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HOW MUCH WOULD A STATE EARNED INCOME TAX CREDIT COST IN FISCAL YEAR 2012?

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The federal Earned Income Tax Credit (EITC) is the nation's most effective anti-poverty program for working families. It lifted 6.5 million people — including 3.3 million children — above the poverty line in 2009.¹ The 24 state-level EITCs modeled after the federal program complement it in combating poverty by reducing taxes for low-income people and providing incentives for work. It is important for policymakers considering a state-level EITC to know its budget cost; this can be estimated by using a simple three-step process outlined below.

Data Sources

The Center's methodology for estimating the cost of a state EITC employs two data sources. First, Internal Revenue Service statistics on the value of all federal EITC claims filed by residents of each state are used to determine the state's share of total U.S. EITC claims. The most recent full-year data, shown in the second column of Table 1, are for claims made for the 2008 tax year.²

Second, projections by the congressional Joint Committee on Taxation (JCT) of the future cost of the federal EITC provide a base for estimating the cost of a state EITC. For fiscal year 2012, the JCT estimates that the federal EITC will cost some \$54.1 billion, including both the tax expenditure (non-refundable) and outlay (refundable) portions.³

¹ Arloc Sherman, "Stimulus Keeping 6 Million Americans Out of Poverty in 2009, Estimates Show," Center on Budget and Policy Priorities, September 9, 2009.

² All but a tiny fraction of federal EITCs for a given year are claimed and paid when taxes are filed in January through April of the following year. As a result, nearly all of the federal cost for tax year 2011 EITCs will be incurred in federal fiscal year 2012, which ends September 30, 2011. Similarly, in most states the cost of tax year 2011 claims will fall in the state fiscal year that ends in 2012.

³ Estimates of the future cost of the federal EITC come from the Joint Committee on Taxation's "Estimates of Federal Tax Expenditures for Fiscal Years 2009-2013," and "Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year 2011 Budget Proposal." The federal EITC for tax years 2009 and 2010 was expanded in the 2009 American Recovery and Reinvestment Act, thereby slightly raising the cost. The estimates here assume that the Recovery Act expansions (as well as expansions enacted in 2001 also scheduled to expire after 2010) are made

Step 1: Estimate the total value of federal EITC claims in a given state for a future fiscal year.

To estimate the total value of the federal EITC in a state in a future fiscal year, we first use the IRS data on EITC claims to divide the value of EITC claims in a given state by the value of all U.S. EITC claims. This percentage is the share of the federal EITC cost attributable to that state in the base year (2008). Then, to estimate the cost of the federal EITC in the state for a future year, we apply that percentage to the JCT's projected total cost of the federal EITC for the chosen year. For example, for tax year 2008, Alabama EITC claims were \$1.24 billion, or 2.44 percent of the nationwide total. Assuming that Alabama's share of federal EITC claims remains constant, Alabama's federal EITC claims in fiscal year 2012 would be 2.44 percent of \$54.1 billion, or \$1.32 billion, as shown in the fourth column of Table 1.

Step 2: Multiply the expected value of the state's federal EITC claims by the percentage at which the state credit is to be set.

Most states' EITCs provide benefits as a set percentage of what the federal program pays. This percentage ranges from 3.5 percent to 40 percent, depending on the state. To estimate the cost of a state EITC, multiply the federal EITC cost for the state, as determined in Step 1, by the percentage at which the state EITC is to be set. This calculation yields an estimate of what the state credit would cost in a given fiscal year if everyone who received the federal credit also received the state credit.

Step 3: Adjust the estimate for the fact that not all federal EITC claimants will claim the state credit.

In practice, a substantial portion of those who receive the federal EITC fail to claim state EITCs. This is especially true in the first few years after a state credit is enacted, when awareness of it may be limited.⁴ In addition, some eligible families have the IRS compute their federal credit and may not receive a state EITC if the state does not compute the state credit amount for them. For these and other reasons, the cost of a refundable state EITC in its initial years is likely to be lower than the full cost of the federal credit multiplied by the state percentage. To account for this, the cost estimate should be reduced by at least 10 percent.

The Results

The estimated fiscal year 2012 costs to states of implementing a refundable EITC for tax year 2011 set at 5, 10, or 20 percent of the federal credit are shown in the last three columns of Table 1. Other percentages may be calculated based on those numbers (for instance, the cost of a 15 percent

permanent, as proposed by the Obama Administration. If the expansions are not made permanent, the costs will be modestly lower.

⁴ Compared to the cost each state would have incurred if every family claiming the federal credit also claimed the state credit, the actual cost of a newly enacted state EITC in its first year of availability was about 81 percent in Vermont, 83 percent in New York, 85 percent in Wisconsin, 88 percent in Oklahoma, 90 percent in Kansas and Minnesota, 91 percent in Colorado, and 97 percent in Massachusetts. In the second year of availability in each state, the cost in Vermont rose to 85 percent, the cost in New York rose to 90 percent, and the cost in Minnesota rose to 93 percent relative to the full-participation cost.

credit would be one-and-a-half times the cost of a 10 percent credit) and the methodology outlined above may be used for other years using the projections of federal cost presented in Table 1.

None of these figures includes the costs of changing tax forms to include a space to claim an EITC or the costs of processing and administering EITC claims; these are likely to increase the overall cost of the credit by less than 1 percent. The estimates presented here apply only to credits that are refundable and that are set at a flat percent of the federal EITC.

Further information on these estimates and on methods of estimating the costs of non-refundable credits and different credit structures may be obtained from the staff of the State Fiscal Project at the Center on Budget and Policy Priorities. Information on the policy implications of state EITCs may be obtained by reviewing the Center on Budget and Policy Priorities forthcoming publication, *A Hand Up: How State Earned Income Tax Credits Help Working Families Escape Poverty*, which will be available on the Center's website, www.cbpp.org, in late 2010.

