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States Can Adopt or Expand Earned Income Tax Credits to Build a Stronger Future Economy

By Erica Williams and Michael Leachman

Half of all states plus the District of Columbia have enacted their own version of the federal Earned Income Tax Credit (EITC) to help working families earning low wages meet basic needs. State EITCs build on the success of the federal credit by keeping working parents on the job and families and children out of poverty. This important state support also extends the federal EITC's well-documented long-term positive effects on children, which in turn boost the nation's future economic prospects.

State EITCs provide extensive benefits to children, families, and communities, and are straightforward to administer and to claim. Lawmakers in states without their own EITC should consider enacting one. States that have cut back or eliminated their credits should reverse course, and states that have limited their credits so that they *only* offset income taxes should make them fully refundable, which would vastly enhance their impact. With this important investment, states can make a big difference in the lives of low- and moderate-income working families.

Why Consider an EITC?

Many children in working families live in poverty — some 9.9 million poor children in 2013 had at least one working parent.[1] And many families with incomes modestly above the federal poverty line, currently about $24,000 for a family of four, also have a hard time affording basic necessities. A full-time job at the minimum wage is insufficient to keep a family with one working parent out of poverty, and sluggish wage growth for low-earning families means that many will likely continue to struggle.

In addition, low- and moderate-income families in almost all states pay higher state and local taxes as a share of their income than do upper-income families. This imbalance results from states relying heavily on sales, excise, and property taxes, all of which fall more heavily on poorer families. Some states have become even more reliant on these taxes in recent years, further increasing taxes on working-poor and near-poor families.

The EITC originated as a federal tax credit for working people and families with low and moderate incomes that, among other things, rewards work, reduces poverty, and improves the

[1] Census Current Population Survey

outlook for low-income children. State lawmakers can leverage the proven effectiveness of the federal EITC to address poverty, low wages, and skewed tax systems by implementing a state-level credit. Just like the federal EITC, state EITCs:

- **Help working families make ends meet.** Refundable EITCs provide low-income workers with a needed income boost that can help them meet basic needs and pay for the very things that allow them to work, like child care and transportation.
- **Keep families working.** EITCs help families that work get by on low wages, which helps them stay employed. They are also structured to encourage the lowest-earning families to work more hours. That extra time and experience in the working world can translate into better opportunities and higher pay over time. Three out of five filers who receive the federal credit use it just temporarily — for just one or two years at a time.[2]
- **Reduce poverty, especially among children.** The federal EITC is the nation's single most effective tool for reducing poverty among working families and children. It lifted about 6.2 million people — over half of them children — out of poverty in 2013. State EITCs build on that record.
- **Have a lasting effect.** Low-income children in families that get additional income through programs like the EITC do better and go farther in school. And children in low-income families that get an income boost during their early childhood years work more and earn more as adults. This is good for communities and the economy because it means more people and families are on solid ground and fewer need help over the long haul.

More States Leveraging the Federal Credit, But Others Have Fallen Back

In recent years, three states — Colorado (2013), Connecticut (2011), and Ohio (2013) — have enacted their own versions of the EITC to bolster the wages of struggling families,[3] and many other states have improved existing credits. In 2014, Washington, D.C. became the first jurisdiction to expand the credit for workers without dependent children in the home, extending the credit's reach to childless workers with somewhat higher incomes and setting its value at 100 percent of the federal credit. Also in 2014, Iowa raised its credit to 15 percent of the federal EITC from 14 percent, Maryland raised its credit to 28 percent of the federal EITC from 25 percent (scheduled to phase in over four years), Minnesota increased in the total value of its credit by 25 percent, Ohio doubled its credit to 10 percent of the federal EITC (though it remains nonrefundable), and Rhode Island cut its credit to 10 percent of the federal EITC from 25 percent but also made it fully refundable, expanding the credit for most households. In 2013, Oregon expanded its credit to 8 percent of the federal EITC from 6 percent, and Iowa doubled its credit to 14 percent of the federal EITC.

In other states, lawmakers have cut back or eliminated this support for families earning low wages. In 2013, North Carolina lawmakers allowed the state's EITC to end after tax year 2013 and cut it by

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[2] Chuck Marr, Jimmy Charite, and Chye-Ching Huang, "Earned Income Tax Credit Promotes Work, Encourages Children's Success at School, Research Finds," Center on Budget and Policy Priorities, revised April 15, 2014, http://www.cbpp.org/cms/?fa=view&id=3793.

