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Stop Taking the Earned Income Tax Credit from Struggling Student Loan Borrowers

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SLBA
Student Loan Borrower Assistance

Executive Summary

The U.S. Treasury is seizing Earned Income Tax Credit (EITC) refund checks from the working poor to repay student loans that are in default. Many of the borrowers facing these seizures were unable to realize the promised benefits of education. Systemic obstacles, a lack of effective support, and abusive practices often precede a borrower's default. The government's policy of seizing these borrowers' EITC runs counter to almost every goal Congress set for the EITC and its student loan programs.

The main victims of these EITC seizures are children, since by far the largest EITC payments go to families with children, and the seizures can have a dramatic impact on children's well-being. The seizures also prevent former students from obtaining and keeping employment and pursuing further education.

By taking EITC payments, the government compounds the existing inequities and injuries that low-income borrowers have already borne. Rather than fulfilling the EITC's goal of lifting hard-working individuals and their families out of poverty, the seizures have the opposite effect of trapping low-income families in poverty.

The effect of the government's EITC seizures is punitive. Whereas defaulted low-income borrowers may face EITC seizures of thousands of dollars, low-income borrowers in good-standing with the same amount of debt have notably lower payment obligations, potentially as low as $0 a month. The seizures even penalize borrowers who are actively utilizing programs designed to get their loans out of default and into good standing, impeding their ability to do so.

While many federal benefits are exempt from seizure, it is anomalous that payments made under one of the most effective anti-poverty programs are subject to seizure, especially since these seizures are made to repay benefits obtained in another government program whose goals include helping the poor find employment.

In order to address the harms caused by the government's current EITC seizure policies, lawmakers should pursue a statutory solution for exempting student borrowers' EITC

payments from seizure. In the interim, the U.S. Department of Education should work with the U.S. Treasury to reimburse the seized EITC payments of low-income borrowers.

Introduction: EITC Seizures Hinder Employment and Push Families Back Into Poverty

What is the EITC?

The Earned Income Tax Credit (EITC) is an anti-poverty government program that provides crucial support to low-income working families. A taxpayer's EITC is calculated as a fixed percentage of earnings until the credit reaches a maximum amount. The credit is fully refundable, meaning that if a family's EITC is greater than its income tax liability, the excess is paid as a tax refund. The amount of the EITC varies based on a recipient's income, marital status, and number of children.[1] By design, the EITC provides substantially more support for families with children.

The EITC has been lauded by Republicans and Democrats alike as one of the federal government's most successful job-creation and anti-poverty programs. [2] President Reagan described the EITC as "the best anti-poverty, the best pro-family, the best job creation measure to come out of Congress."[3] Studies have found that it is one of the government's most significant antipoverty programs, credited with lifting millions of individuals—and particularly children—out of poverty.[4] The EITC also reduces income inequality.[5]

A study by the Congressional Research Service found that, in 2012, the EITC was responsible for a reduction of over 14 percent in the poverty rates of unmarried individuals with children and a reduction of over 20 percent in the poverty of married individuals with children.[6] In 2013 alone, the EITC was credited with raising more than 6 million people out of poverty, including more than 3 million children.[7] That year the EITC was also credited with reducing "the severity of poverty" for an additional 21.6 million people, including 7.8 million children.[8]

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In particular, the EITC has had a positive effect on the workforce participation of single mothers.[9] One study found that EITC expansions were responsible for 34 percent of the increase in employment among single mothers between 1993 and 1999.[10] In addition to encouraging employment, the EITC has led to a reduction in welfare caseloads.[11]

By seizing the EITC payments of low-income borrowers who have defaulted on their student loans, the government strips these borrowers of their best chance at getting out of poverty and improving their lives and the lives of their children. In fiscal year 2008, the

U.S. Treasury subjected 1.3 million tax returns claiming the EITC to tax refund seizure procedures.[12] It is ironic that the government policy of exempting benefit programs for the poor from government seizure does not protect perhaps the most effective anti-poverty program the government offers.

EITC Seizures Further Victimize the Victims

Both federal student loans and the EITC are aimed at lifting low income families out of poverty. But EITC seizures and many aspects of the current federal student loan system have the counterproductive effect of pushing low-income borrowers further into poverty.

