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TESTIMONY BEFORE THE MARYLAND SENATE BUDGET AND TAXATION COMMITTEE

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Position: Support SB 526

The Center on Budget and Policy Priorities supports SB 526, which would increase the Maryland Refundable Earned Income Tax Credit from 20 percent to 25 percent of the federal EITC. The refundable EITC is a proven and popular mechanism for encouraging workforce participation and helping to offset other state taxes low-income families pay. SB 526 would increase these benefits and help hundreds of thousands of low-to-moderate income families in Maryland make ends meet.

Chairman Currie, Vice-Chairman Hogan, and members of the committee:

Thank you for the opportunity to testify about the Earned Income Tax Credit, or EITC. My name is Jason Levitis. I am a Policy Analyst and Counsel to the State Fiscal Project at the Center on Budget and Policy Priorities. The Center is a non-profit, non-partisan research institute in Washington. Our policy work addresses a range of government policies, with a particular focus on their impacts on low- and moderate-income families. My work focuses on state tax and budget policies, with a major concentration on the design and implementation of state tax policies that are targeted to poor families, particularly working-poor families.

My remarks today focus on three areas:

- I will describe the federal EITC and the state EITCs that have been enacted in 20 states.
- I will explain how Maryland's state EITC operates and who benefits.
- I will discuss various options for expanding Maryland's EITC.

Federal and state EITCs

The Earned Income Tax Credit addresses a fundamental problem: many working families do not earn enough to live on. Their wages are low and the costs of supporting a family — food, clothing, housing, transportation, job-related costs, health care and so on — are substantial. Some of those costs may be defrayed through various forms of public programs. But most low-income families who are working receive only limited help from public programs.

In Maryland in 2004, about 158,000 people in *working* families lived below the federal poverty line. (The federal poverty line varies by family size and is adjusted each year for inflation; in 2006 dollars, the poverty line for a family of four is roughly $20,500.) Almost half a million people in Maryland are part of working families that earn incomes slightly above the federal poverty line but still have difficulty making ends meet. Of these low-income Marylanders, more than half are children.

Compounding this poverty, low-income working families in Maryland pay substantial amounts of state and local taxes. These include general sales taxes, excise taxes, and property taxes, among others. The Institute on Taxation and Economic Policy estimated that the lowest-income 20 percent of Maryland households in 2002 paid, on average, 9.4 percent of their incomes in state and local taxes, a higher share than did upper-income households.

The Federal EITC

The Earned Income Tax Credit is a wage supplement for low- and moderate-income working families that is administered through the income tax. The federal Earned Income Tax Credit was enacted in 1975, and major expansions were enacted in 1986, 1990, and 1993. Today it is widely recognized as the single most important public source of income support for working families with children.

The EITC is available, by design, only to working families. The maximum EITC benefit for the 2006 tax year is $4,536 for families with two or more children and $2,747 for families with one child. The greater EITC benefit for larger families reflects recognition that larger families face higher living expenses than smaller families.

The EITC benefit that an eligible family receives depends on the family's income. For families with very low earnings, the value of the EITC *increases* as earnings rise. A family with two or more children, for example, receives an EITC equal to 40 cents for each dollar earned if their earnings are $11,340 or less. The rate is slightly lower, 34 cents, for one-child families. In this way, the EITC acts as a wage subsidy.

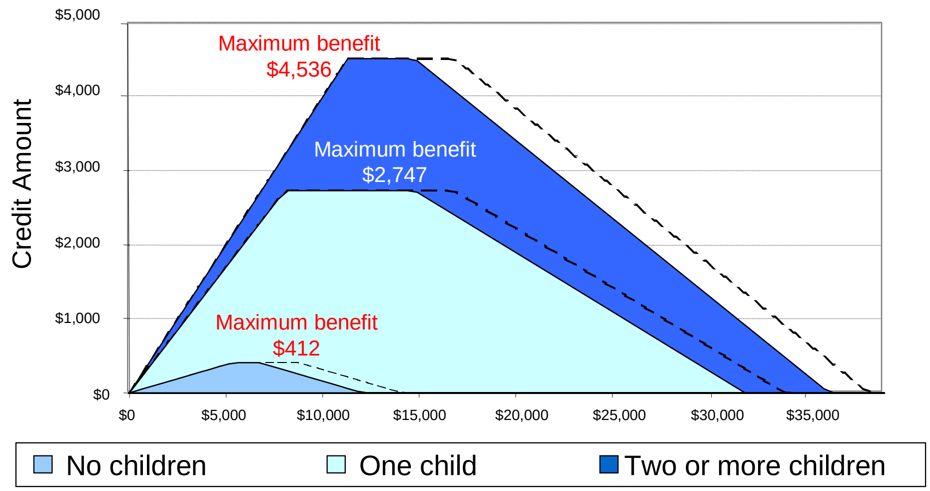
The maximum credit is available to single-parent families with incomes up to $14,810, or two-parent families with incomes up to $16,810. Above those income levels, the EITC gradually phases out, so that families with incomes as high as $38,350 may receive some benefit from the credit.

