Center on Budget and Policy Priorities

820 First Street NE, Suite 510
Washington, DC 20002

Tel: 202-408-1080
Fax: 202-408-1056

center@cbpp.org
www.cbpp.org

Revised May 3, 2010

SOME STATES SCALING BACK TAX CREDITS FOR LOW-INCOME FAMILIES

Measures Would Increase Poverty, Slow Job Growth

By Nicholas Johnson and Erica Williams

Facing large budget shortfalls, a small number of states are scaling back tax credits for low-income working families, which not only harms some of the families hardest hit by the recession but also weakens the economy by lowering overall demand. States have other budget-balancing strategies that are better for both vulnerable families and the state economies.

Millions of low-income working families and individuals are relying on federal and state tax credits, such as Earned Income Tax Credits (EITC), to help them endure the recession. The economic crisis has increased unemployment and reduced work hours and wages. Credits offered by states help to alleviate this hardship and stabilize incomes.

The benefit of such programs also extends to the economy at large. State tax credits for low-income families put money into the hands of people most likely to spend it, and most likely to spend it in their local economy.

Most states are maintaining these important programs. But a few have recently taken steps to cut back their credits. For example:

- Virginia enacted a cut to its EITC that would raise taxes by $6 million on an estimated 114,000 low-income working families. (This cut might be reversed before it takes effect.)

- Minnesota cut back a renters' credit affecting 300,000 low- and moderate-income households and eliminated a gas tax credit.

- Georgia's legislature voted to eliminate $22 million in wage support for 1 million workers earning less than $20,000 per year.

Similar measures have been proposed in New Jersey, Iowa, the District of Columbia, and Montgomery County, Maryland.

Supporters have presented these reductions and proposed reductions in other states as budget-balancing measures. Yet raising taxes on low-income working families is not the best option for raising state revenue. In some cases, proposals and legislation to roll back low-income tax credits are being made alongside proposals to *cut* taxes for wealthy individuals and corporations, which likely would neither strengthen the economy nor create jobs. On balance, it would be far better for working families and for state economies if states would maintain existing refundable low-income tax credits, cancel other costly tax cuts, and raise needed new revenue from higher-income families and profitable corporations.

Refundable Tax Credits Are Helping Families and Broader Economy

Many states offer tax credits targeted to low- and moderate-income families. These include state versions of the EITC — a federal tax credit for working families with incomes below about $48,000, mostly families with children.

EITCs and similar credits are widely recognized as effective tools for fighting poverty and increasing incomes. Indeed, the federal EITC is the nation's most effective anti-poverty program for working families. In 2009, it lifted an estimated 6.5 million people — including 3.3 million children — out of poverty.[1] About half of all states have enacted state versions of the EITC, as have some major localities.[2]

Nearly 25 million tax filers now receive the federal EITC, according to 2007 IRS data, and more than 9 million of them live where there also is a state EITC. Annual state EITC benefits exceed $2.5 billion. Many states also offer other forms of refundable credits to low- and moderate-income families, such as property tax credits. (Most states have very regressive tax systems, meaning they take a larger share of the incomes of low-income families than of high-income families; such credits ameliorate the regressivity.)

While these credits vary in structure and purpose, they all increase the after-tax incomes of low- and moderate-income families, helping them meet the costs of food, housing, transportation, clothing, and other necessities.

In a recession, many families suffer unemployment, reduced work hours, or reduced wages — all of which cause incomes to fall. As a result, the number of working-poor families has increased in each of the last three recessions. After the 2001 recession, for example, rising unemployment and wage cuts caused the number of people qualifying for the federal EITC to increase 11 percent in a single year.[3] (The EITC goes only to working families and individuals; a family can receive the credit if any member of the family has earnings at any point in the tax year.) The depth of the current

---

[1] Center simulation of 2009 policies using Census data from the March 2004-2006 Current Population Surveys and other sources. For a description of the methods used, see Arloc Sherman, "Stimulus Keeping 6 Million Americans Out of Poverty in 2009, Estimates Show," September 9, 2009. Available at http://www.cbpp.org/cms/index.cfm?fa=view&id=2910.

[2] For more information on state EITCs see Erica Williams, Nicholas Johnson, and Jon Shure, "State Earned Income Tax Credits: 2009 Legislative Update," November 10, 2009. Available at: http://www.cbpp.org/files/11-10-10sfp.pdf.

