



The Bell Policy Center *Research • Advocacy • Opportunity... for Colorado*

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The Earned Income Tax Credit helps military families

The federal Earned Income Tax Credit (EITC) provides a needed tax break to military as well as civilian families. Using data from the U.S. Department of Defense and Government Accountability Office (GAO), the Bell Policy Center estimates that, at a minimum, more than 150,000 active duty members of the armed forces and their families nationwide, including more than 3,000 families stationed in Colorado, are eligible for the EITC¹. The basic pay for many grades in the armed forces falls within the maximum eligibility limits for the EITC.

Congress acted in 2001 and 2004 to expand EITC eligibility for more military personnel. Calculating the exact number of military families that receive the EITC varies, depending on whether their spouses work or deployment in a combat zone.

In 2004, 21 million families nationwide, almost all of them families with children, received \$37.5 billion from the EITC. It is the most effective anti-poverty tool, annually lifting at least 2.7 million children nationwide above the poverty level.

EITC Income Eligibility Limits and Benefit Amounts

Table 1 shows for Tax Year 2004 the maximum earned income eligibility limits (adjusted gross income) for the EITC:

Table 1 – Earned Income Eligibility Limits for the EITC

Number of Children	Married Filing Jointly	Other Filing Status
No Qualifying Children	\$12,490	\$11,490
One Qualifying Child	\$31,338	\$30,338
Two or More Qualifying Children	\$35,448	\$34,358

The EITC benefit is structured so families with two or more children and incomes between \$10,750 and \$14,050 (up to \$15,050 for married workers) receive the maximum credit.

¹We used data from Selected Military Compensation Tables 2004 and 2005, and 2003 Demographic Profile of the Military Community to calculate the number of active duty military personnel by family characteristics for those basic military pay grades that are less than the EITC income limits. This number excludes families with a working spouse and does not account for tax exempt combat pay.

For example, for families with two or more children the amount of the credit increases as family earned income increases from \$1 up to \$10,750. As family income increases above \$14,050 for single parents or \$15,050 for married parents filing jointly, the amount of the credit decreases until it is eliminated at \$34,450 for single parents and \$35,458 for married parents. The same type of structure is used for families with one child.

The EITC is tiered in this way to offset the Social Security (FICA) taxes withheld from workers' pay. Single taxpayers and married couples without children receive the smallest credit. In addition, taxpayers without children must be at least 25 and under 65 years old to qualify. And taxpayers may receive no more than \$2,650 in interest, dividends, capital gains and other investment income to be eligible. The maximum EITC that different types of families could receive is:

- Filers with two or more children -- \$4,300.
- Filers with one qualifying child -- \$2,604.
- Filers with no qualifying children -- \$390.

Basic Military Pay

Active duty military personnel receive most of their compensation through basic pay, which is determined by their rank and years of service. In addition, they may receive special pays and incentives for performing various duties or learning special skills such as serving on flight deck duty or pursuing an aviation career. They also receive allowances for housing and subsistence. There are more than 50 special pays, incentives and allowances, including food and housing, and most are tax exempt.

Income earned while serving in a combat zone is also exempt from income taxes.² As described under the effects of deployment section below, receiving combat pay may make more military families eligible for the EITC.

Table 2 shows the annual amount of basic pay by pay grade and years of service for those grades that receive less than \$35,500. Generally, these ranks fall within the eligibility limits of the EITC. However, because combat pay is tax exempt, members who served part of the year in a combat zone could qualify for the EITC even though their salaries are above the limit. Conversely, those within the pay ranges listed on Table 2 with spouses who work may not be eligible because these additional earnings put them over the EITC limits.

Table 3 shows the estimated number of active duty military personnel and their families who are potentially eligible for the EITC by family composition. We estimate that more than 300,000 families receive basic pay that falls within the EITC income limits.

However, earnings by the nonmilitary spouse could push family income above the eligibility limits. While we have data on the percentage of military families with a working spouse, we do not have data on the spouses' earnings. Therefore, we excluded all of those families with working spouses from our estimate of the number of military families eligible for the EITC. This is a conservative estimate that may exclude families whose working spouse's

² The combat zone exclusion allows enlisted personnel to exclude all income earned for each month served in one of 15 designated combat zones. Officers can exclude up to \$6,315.90 per month in combat pay in 2004. Soldiers who serve in a combat zone for a minimum of one day can receive the combat pay exclusion for the entire month.

earnings are low enough that the family could still qualify for the EITC. This estimate also does not include families who would be eligible for the EITC if they excluded their combat pay.