[3] Connecticut's credit, enacted at 30 percent of the federal EITC, shrank immediately to 25 percent due to budget problems but is set to gradually return to 30 percent by tax year 2015. Just prior to the recession, five states enacted new EITCs: Michigan in 2006; North Carolina, Louisiana, and New Mexico in 2007; and Washington in 2008. Washington State has yet to fund its credit.

10 percent in its final year. In 2011, Michigan cut its credit by 70 percent and Wisconsin cut its credit by 21 percent for families with two or more children. Prior to that, in 2010, New Jersey reduced its credit to 20 percent of the federal EITC, from 25 percent.

Nevertheless, one in three recipients of the federal EITC now lives in a state with its own EITC, and state EITCs boost the earnings of working families by about $3 billion annually.

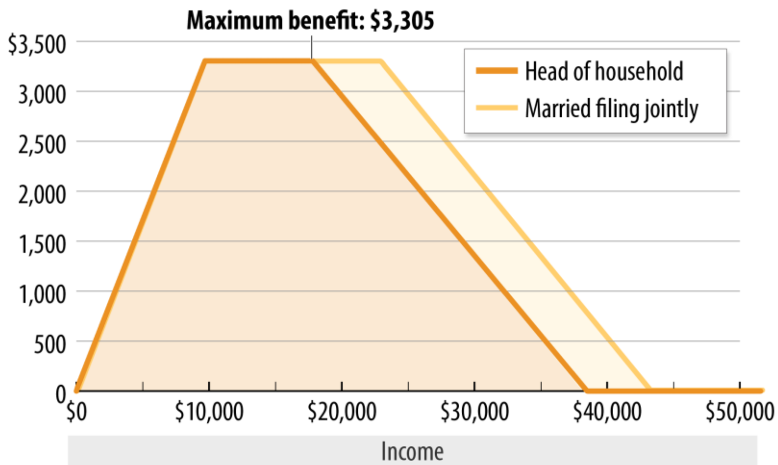
EITC Design Rewards Working Families

The EITC only goes to working families and is designed to reward their effort. For families with very low earnings, the dollar amount of the EITC increases as earnings rise, which encourages families to work more hours when possible. Working families with children earning up to about $39,000 to $52,000 (depending on marital status and the number of children in the family) generally can qualify for a state EITC, but the largest benefits go to families with incomes between about $10,000 and $23,000. Workers without children can also qualify in most states, but only if their income is below about $15,000 ($20,000 for a married couple), and the benefit is small.

The EITC's design also reflects the reality that larger families face higher living expenses than smaller families: the maximum benefit varies for families with one, two, and three or more children. For example, the maximum federal benefit for families with two children in tax year 2013 is $5,460, compared to $3,305 for families with one child. (As with most other federal tax provisions, the IRS adjusts EITC benefit amounts and eligibility levels each year for inflation.) [4]

FIGURE 1

Earned Income Tax Credit for Households With One Child, 2014



Note: Assumes all income is from earnings (as opposed to investments, for example).
Source: Internal Revenue Service

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Figure 1 shows how the EITC works for a single-mother family with one child earning the minimum wage in 2014 (about $15,000 a year for full-time, year-round work). For every dollar she earns, she gets 34 cents in EITC benefits. The value of the credit continues to increase at that rate

[4] The 2009 Recovery Act, enacted in February 2009, included two key provisions to help the EITC go further. First, it expanded the so-called "marriage penalty relief" provision first enacted in 2001. It did so by raising the EITC income eligibility level for married workers by $2,000, thereby extending eligibility for the maximum credit to a more married-couple working families with low incomes. Second, it provided, for the first time, a third benefit tier for larger families. Working families with three or more children receive an EITC equal to 45 cents for each dollar earned up to $13,650, for a maximum credit of $6,143 in 2013. The value of the credit completely phases out for single-parent families with three or more children when their income exceeds $46,997 and for *married-couple* families of this size when their income exceeds $51,997. The American Taxpayer Relief Act of 2012 extended both of these provisions through 2017 and made permanent the original "marriage penalty relief" provision from 2001.