[3] A small portion of this increase was due to expansion of the EITC for married couples.

recession suggests that more people may be eligible for the credit and that participation may be even greater. Indeed, preliminary IRS data point to a substantial increase in the number of people filing for the federal credit in tax year 2009.[4]

The impact of these programs goes beyond reducing economic hardship for individual families. Low-income tax credits put money in the hands of people most likely to spend it, which is good for the economy. During an economic downturn, generating more demand for goods and services is what creates and preserves jobs. Businesses are more likely to hire and retain employees and to maintain or increase orders from their suppliers when they see increased consumption of their products or services. Low-income families spend virtually all of their income to make ends meet, and they tend to spend it locally. So tax credits quickly wind up benefiting local employers.

Most States Are Maintaining Refundable Credits, But a Few Are Considering Cuts

Because refundable tax credits are so important to families and to local economies, most states are preserving them — even in the face of very large, recession-driven budget shortfalls. Of the 23 states plus D.C. with EITCs, only Virginia has enacted a cut to its credit and the state has yet to implement the cut (see below). Nor have there been widespread cuts to property tax credits or other forms of refundable credits. This has held true even as more than 40 states have made cuts to education, health care, human services, and other programs and some 33 states have enacted tax increases and other revenue measures.

Some states are even improving their credits. Washington is launching a Working Families Tax Rebate, a refundable state sales tax credit for low-income families eligible for the federal EITC. The program is slated for implementation in 2012.[5] Indiana, Michigan, and North Carolina implemented increases in their state EITCs last year.

Troublingly, however, a few states have cut or are proposing to cut their credits.

- Earlier this month, Virginia enacted a cut to its EITC that would take effect in 2010 and would cost an estimated 114,000 low-income working families a total of about $6 million. A newspaper report cited a spokesperson for Governor Bob McDonnell as promising that the governor will reverse the cut so that families can claim the full credit for the 2010 tax year. Such a reversal presumably would require legislation and hence a special session of the Virginia legislature, because the 2010 regular session is over.[6]

- Minnesota Governor Tim Pawlenty cut funding for the state Renters' Credit by $51 million for

---

[4] Preliminary data from the IRS for tax year 2009 shows an 8 percent year-over-year increase in the number of EITC filers and 16 percent increase in EITC dollars claimed through March 2010 compared with the same period last year; some portion of this – but not all of it – is due to expanded eligibility rules.

[5] For more information on Washington's Working Families Tax Credit, see http://budgetandpolicy.org/schmudget/overview-of-2010-revenue-measures.

[6] "Think Tank Says Virginia Budget Raises Taxes on Poor," *Richmond Times-Dispatch*, April 16, 2010. Specifically, Virginia's action was to require taxpayers in tax year 2010 to calculate their EITCs under pre-2009 federal tax law. This will raise taxes for many married couples and families with three or more children who benefited in 2009 from changes in the federal credit.

close to 300,000 low- and moderate-income households. One-quarter of the affected households are seniors and people with severe disabilities.

- In Georgia, the state legislature has sent to the governor a bill eliminating the refundability of the state's low-income tax credit, which provides needed tax relief and wage support for workers earning less than $20,000 per year. The change would take nearly $22 million directly out of the pockets of the 1 million affected taxpayers — mostly workers and seniors.[7]

- New Jersey Governor Chris Christie has proposed reducing the state EITC from 25 percent of the federal credit to 20 percent. Approximately 485,000 families would lose more than $45 million. The governor is also proposing eliminating property tax rebates for seniors, renters, and homeowners with incomes below $75,000.[8]

- In the District of Columbia, Mayor Adrian Fenty proposed reducing the District's credit to 39 percent from 40 percent of the federal credit. This change would save the District a tiny fraction of its expenditures but take $1 million from some of the 50,000 low-income workers whose wages get a boost from the DC EITC.[9]

- A similar reduction is being pursued in Montgomery County, Maryland, one of the three localities in the country to offer a local EITC (the other two are New York City and San Francisco). County Executive Isiah Leggett has proposed reducing the county's EITC by one-third or $5.4 million for the 30,500 working families who claim the credit.[10]

- Iowa did not take the action needed in order to conform to federal EITC expansions enacted under the American Recovery and Reinvestment Act of 2009 for tax year 2009. This is a very unusual step; in past years Iowa and virtually all other states with EITCs have maintained conformity to the federal EITC. Because this year Iowa is diverging from other states in not conforming, 72,000 families with three or more children and married couple families with children have lost out on an estimated $2.5 million.[11]

Other Budget-Balancing Strategies Are Better for Families and State Economies

Supporters of the proposed cuts to low-income tax credits defend them as necessary to bring budgets into balance. Certainly, states face dire budget circumstances because of the most severe

---

[7] For more information on Georgia's proposed reduction to its low-income tax credit, see: http://www.gbpi.org/news_commentary.aspx.