The number of EITC eligible military families in Colorado is based on a 2003 report that tallies 31,386 military personnel stationed in Colorado. This includes the Air Force Academy with 6,445, Fort Carson with 15,732, Peterson Air Force Base with 3,558 and Schriever Air Force Base with 2,012, all in the Colorado Springs area.

We estimate that nationwide, 11.6 percent of military families are eligible for the EITC. Based on this percentage, 11.6 percent of Colorado's total is 3,641. We expect that the number of military personnel stationed in Colorado has changed in the past 18 months, but these are the most recent figures available.

Congress Recently Expanded the EITC for Military Families

- The Economic Growth and Tax Reconciliation Act of 2001 changed the definition of earned income.

Prior to 2001, the Internal Revenue Code included as earned income for EITC purposes nontaxable combat zone pay, housing and subsistence allowances, government quarters and furnished meals. This definition forced military taxpayers to track non-taxable items solely to determine EITC eligibility.

The 2001 act changed the definition of earned income for EITC purposes to exclude combat zone pay, housing allowances, and subsistence allowances. As a result, more service members qualified for the EITC, because their earned incomes dropped to within the income eligibility limit.

- The Working Families Tax Relief Act of 2004 allows military personnel to include tax exempt combat zone (CZ) pay or qualified hazardous duty area (QHDA) pay as earned income to qualify for the EITC.

Congress' action in 2001 to exclude combat zone pay in determining eligibility for the EITC had the unintended consequence of causing some low-income military personnel to lose their EITC. Because combat pay is tax exempt, it could not be used in calculating the EITC. Thousands of active duty military personnel lost their EITC because, for tax purposes, they had no taxable earned income.

However, some higher paid military personnel, whose pay would normally exceed the EITC income limits, became eligible for the credit if they spent time in combat. Because their combat pay was tax exempt, their taxable earnings might fall within the EITC limits. The Government Accountability Office (GAO) estimated that 5,000 to 10,000 service men and women lost EITC benefits due to the combat pay exclusion. The GAO could not estimate the number that conversely became eligible.

Congress amended the law in October 2004 to give members of the military the option to include all their combat pay when computing the EITC. The combat pay remains exempt from income taxes. As a result, soldiers will not lose their EITC for earning tax-exempt combat pay, while families with little or no other earnings can count the combat pay to claim the EITC.

Deployment to a Combat Zone

Military families are affected most directly by war. As these families' lives become more complicated as a result of their active military duty, so do their financial affairs. With more than 300,000 National Guard and reservists called to active duty since 9/11, the need for tax assistance is greater than ever. Many families whose loved ones are deployed in combat often experience substantial reduction in overall family income.

Congress' action in 2004 to exclude tax-exempt combat pay from calculating the EITC should increase the number of families that are eligible for the credit. We could not estimate how many families would get the EITC because of combat pay because we do not have data on the pay grades of the servicemen and women deployed, nor do we have data on the length of deployment.

However, some families whose earnings exceed the EITC limits could be eligible depending on the months deployed in a combat zone. For example, a married Marine master sergeant with two children who has 12 years experience receives basic pay of \$39,675, which would put him over the EITC eligibility limits. However, if he were deployed in a combat zone for nine months, he could exclude three-quarters of those annual earnings, \$29,757, when computing the EITC. The \$9,919 that he earned stateside would be used to calculate the amount of his EITC.

Excluding combat pay from the EITC income limits means more military families are likely to qualify for the EITC than in past years.

Examples of Soldiers who Qualify for the EITC

Example 1: An Army sergeant (E5) with three years experience is married with one child and receives \$22,813 in basic pay and \$2,500 in other special pay. If his wife does not work, he and his family would qualify for an Earned Income Tax Credit of \$961.