Workers without a qualifying child also may receive a much smaller federal EITC.

The federal EITC is *refundable*. This means a family receives the full amount of its credit even if the credit amount is greater than its income tax liability. The amount by which the credit exceeds annual income taxes is paid as a refund. If a family has no income tax liability, the family receives the entire EITC as a refund. This enables the EITC to operate as a wage subsidy and an offset to *all* federal taxes, not simply an offset to income tax liability.

FIGURE 1

The Federal Earned Income Tax Credit in Tax Year 2006



Note: Married couples with income in the phaseout range qualify for a higher credit than single parents — shown by dashed lines.

State EITCs

Since the late 1980s, some 20 states have enacted EITCs of their own. State EITCs have received broad support. EITCs have been enacted in states led by Republicans, in states led by Democrats, and in states with bipartisan leadership. The credits are supported by business groups as well as by social service advocates.

State EITCs are very simple. They are nearly always set at a flat percentage of the federal credit. In other words, a family's state EITC equals its federal credit multiplied by a given percentage rate — for instance, 30 percent in New York, 20 percent in New Jersey, and 35 percent in the District of Columbia. A New York family that receives a $3,000 federal EITC, for example, would qualify for a $900 New York State EITC.

Because it is administered through the income tax, compliance and administrative costs of the EITC are quite low. Administrative costs for the federal EITC have been shown to be in the range of 1 percent to 2 percent, much lower than the costs of other federally funded income support programs such as Food Stamps. For states, the administrative cost of an EITC is even lower because the Internal Revenue Service does much of the work. For instance, the federal government uses mechanisms such as large databases of Social Security numbers to screen for ineligible EITC applicants and reject their claims. States, in effect, piggyback on these federal enforcement mechanisms

Sixteen of the existing 20 state EITCs follow the federal practice of offering credits that are *refundable*. This enables the EITC to operate as a wage subsidy and an offset to *all* state and local taxes, not simply an offset to state income tax liability.

Research about the Effect of EITCs

The effectiveness of the federal EITC both in supporting work and in alleviating child poverty has been confirmed by a number of recent studies.

- The EITC now lifts about 4.5 million people — roughly half of them children — out of poverty each year; it is the nation's most effective antipoverty program for working families.

- A substantial body of academic research now shows that the credit has contributed to a significant increase in labor force participation among single mothers.

- Interviews with EITC recipients show that many use their EITC refunds to make the kinds of investments — paying off debt, investing in education, securing decent housing — that enhance economic security and promote economic opportunity.

Maryland's EITCs

How Maryland's EITCs Work

Maryland is the only state with two earned income tax credits — a smaller refundable EITC, and a larger non-refundable EITC. The refundable EITC is set at 20 percent of the federal EITC, and is available only to families with children. The non-refundable EITC is equal to 50 percent of the federal EITC, and is available to everyone who receives the federal EITC if they have pre-credit Maryland income tax liability. The credits interact in a complicated fashion, the effect of which is to limit the benefit to either a tax offset equal to 50 percent of the federal credit, or a refund of 20 percent of the federal credit, but not both.[1]

Maryland is unique among states in another way: its use of local EITCs. In keeping with its two-tier state EITC structure, Maryland authorizes two local EITCs, one non-refundable and one refundable. Every locality in Maryland with a local income tax is required to offer a relatively large non-refundable EITC. Localities also have the option of offering a smaller refundable EITC. Montgomery County is currently the only locality that takes advantage of this option.

Who Benefits from Maryland's EITCs?

Because of their targeted structure, EITCs overwhelmingly benefit low-income families, primarily those with children. In 2003, about 50 percent of the benefit from the federal EITC in Maryland went to families earning less than $15,000. And 80 percent went to families earning less than $25,000.

[1] This works operationally in the following way: The value of the 20-percent refundable credit is reduced by the extent to which a family benefits from the 50-perecnt non-refundable credit. The effect is economically equivalent to a family having to choose between the credits.

