



# CENTER ON BUDGET AND POLICY PRIORITIES

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## HOW MUCH WOULD A STATE EARNED INCOME TAX CREDIT COST?

Seventeen states now offer tax credits for low- and moderate-income working families based on the federal Earned Income Tax Credit. A number of additional states are considering enacting EITCs in the 2003 legislative session. The following provides guidelines that policymakers and others can use to estimate the cost of a refundable state Earned Income Tax Credit that is set at a percentage of the federal credit. The estimating procedure is a simple three-step process.

The estimating procedure makes use of two sets of data. The first set is published Internal Revenue Service data on the amount of federal EITC claims filed by residents of each state. The most recent full-year data, shown in the second column of the table on pp. 3-4, are for claims made in 2001. These claims are for tax year 2000, meaning that the claims were based on 2000 earnings. All but a tiny fraction of EITCs are claimed and paid when taxes are filed in January through April of the following year, in this case in early 2001. As a result, nearly all of the cost for tax year 2000 EITCs is incurred in federal fiscal year 2001 and reflected in this data. In most states, the cost of tax year 2000 claims would fall in state fiscal year 2000-01 as well.

The second source of data is U.S. Department of Treasury projections of the cost of the federal EITC in future years. Treasury projections released in February, 2003, indicate that the cost of the federal EITC will grow from \$32.28 billion in federal fiscal year 2002 to \$36.47 billion in federal fiscal year 2004, an average annual growth rate of 6.4 percent that takes into account the first phase of the modest expansion of the EITC enacted in 2001. After fiscal year 2004, annual growth is expected to range from 2.5 percent to 4.0 percent.<sup>1</sup>

Using these data, the cost of a refundable state EITC in fiscal year 2004 is relatively easy to estimate.

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

The cost of the federal EITC in a state in a future fiscal year may be determined by calculating the share of the federal EITC attributable to the state in the base year and using that share to project the cost of the federal EITC in the state in a future year. For example, in 2000, Alabama EITC claims totaled \$819 million, or 2.58 percent of nationwide EITC claims for that tax year. Assuming that Alabama's share of federal EITC claims remains approximately

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<sup>1</sup> The independent Congressional Budget Office and the congressional Joint Committee on Taxation each have predicted somewhat slower EITC growth than Treasury predicts; CBO's March forecast predicted annual EITC growth through 2007 of only about 1.5 percent while JCT's December forecast predicted annual growth through 2007 of only about 2.3 percent.

constant, Alabama's federal EITC claims in fiscal year 2004 may be expected to equal 2.58 percent of \$36.47 billion, or \$940 million, as shown in the fourth column of the table on p. 3.

*Step 2: Multiply federal claims by the percentage at which the state credit is to be set.*

If the state EITC is set at a specified percentage of the federal EITC, the cost of the federal credit in the state, as determined in Step 1, should be multiplied by the percentage rate. This yields an estimate of what the state credit would cost in a given fiscal year if everyone who receives the federal credit also receives the state credit.

*Step 3: Adjust the estimate for the fact that not all federal EITC claimants will claim the state credit in the first few years.*

In practice, a substantial portion of federal EITC claimants fail to claim state EITCs, especially in the first few years after enactment of the state credit.<sup>2</sup> This appears to be true for several reasons. Awareness of the credit may be limited in the first few years after enactment of the state credit. In addition, some eligible families have the IRS compute their federal credit; such families 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 after enactment is likely to be lower than the full cost of the federal credit multiplied by the state percentage. To reflect this difference, the estimate may be reduced by 10 percent.

The last two columns of the table below show the estimated costs of refundable state EITCs set at either 10 percent or 20 percent of the federal credit in FY 2004, based on the method described above. Other percentages may be calculated based on those numbers (for instance, the cost of a 15 percent credit would be one-and-a-half times the cost of a 10 percent credit). The same method may be used for other years, using the projections of the federal credit shown in the table on this page. None of these figures include the costs of changing tax forms to include a space to claim an EITC or the costs of processing and administering EITC claims; those costs are likely to increase the overall cost of the credit by a very small amount.

### U.S. Treasury Projections of Federal EITC Costs

<u>Fiscal Year</u>	<u>Cost (millions)</u>
2002	\$32,280
2003	\$35,540
2004	\$36,470
2005	\$37,370
2006	\$38,860
2007	\$40,060
2008	\$41,170

Source: *Budget of the United States Government, FY 2004: Analytical Perspectives*, Table 6-1.

<sup>2</sup> 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 69 percent in the District of Columbia, 81 percent in Vermont, 83 percent in New York, 84 percent in New Jersey, 85 percent in Wisconsin, and 90 percent in Kansas, Maryland and Minnesota. In only two states for which data are available, Colorado (93 percent) and Massachusetts (97 percent), was first-year participation above 90 percent, possibly due to aggressive outreach and (in Colorado) the availability of a well-publicized sales tax rebate at the same time. In the second year of availability in each state, participation rates typically rise slightly above the first-year rate. Similar research is reported in the fiscal note prepared by the North Carolina General Assembly's Fiscal Research Division on HB 952 in 1999 (see [www.ncga.state.nc.us/html1999/bills/fiscalInfo/house/hfn0952.pdf](http://www.ncga.state.nc.us/html1999/bills/fiscalInfo/house/hfn0952.pdf)).