Example 2: A marine corporal (E4) with four years experience is married with two children and receives \$21,769 in basic pay and another \$3,000 in special pay and incentives. If her husband does not work, she and her family would qualify for an Earned Income Tax Credit of \$2,250.

Example 3: An Air Force staff sergeant (E5) with four years experience is single with one child and receives \$23,893 in basic pay and \$2,000 in special pay. He would qualify for an Earned Income Tax Credit of \$713.

Example 4: A Navy chief petty officer (E7) with six years experience is married with three children and receives \$31,705 in basic pay and \$1,500 in special pay. If his wife does not work, they would qualify for an Earned Income Tax Credit of \$470.

Example 5: An Army sergeant (E5) with four years experience is married with two children and receives \$23,893 in basic pay and \$1,500 in special pay. Her husband works part-time and earns \$9,000 per year. They qualify for an Earned Income Tax credit of \$228.

Example 6: A Marine gunnery sergeant (E7) with six years experience is single without children and receives \$31,705 in basic pay and \$1,500 in special pay. She served in Iraq for nine months.

She can exclude 75 percent of her earnings. \$24,904, because they were earned in combat. Based on her remaining earnings of \$8,301, she would qualify for an Earned Income Tax Credit of \$242.

Attached are tables that show the basic military pay rates by grade and years of experience that fall below the EITC income eligibility limits and the estimated number of EITC eligible families. Appendix A lists the steps we used to calculate the number of active duty military personnel eligible for the EITC and Appendix B lists the sources of the data we used.

Table 2 – Military Basic Pay Grades with Salaries Less Than the EITC Income Limits (Tax Year 2004)

Pay Grade	Years of Experience								
	Under 2	2	3	4	6	8	10	16	20
Officer 2	\$31,298								
Officer 1	\$27,173	\$28,278	\$34,182	\$34,182	\$34,182	\$34,182	\$34,182	\$34,182	\$34,182
Officers 0-1E				\$34,182					
Warrant Officer 3	\$34,186								
Warrant Officer 2	\$30,071	\$31,788	\$33,289	\$34,384	\$35,320				
Warrant Officer 1	\$26,554	\$28,728	\$30,182	\$31,122	\$33,628	\$35,140			
Enlisted 7	\$25,740	\$28,094	\$29,167	\$30,596	\$31,705	\$33,617	\$34,693		
Enlisted 6	\$22,266	\$24,494	\$25,574	\$26,626	\$27,720	\$30,193	\$32,224	\$33,491	\$33,718
Enlisted 5	\$20,401	\$21,762	\$22,813	\$23,893	\$25,567	\$27,011	\$28,076	\$28,076	\$28,076
Enlisted 4	\$18,698	\$19,660	\$20,722	\$21,769	\$22,698	\$22,698	\$22,698	\$22,698	\$22,698
Enlisted 3	\$16,884	\$17,946	\$19,026	\$19,026	\$19,026	\$19,026	\$19,026	\$19,026	\$19,026
Enlisted 2	\$16,052	\$16,052	\$16,052	\$16,052	\$16,052	\$16,052	\$16,052	\$16,052	\$16,052
Enlisted 1	\$14,321	\$14,321	\$14,321	\$14,321	\$14,321	\$14,321	\$14,321	\$14,321	\$14,321
Enlisted 1 (less than four months)	\$13,248								

Table 3 – Estimated Active Duty Military Personnel and Families Eligible for the EITC

Family Composition	Total Families with Basic Pay Below EITC Limits	Total Families with Basic Pay Below EITC Limits and Non-Working Spouses
Single, no children	0	0
Married, no children	0	0
Single, one child	10,767	10,767
Married, one child	100,825	49,727
Single, two children	9,438	9,438
Married, two or more children	167,193	77,104
Single, three or more children	14,105	14,105
Total*	302,328	161,141

*These estimates do not include those families whose basic pay would place them over the EITC limits but who could be eligible if part of it were excluded as combat pay. The estimates are also based on military pay for a full year. Soldiers entering service during the year might qualify based on part-year earnings.