In 2000, about 176,000 Maryland tax filers benefited from the state refundable EITC, at a cost of around $55 million dollars. Almost 250,000 claimed the non-refundable EITC, at a cost of about $62 million.

Geographically, the benefit of the EITC is spread throughout the state. Table 1 shows that in every county in the state, thousands of filers receive the federal EITC, bringing millions of dollars to the county. Most of these filers can also benefit from Maryland's state EITCs.

TABLE 1: RECEIPT OF FEDERAL EITC IN MARYLAND (TY2003)

County	Number of Tax Filers Receiving EITC	Total EITC Amounts Received ($)
Allegany	4,955	8,192,233
Anne Arundel	21,080	33,100,857
Baltimore	43,591	72,069,979
Baltimore City	76,965	142,042,679
Calvert	3,526	5,918,914
Caroline	2,679	4,679,145
Carroll	5,192	7,977,846
Cecil	5,200	8,797,635
Charles	6,859	11,677,780
Dorchester	3,155	5,481,595
Frederick	8,292	12,724,105
Garrett	2,154	3,537,980
Harford	10,003	16,215,449
Howard	8,358	13,130,257
Kent	1,491	2,484,628
Montgomery	41,159	65,357,420
Prince George's	62,147	106,177,303
Queen Anne's	1,708	2,794,429
Somerset	2,091	3,764,978
St. Mary's	4,987	8,409,130
Talbot	2,130	3,495,379
Washington	8,470	13,755,536
Wicomico	7,588	13,799,061
Worcester	3,836	6,271,402
Statewide total	**337,616**	**571,855,720**

Source: The Brookings Institution, Metropolitan Policy Program, Earned Income Tax Credit data from Internal Revenue Service, TY2003; Center on Budget and Policy Priorities.

Options for expanding Maryland's EITCs

EITCs — both federal and state — have proven to be excellent and popular policies. The expansion of an existing EITC is also frequently a good policy to consider. It is important to note, however, that all of these options have monetary costs, and they are only prudent policy if the state has the necessary resources. I will not comment here on the relative cost and affordability of each option.

- **Expand the refundable EITC.** The most straightforward way to help low-income working families is increase to the value of Maryland's refundable EITC, currently set at 20 percent of the federal EITC. Senate Bill 526 enacts this option, increasing the refundable EITC to 25 percent of the federal EITC. This option would help every family (176,000 of them in 2002) that currently claims Maryland's refundable EITC. It would also help some thousands of additional families who currently claim the non-refundable EITC because the refundable EITC is less than their tax liability. These families would now receive a refund. Because the benefit of this option is fully refundable, it would act as an additional wage subsidy and work incentive for families at the edge of the workforce.

- **Expand the non-refundable EITC.** This option would increase the amount of the non-refundable EITC, currently set at 50 percent of the federal EITC. House Bill 851 enacts this option, gradually raising the non-refundable EITC to 75 percent of the federal EITC. This option would have the effect of increasing Maryland's income tax thresholds — the lowest income at which income tax is due — for eligible families. But because it is non-refundable, this option would provide no benefit at all for many low-income families. Among two-parent families of four, only those earning more than $26,000 per year would benefit. This option also lacks the benefits of refundability, such as offsetting other taxes and creating a powerful work incentive for those just entering the workforce.

- **Make childless adults eligible for the refundable EITC.** Another option to consider is allowing childless adults to claim the refundable EITC, in addition to the non-refundable EITC for which they are currently eligible. As noted above, refundability offers some important advantages, including offsetting other state and local taxes and creating an incentive to begin and increase workforce participation. Expanding the refundable EITC to include childless adults and couples would extend these benefits to a group that faces significant unemployment and poverty. It would simplify tax compliance and administration, since the refundable EITC would be the same fraction of the federal EITC for every tax filer. And it would be relatively inexpensive, since the benefit provided is small compared to the EITC for families with children.

- **Expand use of local refundable EITCs.** At present, Montgomery County is the only local jurisdiction that offers a refundable EITC. This credit is invisible to taxpayers on the state tax forms because it is paid out automatically to county residents who claimed the state credit, but it could be an important form of support to many of the state's low-wage workers.

To conclude, the Earned Income Tax Credit is an administratively straightforward mechanism that has proven successful in supporting work and lifting low-income working families out of poverty. Expanding it would increase these benefits. I welcome your questions.

Note: Substantively identical testimony was submitted to the Maryland House of Delegates Finance Committee on February 22, 2007, in support of House Bill 223.