TABLE 1: ESTIMATED COST OF REFUNDABLE STATE EARNED INCOME TAX CREDITS

| State | Amount of Federal EITC Claims, TY 2008 (\$ millions) | Percent of Total U.S. EITC Claims, TY 2008 | Estimated Cost of Federal EITC in FY 2012 (\$ millions) | Estimated Cost of State EITC in FY 2012 | | |
|--|--|--|---|--|---|---|
| | | | | Set at 5% of Federal Credit* (\$ millions) | Set at 10% of Federal Credit* (\$ millions) | Set at 20% of Federal Credit* (\$ millions) |
| Alabama | 1,236,759 | 2.44% | 1,320 | 59 | 119 | 238 |
| Alaska | 61,815 | 0.12% | 66 | 3 | 6 | 12 |
| Arizona | 1,001,197 | 1.97% | 1,069 | 48 | 96 | 192 |
| Arkansas | 655,575 | 1.29% | 700 | 31 | 63 | 126 |
| California | 5,481,142 | 10.81% | 5,851 | 263 | 527 | 1,053 |
| Colorado | 563,786 | 1.11% | 602 | 27 | 54 | 108 |
| Connecticut | 345,990 | 0.68% | 369 | 17 | 33 | 66 |
| Delaware** | 128,227 | 0.25% | 137 | 6 | 12 | 25 |
| Florida | 3,825,237 | 7.54% | 4,084 | 184 | 368 | 735 |
| Georgia | 2,339,271 | 4.61% | 2,497 | 112 | 225 | 450 |
| Hawaii | 172,619 | 0.34% | 184 | 8 | 17 | 33 |
| Idaho | 232,570 | 0.46% | 248 | 11 | 22 | 45 |
| Kentucky | 768,208 | 1.51% | 820 | 37 | 74 | 148 |
| Maine** | 166,539 | 0.33% | 178 | 8 | 16 | 32 |
| Mississippi | 963,186 | 1.90% | 1,028 | 46 | 93 | 185 |
| Missouri | 980,059 | 1.93% | 1,046 | 47 | 94 | 188 |
| Montana | 141,891 | 0.28% | 151 | 7 | 14 | 27 |
| Nevada | 373,849 | 0.74% | 399 | 18 | 36 | 72 |
| New Hampshire | 119,381 | 0.24% | 127 | 6 | 11 | 23 |
| North Dakota | 73,092 | 0.14% | 78 | 4 | 7 | 14 |
| Ohio | 1,780,167 | 3.51% | 1,900 | 86 | 171 | 342 |
| Pennsylvania | 1,611,545 | 3.18% | 1,720 | 77 | 155 | 310 |
| South Carolina | 1,025,672 | 2.02% | 1,095 | 49 | 99 | 197 |
| South Dakota | 112,124 | 0.22% | 120 | 5 | 11 | 22 |
| Tennessee | 1,307,355 | 2.58% | 1,396 | 63 | 126 | 251 |
| Texas | 5,517,268 | 10.88% | 5,890 | 265 | 530 | 1,060 |
| Utah | 320,501 | 0.63% | 342 | 15 | 31 | 62 |
| Virginia** | 1,076,990 | 2.12% | 1,150 | 52 | 103 | 207 |
| West Virginia | 287,082 | 0.57% | 306 | 14 | 28 | 55 |
| Wyoming | 59,426 | 0.12% | 63 | 3 | 6 | 11 |
| Other | 55,063 | 0.11% | 59 | 3 | 5 | 11 |
| States That Have Enacted Refundable EITCs | | | | | | |
| District of Columbia | 94,078 | 0.19% | 100 | | | |
| Illinois | 1,979,163 | 3.90% | 2,113 | | | |
| Indiana | 998,418 | 1.97% | 1,066 | | | |
| Iowa | 358,193 | 0.71% | 382 | | | |
| Kansas | 372,693 | 0.73% | 398 | | | |
| Louisiana | 1,223,396 | 2.41% | 1,306 | | | |
| Maryland | 722,374 | 1.42% | 771 | | | |
| Massachusetts | 622,413 | 1.23% | 664 | | | |
| Michigan | 1,526,648 | 3.01% | 1,630 | | | |
| Minnesota | 548,208 | 1.08% | 585 | | | |
| Nebraska | 233,344 | 0.46% | 249 | | | |
| New Jersey | 1,049,299 | 2.07% | 1,120 | | | |
| New Mexico | 426,626 | 0.84% | 455 | | | |
| New York | 3,241,226 | 6.39% | 3,460 | | | |
| North Carolina | 1,818,663 | 3.59% | 1,942 | | | |
| Oklahoma | 673,746 | 1.33% | 719 | | | |
| Oregon | 463,283 | 0.91% | 495 | | | |
| Rhode Island | 148,347 | 0.29% | 158 | | | |
| Vermont | 68,657 | 0.14% | 73 | | | |
| Washington | 725,169 | 1.43% | 774 | | | |
| Wisconsin | 642,777 | 1.27% | 686 | | | |
| U.S. Total | 50,720 | 100.00% | 54,147 | | | |

* Estimates of state EITCs assume participation rate equal to 90% of federal participation.

** Delaware, Maine, and Virginia already offer non-refundable credits. Since the cost shown is the total cost of a refundable credit, the added cost of making the credit refundable in these states would be substantially less.

Source: State claims taken from IRS Statistics of Income Bulletin, Tax Year 2008: Historical Table 2, May 2010. FY 2012 cost calculated based on Joint Committee on Taxation estimates of federal tax expenditures.