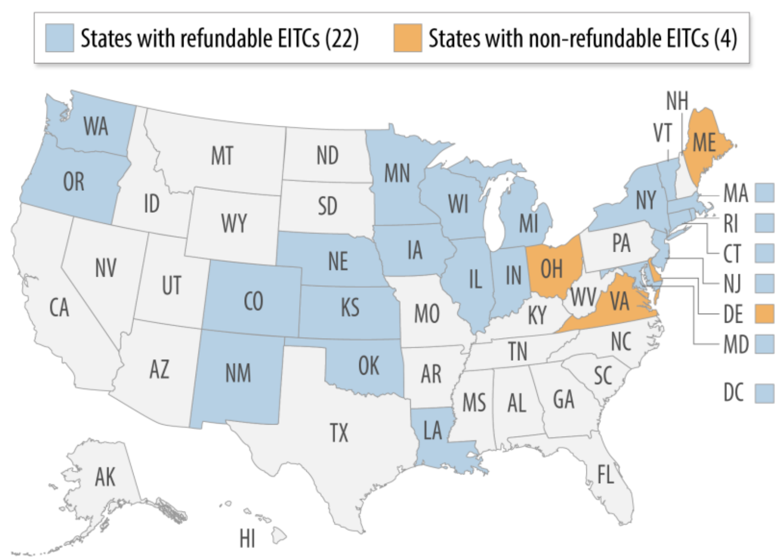
until her earnings reach $9,720. At that point, she receives the maximum benefit of $3,305. Once her earnings exceed $17,830, the credit shrinks by about 16 cents for each additional dollar of earnings until reaching zero (at about $39,000 in earnings).

Most States Model Their EITCs on Federal Credit

Nearly all state EITCs are modeled directly on the federal EITC. This means that they use federal EITC eligibility rules and offer a state credit that is a specified percentage of the federal credit. (The percentages are shown in Table 1.) Minnesota uses federal eligibility rules, and its credit parallels major elements of the federal structure; however, it has its own schedule for the income levels at which the credit phases in and out. Indiana uses old federal guidelines that exclude recent expansions and improvements to the federal credit. And, Washington, D.C.'s newly expanded EITC for workers without dependent children will phase in following federal guidelines, but the maximum credit will extend to 150 percent of the poverty line (for an individual), and the credit will fully phase out at twice the poverty line.

FIGURE 2

Twenty-five States and D.C. Have Enacted EITCs, 2015



Source: CBPP analysis.

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Twenty-one states and Washington, D.C. follow the federal practice of offering a fully "refundable" EITC. (See Figure 2.) In other words, the amount by which the credit exceeds annual income taxes is paid as a refund; a family with no income tax liability receives the entire EITC as a refund. Without it, the EITC would fail to offset the other substantial state and local taxes families pay. Refundability is what makes the EITC so effective at reducing poverty, because it lets families keep more of what they earn and helps them keep working despite low wages.

The remaining four states with EITCs — Delaware, Maine, Ohio, and Virginia — offer non-refundable credits. That means the credits are available only to the extent that they offset a family's state income tax. A non-refundable EITC can reduce *income* taxes for families with state income tax liability, but it does not make up for other taxes that working families pay. Nor does it do much, if anything, to help keep families working and out of poverty. Ohio's EITC is limited even further, to no more than half of income taxes owed on taxable income above $20,000.

TABLE 1

State Earned Income Tax Credits

State	Percentage of Federal Credit	Refundable
Colorado[a]	10%	Yes
Connecticut	30%	Yes
Delaware	20%	No
District of Columbia[b]	40% (100%)	Yes
Illinois	10%	Yes
Indiana[c]	9%	Yes
Iowa	15%	Yes
Kansas	17%	Yes
Louisiana	3.5%	Yes
Maine	5%	No
Maryland[d]	25.5%	Yes
Massachusetts	15%	Yes
Michigan	6%	Yes
Minnesota[e]	Average 34%	Yes
Nebraska	10%	Yes
New Jersey	20%	Yes
New Mexico	10%	Yes
New York	30%	Yes
Ohio[f]	10%	No
Oklahoma	5%	Yes
Oregon[g]	8%	Yes
Rhode Island	10%	Yes
Vermont	32%	Yes
Virginia	20%	No
Washington[h]	Scheduled to be 10% when	Yes
Wisconsin	4% — one child 11% — two children 34% — three children No credit for childless workers	Yes

