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A SIMPLE, INEXPENSIVE WAY FOR MARYLAND TO PROTECT CERTAIN LOW-INCOME WORKERS FROM TAX INCREASES

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Closing Maryland's budget shortfall will require significant tax increases, including some that will have a disproportionate impact on the state's lowest-income workers. Governor O'Malley's proposal, for example, relies heavily on increases in the sales tax, tobacco tax, vehicle titling tax, and gambling revenues, all of which would hit low-income families much harder than middle- and upper-income Marylanders. In combination, these tax increases could cost a low-income person or family several hundred dollars.[1]

KEY FINDINGS

- The federal government and 21 other states allow low-income workers without children living at home to claim the Earned Income Tax Credit. Of states with an EITC, only Maryland and Wisconsin do not.
- Eliminating this restriction would help tens of thousands of employed, low-income Maryland residents meet the added costs of regressive tax changes such as a sales tax increase.
- The change would be easy to administer, would have a small fiscal impact (substantially less than $4 million annually), and would simplify the Maryland income tax instructions.

The governor's proposal includes a number of policy changes intended to shield low-income taxpayers from the impact of regressive changes. But all but one of these measures would provide little or no aid to one group of low-income Marylanders: working poor single persons and couples without children living at home. The one exception, the proposed refundable sales tax credit, would potentially provide $50 per tax filer. This measure is potentially an important benefit for low-income workers without children living at home, but it is insufficient for two reasons. First, some of these workers will see their taxes increase by significantly more than $50. And second, new credits such as this one rarely achieve high participation, so it is likely that many taxpayers would receive no benefit.

Fortunately, there is a simple and inexpensive means to reach these taxpayers: Maryland could revoke a provision in state law that excludes workers without children living at home from Maryland's Refundable Earned Income Tax Credit (EITC). This exclusion sets Maryland's EITC apart from the federal EITC and 21 of the other 22 state-level EITCs (counting the District of

[1] For more information on the impact of proposed tax increases on low-income families in Maryland, see "Options for Protecting Maryland's Low- and Moderate-Income Families from Regressive Tax Increases," Center on Budget and Policy Priorities, October 25, 2007.

Who Would Benefit?

Expanding the Maryland EITC to workers without children living in the home would benefit the following types of residents, among others:

- Workers age 25 through 64 (the eligible age group) who earn less than $12,590 ($14,590 for couples).
- Workers (largely fathers) who have children they are helping to support, but whose children live with their other parent or another relative.
- Individuals or couples whose children are too old to count as qualifying children under the EITC, but who still may be helping those children.
- Workers whose incomes are low below they have only been able to obtain part-time or intermittent employment.
- Workers who have some barriers to work that may prevent them from earning a higher wage or from working full time.

Columbia's), all of which allow workers without children in the home to claim a small credit. Allowing these taxpayers to claim Maryland's refundable EITC would reduce the impact of regressive tax increases by as much as $85 per year — or $107 if Maryland's EITC is increased in size, as the governor has proposed.

This remedy is good policy for these reasons:

This change would bring Maryland into line with federal policy and with the policy in 21 of the 22 other states with EITCs. Low-income workers without a qualifying child in their home are eligible for the federal EITC. (The size of the credit is smaller for such workers than it is for families with children, and the income eligibility rules are stricter.) Some twenty-three states, counting the District of Columbia as a state, have enacted state-level EITCs, and twenty-one states follow the federal EITC in allowing childless workers to qualify. Just this year, Illinois and New Jersey amended their EITCs to allow workers without children in the home to receive the credit. Maryland remains one of the two states that exclude these workers; the other is Wisconsin.

The change would be easy to administer, and would make the current income tax instructions slightly simpler than they are now. Because this change would bring Maryland's EITC rules more closely into conformity with federal rules, it would be simple to administer. Indeed, this change would allow the Comptroller to delete the instruction in the income tax booklet that a taxpayer must have a qualifying child for purposes of the federal earned income credit in order to claim the Maryland credit (see page 11 of the 2006 Maryland resident income tax booklet). It would require no other changes to the Maryland income tax booklet or form.

Another way that this change would ease administration is that the change would make Maryland's Refundable EITC consistent with a *separate* credit offered in Maryland that is a nonrefundable EITC. This nonrefundable EITC is *already* available to workers without children at home. Making the two credits consistent would eliminate a possible source of confusion for taxpayers.

The cost to the state budget would be low – well below $4 million. Marylanders without children at home received about $15 million in federal EITC benefits for the 2006 tax year, so broadening the refundable EITC would cost the state *at most* $3.75 million (25 percent of $15 million). Because of the way the Maryland EITC interacts with other tax calculations (including the nonrefundable credit), the actual impact would be *substantially less* than $3.75 million.