The obstacles facing low-income students leave them at a higher risk of ending their education without a degree and defaulting on their student loans. In 2013, bachelor's degree attainment rates for students who began a degree program were 78 percentage points lower for students from lower income families than for students from higher income families.[14]

These lower completion rates are often caused by factors that are out of a borrower's control and cannot be explained by lower education achievement.[15] The absence of a social and economic safety net, a lack of guidance, and the need to continue working while in school pose serious obstacles to college completion for low-income students.[16]

A 2012 Pell Institute report found that low-income students were roughly 3.5 times more likely to attend a private for-profit college.[17] For-profit schools are associated with a multitude of problems, including aggressive and misleading recruiting, uncertain academic quality, low spending on instruction as compared to marketing, lack of student services, and poor job placement services.[18] The students attending these for-profit institutions are more likely to experience low graduation rates, high debt loads, and high rates of student loan default.[19]

Voices of Borrowers: Tax Refund Was Seized, and Now Struggles to Get Housing and Child Care for Her Children

"This year my taxes were taken by the department of education. Unfortunately this has happened at a very bad time. Currently I am sleeping on my mothers couch with my 1 yr old and my 7 yr old sleeps on the other couch . . . We have been living with my mom for 2 months now. I lost my job because I couldn't get proper child care for my children. I owe a balance to the public housing authority . . . which is why nobody will rent to me, I was planning on using my taxes to pay that off. Before my taxes were taken I was and still am on a repayment plan to get out of default with my student loans. As of right now my children and myself are house to house with family so we don't risk getting my mom in trouble with her landlord. I'm looking for help but its not a lot of that here in this city. I'm praying for a miracle."[13]

Students targeted by for-profit colleges' high pressure recruitment tactics are often misled about the cost of their degree program, loan terms, completion rates, and job placement rates, as well as their ability to transfer credits and the school's accreditation status.[20] After falling victim to these misleading advertising techniques, students who attend for-profit colleges usually leave before completing their programs. Fifty-four percent of students who enrolled in a for-profit college for the 2008-09 academic year left their school without a degree by the middle of 2010.[21]

Borrowers who do not complete their degrees are three times more likely to default on their student loans than borrowers who graduate,[22] and the rise in student loan delinquency and default is associated with the rise in the number of borrowers—particularly low-income borrowers—attending for-profit institutions.[23]

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Students of color are disproportionately injured by this inequitable system.[24] On average, students of color take out more student debt than white students and make up a disproportionately large portion of the student body at for-profit institutions. Higher debt loads, "combined with disparities in education and broader societal inequalities, including the racial wealth gap and discrimination in the labor and credit markets—has contributed to higher default rates for students of color."[25] Without sufficient support systems or adequate protection from abuse, low-income borrowers and borrowers of color are often set up for failure and are then left holding the bag when they are unable to pay their student loans.

EITC Seizures Hit Low Income Children the Hardest

Seizures of EITC refunds hit low income children the hardest. By design, the EITC provides substantially more support for families with children. The amount of the EITC varies based on a recipient's income, marital status, and number of children.[26] In 2015, families with two children could receive a credit of up to $5,548 and families with one child could receive a credit of up to $3,359, but workers without children could receive no more than $503.[27] The majority of EITC recipients are individuals with children.[28]

The EITC has had tremendous success in improving outcomes for children, pulling more than 3 million children out of poverty in 2013 alone and reducing the severity of poverty for another 7.8 million children that year.[29] Recent research has consistently confirmed that pulling children out of poverty when they are young produces significant benefits throughout their lives. Such poverty reduction is associated with better health outcomes and schooling for children, as well as higher college attendance rates, more hours worked, and higher earnings in adulthood.[30] The EITC may improve infant health: "infants born to mothers who could receive the largest EITC increases in the 1990s had the greatest improvements in such birth indicators as low-weight births and premature births."[31] Receipt of the EITC is linked to improved school performance and higher college attendance rates for the children of recipients."[32] Seizing borrowers' EITC payments deprives their children of these crucial opportunities.