[8] To read Governor Christie's FY 2011 budget proposal, go to: http://www.nj.gov/treasury/omb/publications/11bib/BIB.pdf.

[9] For more information on DC's FY 2011 budget proposal, see: http://www.dcfpi.org/wp-content/uploads/2009/03/FY11tax1.pdf.

[10] For more information on Montgomery County's budget proposal, see: http://www.montgomerycountymd.gov/content/omb/FY11/FY10-FY11_budget_adjustments.pdf.

[11] The action in Iowa was not incorporated into the state income tax forms for 2009, and does not appear to have been publicized on the state tax department's website until April 12. But tax department staff report that the adjustment was incorporated into tax software, and the department also plans to adjust claimants' tax refunds. For tax year 2010, it appears that both Iowa and Virginia will not allow state EITC recipients to benefit from the federal EITC changes. It appears that all other states with EITCs, however, are conforming to the federal changes.

drop in revenue on record. Budget shortfalls are projected to be $180 billion for fiscal year 2011 and $120 billion for fiscal year 2012, and nearly all state governments are bound by constitutional requirements to balance their budgets.

But alternatives to cutting low-income tax credits exist. For instance:

- In New Jersey, legislative leaders have proposed extending a tax on taxpayers with incomes over $400,000 that was in effect last year; the proposal would save the state $1 billion per year, enabling it to balance the budget without the governor's proposed cuts in the EITC, property tax rebates, and other programs.

- Georgia's governor is considering whether to sign legislation cutting the state's capital gains tax in half (which would mainly benefit the very wealthiest families) and eliminating a tax on corporate net worth. Vetoing these bills would save the state treasury $380 million annually, far more than the savings from the proposed cut in the state's low-income tax credit (see above).

- Virginia's legislature this year voted to phase out a corporate tax break, but the governor line-item vetoed that measure. Allowing that phase-out to take effect would have saved the state $30 million, more than enough to sustain the EITC.[12]

Such budget-balancing strategies would be better for the economy than repealing low-income credits. As economist and Nobel laureate Joseph Stiglitz and Peter Orszag — now director of the federal Office of Management and Budget — have pointed out, tax measures that reduce the incomes of high-wealth individuals and corporate shareholders are more likely to be paid from savings and retained earnings, so they will have relatively little effect on how much those individuals spend. Reductions in the after-tax incomes of *low-income* families, on the other hand, have a greater impact on consumption and hence the overall economy.[13]

Moreover, there is no good evidence that state tax cuts billed as "job-creation measures" will, in fact, create any jobs. Careful studies have found that the vast majority of jobs created in the wake of such measures would have been created anyway.[14] And because states must balance their budgets, they generally pair expensive tax cuts with major cuts to programs and services (such as low-income tax credits); any stimulus effects of the tax cuts are offset by the reduction in demand resulting from spending cuts.

Conclusion

---

[12] "Virginia Governor Acts to Keep Conformity With Federal Domestic Production Deduction," *Daily Tax Report*, April 15, 2010.

[13] Nicholas Johnson, "Budget Cuts or Tax Increases at the State Level: Which Is Preferable When the Economy Is Weak?" Center on Budget and Policy Priorities, April 27, 2010. Available at: http://www.cbpp.org/cms/?fa=view&id=1032.

[14] See for example Scott Schuh, Michael W. Klein, and Robert K. Triest, *Job Creation, Job Destruction, and International Competition,* The Upjohn Institute, Kalamazoo, MI, 2003. Cited in Iris J. Lav and Robert Tannenwald, "The Zero-Sum Game: States Cannot Stimulate Their Economies by Cutting Taxes," Center on Budget and Policy Priorities, March 2, 2010. Available at: http://www.cbpp.org/cms/index.cfm?fa=view&id=3100.

The challenges of state budget crises are real, but so are the challenges that working families face. It makes little sense for states to sacrifice important measures that reduce taxes and support wages for those hardest hit by a recession in the name of a balanced budget, when better approaches exist. State refundable tax credits targeted at low-income working families encourage work, stabilize income, and spur consumption. And they are far more beneficial to state economies than tax cuts for wealthy individuals, which generally do not increase consumption, and for corporations, which have not been proven to create jobs. States should focus on maintaining and improving policies that work and limit those with high costs and poor results.