Maryland's Refundable EITC would continue to focus its benefit heavily on families with children. Some 97 percent to 98 percent of the benefits of the federal EITC go to families with children at home, because the credit is larger for such families and the income limits more generous. One would expect the distribution to be much the same for the Maryland Refundable EITC after this change is implemented.

The EITC benefit would help tens of thousands of Maryland workers meet the added cost of likely regressive tax increases. As noted above, low-income workers in Maryland are likely to face tax increases of as much as several hundred dollars. These tax increases are larger, relative to income, than the increases faced by other Marylanders, and low-income families are far less able to afford them.

The governor has proposed a number of measures to help reduce the impact of these tax increases on low-income families, but only one of those — the refundable sales tax credit — is likely to offer significant assistance to workers without children living at home, and that credit is unlikely to reach a majority of its intended beneficiaries:

- The governor's proposal to increase the size of Maryland's Refundable EITC from 20 percent to 25 percent of the federal credit would benefit over 200,000 low- and moderate-income working families with children living at home, but do nothing for other workers.

- A change to the income tax would cut taxes for a wide range of Marylanders, predominantly middle- and upper middle income families. But it would do little or nothing for low-income taxpayers, who already pay little or no income taxes but would face significant increases in other taxes.

- A property tax cut would primarily benefit the owners of residential and business property, a group that typically excludes low-income workers.[2]

- Doubling the extra exemption for seniors would do nothing for workers under 65, nor workers over 65 who already earn too little to pay income tax but would face significant increase in other taxes.

- A new refundable sales tax credit would potentially be worth $50 to taxpayers earning less than $30,000 per year, including those without children at home. But benefiting from this credit

[2] Renters ultimately might benefit from the proposed reduction in property taxes if landlords lower rents or refrain from raising rents as much as they otherwise would. But the impact would not be consistent for all low-income renters. Moreover, renters would likely experience little relief in the short run.

would depend on taking the steps to claim it, and experience in other states has shown that participation in similarly small refundable sales tax credits tends to be low in the absence of aggressive outreach and education. In Kansas, for example, a credit worth up to $130 and intended to balance out the state's sales tax on food was estimated to reach only 33 percent of eligible families in 1995.[3] Other states have had similar difficulty with such credits.[4] This problem is particularly acute with taxpayers who do not file income tax forms — a group that includes many low-income workers without children at home. If Maryland achieved similar results with its sales tax credit, well under half of these workers would receive any benefit.

All together, these measures would at best provide little more than $50 for a typical worker or working couple without children at home, and in many cases would provide no assistance at all.

Even among the subset of these workers who did receive the refundable sales tax credit, $50 would in some cases be far too little to compensate for the tax increases that are they are likely to face. Data from the Institute on Taxation and Economic Policy suggests that regressive tax increases included in the Governor's plan would raise taxes by over $100 on an average family earning less than $20,000. Families in this income range without children at home might spend less on items subject to consumption taxes that are likely to be increased, but many of these families would still likely face tax increases of well over $50.[5]

Allowing childless workers to claim Maryland's refundable EITC would cut their taxes by up to $107 if the EITC were increased to 25 percent of the federal credit, or $85 at its current size. (The *average* worker or couple made eligible could receive a credit of about $80, or $60 at the EITC's current size.) Participation in the state EITC is likely to be significantly higher for these workers, since — in contrast to most refundable sales tax credits — the state EITC in Maryland is already well-known and is the subject of an extensive outreach and education campaign. The credit is a worth a modest amount, but it is a significant sum — perhaps the price of a month of groceries — for a worker or couple struggling to escape poverty.

In general, low-income workers who do not have children living with them are eligible for very few benefits from other state or federal programs. This is true even for those workers who are paying child support or otherwise helping to raise children who do not live with them. A number of policy experts have suggested that boosting the incomes of such workers is an important, but largely missing, part of an effective anti-poverty strategy.[6] Allowing those workers to claim the Maryland Refundable EITC would be a small step in the right direction.

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[3] Steven D. Gold and David S. Liebschutz, *State Tax Relief for the Poor, 2nd Ed.* (Albany: The Nelson A. Rockefeller Institute of Government, 1996), pg. 106.
[4] Gold and Liebschutz, pg. 106.
[5] Low-income workers without children at home would be likely to be hit particularly hard by the proposed $1.00-per-pack cigarette tax increase. According to the Centers for Disease Control and Prevention, smoking prevalence is significantly higher among adults living below the poverty line, and the gap is increasing over time.
[6] Indeed, there are proposals in Congress to improve modestly the EITC for workers without custodial children; the change suggested in this memo would allow the Maryland EITC to piggyback on any such improvement.