Appendix A - Calculating Eligibility for the EITC by Family Composition

We followed the procedures listed below to calculate the number of military families eligible for the EITC:

- 1 Single soldiers with no children
 - a) Generally, single soldiers without children would not be eligible for the EITC because the lowest rate of basic pay exceeds the EITC income limits.
 - b) However, some could be eligible if they are deployed in combat for part of the year. Because combat pay is tax exempt, soldiers may choose not to include it in figuring their EITC eligibility.
 - c) Soldiers must be over 25 years old and not have more than \$2,650 in investment income to receive the EITC.
- 2 Married soldiers with no children.
 - a) Generally, married soldiers without children would not be eligible for the EITC because the lowest rate of basic pay exceeds the EITC income limits.
 - b) However, some could be eligible if the active duty military person is deployed in combat for part of the year. The excluded combat pay would not count against the EITC income limits.
 - c) If the spouse worked, their income would count toward the EITC; therefore family-earned income must be below the income limits.
 - d) One of the taxpayers must be over 25 years old and not have more than \$2,650 in investment income to receive the EITC.
- 3 Single soldiers with one child
 - a) We used the percentage of single parents by pay grade to calculate the number single soldiers within the EITC eligible pay grades with the family size of two.
 - b) This represents the number of families with one parent and one child.
 - c) Because combat pay is exempt from the EITC limits, serving in combat could expand eligibility to soldiers in pay grades that exceed the EITC income limits, so long as soldiers have taxable earnings that are below the income limits.
 - d) The soldier cannot have more than \$2,650 in investment income.
- 4 Married soldiers with one child
 - a) We used the percentage of married personnel by pay grade to calculate the number of married soldiers within the EITC eligible pay grades for a family size of three.
 - b) This represents the number of married soldiers with one child.
 - c) Because earnings for the non-active duty spouse could affect eligibility, we used data from the survey of active duty families to calculate the number of working spouses. We do not have data on the spouses' earnings.
 - d) Our conservative estimate excludes those families with a working spouse from our estimate of total military families eligible for EITC. Depending on the spouses' earnings, the families could still potentially qualify for the EITC.

- e) Deployment in combat could expand eligibility in this category for those families in which the spouse's income would qualify for EITC when the combat pay is excluded.
 - f) The couple cannot have more than \$2,650 in investment income.
- 5 Single soldiers with two children
- a) We used the percentage of single parents to calculate the number of single parents in each EITC eligible pay grade for a family size of three.
 - b) This represents the number of single soldiers with two children.
 - c) Deployment in combat for part of the year could increase the number of families eligible for the EITC by excluding part of the earnings for soldiers in pay grades above the EITC income limits.
 - d) The soldier can not have more than \$2,650 in investment income.
- 6 Married soldiers with two or more children
- a) We used the percentage of married personnel by pay grade to calculate the number of married soldiers within the EITC eligible pay grades for a family size of four, five and six.
 - b) This represents the number of married soldiers with two or more children.
 - c) Because earnings for the non-active duty spouse could affect eligibility, we used data from the survey of active duty families to calculate the number of working spouses. We do not have data on the spouses' earnings.
 - d) Our conservative estimate excludes those families with a working spouse from our estimate of total military families eligible for EITC. Depending on the spouses' earnings, the families could still potentially qualify for the EITC.
 - e) Deployment in combat could increase the number of families eligible for the EITC, since those in pay grades above the EITC income limits can choose to exclude their combat pay from figuring their EITC eligibility.
 - f) Families with working spouses could become eligible if the spouse's earnings are less than the EITC income limits and part or all of the soldiers earnings are exempt combat pay. The number of eligible families depends on the spouse's earnings and the length of deployment in a combat zone.
 - g) The couple cannot have more than \$2,650 in investment income.
- 7 Single parents with three or more children
- a) We used the percentage of single parent families by pay grade to calculate the number of single soldiers within the EITC eligible pay grades for a family size of four, five and six.
 - b) This represents the number of single soldiers with three or more children.
 - c) Deployment in combat could increase the number of families eligible for the EITC since those in pay grades above the EITC income limits can choose to exclude their combat pay from figuring their EITC eligibility.
 - d) The soldier can not have more than \$2,650 in investment income to receive the EITC.

Appendix B: Sources

U.S. Department of Defense. Directorate of Compensation. *Selected Military Compensation Tables*. Washington, D.C., January 2004.

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