[a] Colorado's EITC will take effect when state revenues surpass the state's revenue limit, known as TABOR.
[b] The District of Columbia now offers a credit, equal to 100 percent of the federal EITC, to childless adults with incomes up to twice the poverty line (for one person).
[c] Indiana decoupled from federal provisions expanding the EITC for families with three or more children and raising the income phaseout for married couples.
[d] Maryland's refundable EITC will reach 28 percent of the federal credit by tax year 2018. The state also offers a non-refundable EITC set at 50 percent of the federal credit. Taxpayers in effect may claim either the refundable credit or the non-refundable credit, but not both.
[e] Minnesota's credit for families with children, unlike the other credits shown in this table, is structured as a percentage of income rather than a percentage of the federal credit. The average given above reflects total projected state spending for the Working Family Credit divided by projected federal spending on the EITC in Minnesota as modeled by Minnesota's House Research Department. This average fluctuates from year to year.
[f] Ohio's EITC is limited to half of income taxes owed on income above $20,000.
[g] Oregon's EITC is set to expire at the end of tax year 2019.
[h] Washington's EITC will likely be worth 10 percent of the federal credit or $50, whichever is greater.

State EITCs Are Easy to Administer and Less Expensive Than Many Other Tax Cuts

State EITCs are easy to administer and claim. States incur virtually no costs for determining eligibility for their credit — families eligible for the federal credit also are eligible for the state credit. And because state credits typically are set at a fixed percentage of the federal credit, state revenue departments need only add one line to a state's income tax form. State EITCs are easy to claim because filers need only multiply their federal EITC by a specified rate to determine their state credit.

State EITCs also offer a good value to states. For a modest investment, they make a big difference in the lives of low-income families. Existing refundable EITCs in states with income taxes cost less than 1 percent of state tax revenues each year.[5] Because state EITCs are well-targeted to low- and moderate-income working families, the cost is more modest than other tax cuts that states often consider.[6] Though low-income households tend to comprise a substantial share of all taxpayers, they account for a smaller share of tax revenue. A few hundred dollars for each family makes a big difference to the family's ability to make ends meet without making a major dent in a state's treasury.

States can also use an EITC to help make low-income families whole again after raising a regressive tax, like the sales tax or gas tax, by setting aside part of the resulting revenue to finance an EITC.

States finance their EITCs in whole or part from money available in a state's general fund. Federal regulations allow states to finance the refundable part of a credit going to families with children from a state's share of the federal Temporary Assistance for Needy Families (TANF) block grant. Most states, however, have few such funds, because the value of the TANF block grant — which does not adjust for inflation each year — has eroded over time. No matter how it is financed, an EITC can complement a state's welfare program by assisting low-income working families with children as they transition from welfare to work.

[5] Four factors affect the cost of a state EITC: the number of families that claim the federal credit, the percentage of the federal credit at which the state credit is set, whether the credit is refundable, and how many state residents who receive the federal credit also claim the state credit.

[6] For further information about estimating the cost of a state EITC, see Erica Williams and Michael Leachman, "How Much Would a State Earned Income Tax Credit Cost in Fiscal Year 2016?" Center on Budget and Policy Priorities, updated January 28, 2015, http://www.cbpp.org/cms/index.cfm?fa=view&id=2992.

Even States Without an Income Tax Could Offer a State EITC

Like the federal EITC, state EITCs have a long, successful history of using the income tax as a mechanism for providing increased economic security to low-income working families. But there has been debate about whether a state that has no income tax could offer similar assistance. Without a state income tax, state revenue departments do not typically collect the information about family income and structure needed to determine EITC eligibility.

The arrangement for Washington's Working Families Tax Exemption, however, illustrates how states without an income tax could work with the IRS to provide a state credit.[a] To confirm eligibility, Washington State will use data on federal EITC claimants provided by the IRS to state revenue departments under a data-sharing arrangement. Piggybacking on federal efforts saves administrative costs for the state. When the credit is fully phased in, state officials estimate that administration will constitute only about 4 percent of the cost of the EITC.[b] If Washington were to increase the size of the credit, this share would be even smaller.

The other states without a broad-based income tax (Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, and Wyoming) could follow Washington's lead. State EITCs could be particularly helpful in these states, whose tax systems rely heavily on excise taxes, property taxes, and in most cases sales taxes. As such, low- and moderate-income families in these states pay a higher share of their income in taxes than wealthier families.

[a] The Washington credit was scheduled to take effect in tax year 2009, but — in large part because of the recession and resulting revenue shortfalls — policymakers have not yet financed the credit.

[b] Fiscal note for Washington ESSB 6809. Note that administrative costs in states that already have an income tax are substantially lower, typically well below 1 percent of the credit's value.