. However, EITC filers accustomed to receiving a lump sum may be surprised not to receive it. Making the monthly payments optional gives recipients the ability to choose which mode is better for them.

> Recommendation: **Make monthly payments optional for the recipient.** Surveys have found that about half of respondents would initially prefer a periodic payment, and half would rather receive a lump-sum payment that some find preferable for savings. Some studies have also found that filers are very satisfied with periodic payments once they receive them. Data from behavioral economics suggests that the best mechanism for this selection is a simple forced choice (with no default option) between monthly payments and a lump sum payment. A middle option could also be added, for “half of your refund in periodic payments and the other half in a lump sum.” (In a state with an advance credit, clearly a worker needs to be able to claim a lump sum credit the next year if they don’t file for an advance.)

6. *Should periodic payments be available to all EITC recipients?*
A range of recipients may prefer monthly payments, but some may be eligible only for small amounts. With deferred payments, there is no risk of overpayments. Only those claimants who are eligible for EITC, and have a known credit awaiting them, would receive the payments.

Recommendation: **Make periodic payments worth electing.** Some participants in prior studies on periodic payments found them unhelpful when the payments were too small. Consider extending eligibility for periodic payments only to those who will be entitled to at least $20 per month. If monthly periodic payments would be too low to make a meaningful difference for many recipients, consider allowing taxpayers to elect quarterly payments instead.

7. *Will monthly payments affect other safety net programs?*
Generally, tax refunds are not treated as income for the purposes of eligibility for other programs.

Recommendation: **Work with your Congressional delegation and across state agencies to ensure these payments do not penalize recipients of other government aid.**

ADDITIONAL CONSIDERATIONS FOR IMPLEMENTATION:

Policymakers should engage early in conversations with the agencies who will oversee periodic payments to ensure that they are prepared for implementation, and so they can provide information about their existing limitations that will need to be mitigated. For example, what will the costs of administering a periodic payment program be? (*Note: The state of Colorado estimated this cost, including about $1 per recipient for debit card servicing, and about $3.50 per recipient for additional staffing.)*