The estimates presented here only apply to credits that are refundable and that are set at a flat percent of the federal EITC. Further information on these estimates, or on methods of estimating the costs of non-refundable credits or different credit structures, may be obtained from the staff of the State Fiscal Project at the Center on Budget and Policy Priorities. Further information on the policy implications of state EITCs may be obtained by calling the Center or by reviewing the Center on Budget and Policy Priorities publication entitled *A Hand Up: How State Earned Income Tax Credits Help Working Families Escape Poverty*, available by phone or on the Center's web site, [www.cbpp.org](http://www.cbpp.org).

<b>Estimated Cost of Refundable State Earned Income Tax Credits</b> (dollars in millions)						
State	Federal EITC claims, TY 2000	Percent of total U.S. claims	Cost of Federal EITC in FY 2004 (estimated)	Estimated Cost of State EITC in FY 2004		
				Set at 5% of Federal Credit*	Set at 10% of Federal Credit*	Set at 20% of Federal Credit*
Alabama	\$819	2.58%	\$940	\$42	\$85	\$169
Alaska	\$40	0.13%	\$46	\$2	\$4	\$8
Arizona	\$563	1.77%	\$646	\$29	\$58	\$116
Arkansas	\$440	1.39%	\$505	\$23	\$45	\$91
California	\$3,778	11.90%	\$4,338	\$195	\$390	\$781
Colorado	\$330	1.04%	\$379	**	**	**
Connecticut	\$214	0.67%	\$246	\$11	\$22	\$44
Delaware	\$79	0.25%	\$91	\$4	\$8	\$16
District of Columbia	\$84	0.26%	\$96	**	**	**
Florida	\$2,181	6.87%	\$2,504	\$113	\$225	\$451
Georgia	\$1,271	4.00%	\$1,459	\$66	\$131	\$263
Hawaii	\$94	0.30%	\$108	\$5	\$10	\$19
Idaho	\$130	0.41%	\$149	\$7	\$13	\$27
Illinois***	\$1,228	3.87%	\$1,410	\$63	\$127	\$254
Indiana	\$570	1.79%	\$655	**	**	**
Iowa***	\$213	0.67%	\$245	\$11	\$22	\$44
Kansas	\$224	0.71%	\$257	**	**	**
Kentucky	\$478	1.51%	\$549	\$25	\$49	\$99
Louisiana	\$922	2.90%	\$1,059	\$48	\$95	\$191
Maine***	\$112	0.35%	\$129	\$6	\$12	\$23
Maryland	\$493	1.55%	\$566	**	**	**
Massachusetts	\$385	1.21%	\$442	**	**	**
Michigan	\$880	2.77%	\$1,011	\$45	\$91	\$182
Minnesota	\$305	0.96%	\$350	**	**	**
Mississippi	\$664	2.09%	\$762	\$34	\$69	\$137
Missouri	\$610	1.92%	\$700	\$32	\$63	\$126
Montana	\$100	0.31%	\$115	\$5	\$10	\$21
Nebraska	\$140	0.44%	\$161	\$7	\$14	\$29
Nevada	\$198	0.62%	\$227	\$10	\$20	\$41
New Hampshire	\$73	0.23%	\$84	\$4	\$8	\$15

(continued)

State	Federal EITC claims, TY 2000	Percent of total U.S. claims	Cost of Federal EITC in FY 2004 (estimated)	Estimated Cost of State EITC in FY 2004		
				Set at 5% of Federal Credit*	Set at 10% of Federal Credit*	Set at 20% of Federal Credit*
New Jersey	\$701	2.21%	\$805	**	**	**
New Mexico	\$291	0.92%	\$334	\$15	\$30	\$60
New York	\$2,203	6.94%	\$2,530	**	**	**
North Carolina	\$1,078	3.39%	\$1,238	\$56	\$111	\$223
North Dakota	\$52	0.16%	\$60	\$3	\$5	\$11
Ohio	\$1,074	3.38%	\$1,233	\$55	\$111	\$222
Oklahoma	\$458	1.44%	\$526	**	**	**
Oregon***	\$297	0.94%	\$341	\$15	\$31	\$61
Pennsylvania	\$1,041	3.28%	\$1,195	\$54	\$108	\$215
Rhode Island***	\$89	0.28%	\$102	\$5	\$9	\$18
South Carolina	\$648	2.04%	\$744	\$33	\$67	\$134
South Dakota	\$72	0.23%	\$83	\$4	\$7	\$15
Tennessee	\$794	2.50%	\$912	\$41	\$82	\$164
Texas	\$3,362	10.59%	\$3,861	\$174	\$347	\$695
Utah	\$170	0.54%	\$195	\$9	\$18	\$35
Vermont	\$46	0.14%	\$53	**	**	**
Virginia	\$687	2.16%	\$789	\$35	\$71	\$142
Washington	\$456	1.44%	\$524	\$24	\$47	\$94
West Virginia	\$209	0.66%	\$240	\$11	\$22	\$43
Wisconsin	\$368	1.16%	\$423	**	**	**
Wyoming	\$46	0.14%	\$53	\$2	\$5	\$10
<b>U.S. Total</b>	<b>\$31,760</b>	<b>100.00%</b>	<b>\$36,470</b>			

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

\*\* State already has enacted a refundable state EITC.

\*\*\* For Illinois, Iowa, Maine, Oregon and Rhode Island, cost shown is the total cost of a refundable credit; since those states already offer non-refundable credits, the added cost of making the credit refundable would be substantially less than the amount shown here.

Sources: Internal Revenue Service; Budget of the United States Government - FY 2004, Analytical Perspectives, pg. 105; Center on Budget and Policy Priorities.