EITC Seizures Run Counter to the Department of Education's Own Goals

> **In A Borrower's Own Words: Her Federal and State Tax Refunds Were Taken, and Now She's Facing Eviction**
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> "My entire federal and state taxes were taken and also I'm being garnished every paycheck. What I was planning to use my taxes on this year is to catch up on rent which is $1200 so I wouldn't get evicted I was planning on purchasing a more reliable vehicle as mine has been broke down for some time now. Was going to stock up on food and also I owe a couple family members money from helping me pay some bills during the year. My house had been robbed and was going to purchase a few items of my children's that was taken and also we have Christmas after taxes and so my children did not get any Christmas gifts or a Christmas this year. To top matters off as they are garnishing me now too and so I'm short every month and falling more and more behind every paycheck and on the verge of losing everything. My water, heat, electric are all closeto being shut off and landlord is asking me about rent. I can't ask for any help from family as I owe them already and they won't help until paid."

The government's policy of seizing borrowers' EITC payments also runs counter to the Department of Education's goals of securing repayment of student loans[33] and giving borrowers the opportunity to make fair, affordable monthly payments.[34] The Department of Education offers a student loan borrower several different income contingent repayment plans, but only for borrowers who have cured their default and resume regular payments.

The U.S. government's policy of seizing EITC refunds has the irrational effect of making it *harder* for low-income borrowers to get their loans out of default, resume a regular payment plan, and realize the benefits of education. Particularly counterproductive is the government's policy of continuing to seize the EITC of borrowers who are actively in the process of getting their student loans out of default through loan rehabilitation. Through "rehabilitation," a borrower may get a loan out of default by making nine consecutive on-time payments over a period of ten months. The payment amount is determined based on the borrower's income.

The government's practice of seizing borrowers' EITC payments while borrowers are in the process of trying to rehabilitate their loans sets these borrowers up for failure and notably diminishes the likelihood that these borrowers, who are making a good-faith effort to repay their loans, will be able to do so.

For example, an unmarried borrower making $25,000 per year with two children would have a rehabilitation payment of only $5 a month to get his or her loans out of default. However, the same borrower would lose approximately $4,000 in seized EITC payments, even while going through the process of loan rehabilitation.[35] Such a dramatic seizure may make it impossible for a low-income borrower to pay rent and buy food, much less complete the payments necessary to rehabilitate the loan. The EITC seizures thus thwart borrowers' efforts to get their loans out of default and run counter to the Department of Education's goals of decreasing default rates and giving borrowers the opportunity to make affordable payments.

The U.S. government's policy of seizing EITC refunds has the irrational effect of making it harder for low-income borrowers to get their loans out of default, resume a regular payment plan, and realize the benefits of education.

EITC Seizures Are Particularly Draconian and Arbitrary

To recover student loans in default, the Department of Education can administratively garnish 15 percent of wages, offset certain government benefits or payments, and seize income tax refunds. While a borrower can often get relief from a wage garnishment or benefits offset on the basis of financial hardship, the U.S. Department of Education rarely refunds a seized tax refund due to financial hardship and will only do so in the case of "extreme hardship." It generally limits extreme hardship to imminent eviction or foreclosure.[36]

Moreover, the same borrowers whose EITC is seized may simultaneously be subject to wage garnishment and to offset of certain government benefits. The sudden impact of multiple seizures can result in loss of a home, a vehicle needed to get to work, or other consequences that can throw a family back into poverty.

A Borrower's Own Words: Tax Refund Was Seized and Now Homeless

My family and I have been staying in a scattered home shelter since June 2015. We were planning on using our tax money to get back on our feet. Unfortunately it didn't happen. My husband and I both owed student loans 5000$ a piece and they took it… All of it!!! Needless to say we're still homeless, trying to find a home for our 3 children.

Recommended Reforms

The necessity of changing this broken system of EITC seizures has long been recognized. The National Taxpayer Advocate's 2009 Annual Report to Congress noted that under current law "the IRS ordinarily will retain the full amount of EITC benefits (designed to pull taxpayers out of poverty) to satisfy a debt even though the taxpayer remains low income, is otherwise eligible for low income tax benefits, and is relying on the EITC to pay basic living expenses."[37] The report recommended that Congress "limit the portion of the tax refund attributable to the EITC that the IRS may offset to 15 percent."[38]

1. Congress Should Act to Stop Seizing EITC Benefits from Student Loan Borrowers

Seizure of the EITC for student loan borrowers is counterproductive to the goals of both the EITC and to the Department of Education. The imminent reauthorization of the Higher Education Act (HEA) provides Congress with an opportunity to correct this policy by including a provision that would eliminate the seizure of student loan borrowers' EITC payments.

This change would be consistent with current policy. Current U.S. law already recognizes the importance of exempting payments made under programs intended to reduce poverty from seizure for all types of federal non-tax debts. For example, federal law allows the U.S. Treasury to exempt any means-tested federal payments from its administrative offset program if offset would frustrate the program's goals.[39] The list of currently exempted payments is extensive.[40] Since the EITC is an anti-poverty program—and a very important and successful one—it is irrational to treat it differently and to subject these payments to seizure. Congress should prohibit seizure of EITC refunds.

2. The Department of Education Should Return the Tax Refunds of Borrowers Receiving the EITC

The U.S. Department of Education should also work with the U.S. Treasury to quickly put in place interim solutions. The Department of Education presently reimburses a borrower's tax refund offset due to the borrower's financial hardship, but will only do so if the borrower is experiencing extreme hardship, generally limited to cases of imminent eviction or foreclosure[41] where the borrower provides a court order indicating that the foreclosure or eviction has been approved.[42] As the borrower stories in this report document, this standard ignores the ways that borrowers experience extreme financial hardship and needs to be relaxed.

A borrower's EITC eligibility is itself an indication of a borrower's economic hardship. Given the economic reality facing the majority of EITC recipients and their children, the Department of Education should amend its "extreme hardship" exception to mandate reimbursement of all EITC payments seized from student loan borrowers.

3. The Department of Education Should Cease Seizure of EITC Refunds from Borrowers in Rehabilitation Agreements

As stated above, the government's practice of seizing EITC refunds while borrowers are in the process of trying to rehabilitate their loans diminishes the likelihood that these borrowers, who are making a good-faith effort to repay their loans, will be able to do so. At a minimum, the Department of Education should immediately reimburse the EITC payments of borrowers who are actively working to get their loans out of default. A better policy to encourage successful rehabilitations would be to cease all Treasury seizures--whether of an EITC refund or some other payment--from borrowers who are in rehabilitation agreements.

Conclusion

The government's seizure of EITC payments is a draconian measure that is incompatible with both the goals of the EITC and the Department of Education's policy objectives. These seizures deprive low-income borrowers and their children of vital funds and opportunities for advancement. Rather than pushing low-income borrowers and their children into cycles of poverty, the government should facilitate the job creation and poverty reduction goals of the EITC by exempting EITC payments from offset. Such a policy change would not only benefit borrowers, but would also help meet one of the Department of Education's policy objectives by enabling more borrowers to get their student loans out of default in the long run.

This policy brief was written by Yael Shavit and Persis Yu. For more information, please email National Consumer Law Center attorney and director of NCLC's Student Loan Borrower Assistance Project at Persis Yu at pyu@nclc.org.

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[2] Congressional Research Service, *The Earned Income Tax Credit (EITC): An Economic Analysis* (June 2, 2015) available at http://taxfoundation.org/sites/default/files/docs/2015-13069-1.pdf.

[3] Economic Policy Institute, *The Earned Income Tax Credit and the Child Tax Credit* at 1 (Sept. 25, 2013) available at http://www.epi.org/publication/ib370-earned-income-tax-credit-and-the-child-tax-credit-history-purpose-goals-and-effectiveness.

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[12] National Taxpayer Advocate, *2009 Annual Report to Congress* at 367 (Dec. 31, 2009) available at https://www.irs.gov/pub/irs-utl/2_09_tas_arc_vol_1_lr.pdf.

[13] The borrower stories included in this report were provided in response to a National Consumer Law Center blog post from March 7, 2016. See Student Loan Borrower Assistance, "Earned Income Tax Credits Seized from Struggling Student Loan Borrowers," (Mar. 7, 2016), available at http://www.studentloanborrowerassistance.org/earned-income-tax-credits-seized-struggling-student-loanborrowers-2/?utm_source=feedburner&utm_medium=email&utm_campaign=Feed%3A+studentloanborrowerassistance%2FyPwH+%28Student+Loan+Borrower+Assistance%29.

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