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HOW MUCH WOULD A STATE EARNED INCOME TAX CREDIT COST IN 2008?

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Twenty states have enacted 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 2007 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 The first set is preliminary unpublished Internal Revenue Service data on the total value of federal EITC claims filed by residents of each state. The most recent full-year data, shown in the second column of Table 2, are for claims made for the 2005 tax year.

All but a tiny fraction of federal EITCs claimed 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 cost for tax year 2005 EITCs was incurred in federal fiscal year 2006 (which ended in October 2006). Similarly, in most states the cost of tax year 2007 claims will fall in the state fiscal year that ends in 2008.

The second data source is the Office of Management and Budget's projections of the cost of the federal EITC in future years, published in the President's Budget. For example, the Fiscal Year 2008 Budget, released in February 2007, suggests that the federal EITC will cost some \$42.9 billion in federal fiscal year 2008, including both the tax expenditure (non-refundable) and outlay (refundable) portions, as shown in Table 1.

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

Step 1: Estimate the total value 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 estimated by calculating the share of the federal EITC attributable to the state in the base year and applying that share to the expected total cost of the federal EITC in a future year. For example, for tax year 2005, Alabama EITC claims totaled \$1.06 billion, or 2.56 percent of the nationwide total. Assuming that Alabama's

share of federal EITC claims remains approximately constant, Alabama's federal EITC claims in fiscal year 2008 would be 2.56 percent of \$42.9 billion, or \$1.1 billion, as shown in the fourth column of Table 2.

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

If the state EITC is set at a fixed 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.

TABLE 1: PROJECTIONS OF FEDERAL EITC COST	
Fiscal Year	Cost (billions)
2006	\$41.2
2007	\$41.8
2008	\$42.9
2009	\$43.7
2010	\$44.7
2011	\$46.2

Sources: Budget of the United States Government - FY 2008, Analytical Perspectives; Center on Budget and Policy Priorities.

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 federal EITC claimants fail to claim state EITCs, especially in the first few years after the state credit is enacted.¹ 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 cost estimate should be reduced by at least 10 percent.

The last three columns of Table 2 show the estimated costs to states in fiscal year 2008 of implementing refundable EITCs for tax year 2007, based on the method described above. The three columns show the cost for EITCs set respectively at 5 percent, 10 percent, and 20 percent of the federal credit.

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 federal cost shown 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 costs are likely to increase the overall cost of the credit by less than one percent.

¹ 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.

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 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. Further information on the policy implications of state EITCs may be obtained by calling the Center or by reviewing the forthcoming Center on Budget and Policy Priorities publication entitled *A Hand Up: How State Earned Income Tax Credits Help Working Families Escape Poverty*, available on the Center's web site, www.cbpp.org.

TABLE 2: ESTIMATED COST OF REFUNDABLE STATE EARNED INCOME TAX CREDITS

State	Amount of Federal EITC Claims, TY 2005 (\$ millions)	Percent of Total U.S. EITC Claims, TY 2005	Estimated Cost of Federal EITC in FY 2008 (\$ millions)	Estimated Cost of State EITC in FY 2008		
				Set at 5% of Federal Credit* (\$ millions)	Set at 10% of Federal Credit* (\$ millions)	Set at 20% of Federal Credit* (\$ millions)
Alabama	1,058	2.56%	1,098	49	99	198
Alaska	64	0.16%	67	3	6	12
Arizona	751	1.81%	778	35	70	140
Arkansas	559	1.35%	580	26	52	104
California	4,374	10.57%	4,537	204	408	817
Colorado	450	1.09%	466	21	42	84
Connecticut	279	0.67%	289	13	26	52
Delaware**	104	0.25%	108	5	10	20
Florida	2,947	7.12%	3,056	138	275	550
Georgia	1,813	4.38%	1,881	85	169	339
Hawaii	139	0.34%	144	6	13	26
Idaho	186	0.45%	193	9	17	35
Iowa**	291	0.70%	302	14	27	54
Kentucky	635	1.53%	658	30	59	118
Louisiana	1,080	2.61%	1,120	50	101	202
Maine**	144	0.35%	149	7	13	27
Mississippi	821	1.99%	852	38	77	153
Missouri	811	1.96%	841	38	76	151
Montana	124	0.30%	128	6	12	23
Nevada	285	0.69%	296	13	27	53
New Hampshire	99	0.24%	103	5	9	19
New Mexico	367	0.89%	381	17	34	69
North Carolina	1,483	3.58%	1,538	69	138	277
North Dakota	65	0.16%	68	3	6	12
Ohio	1,435	3.47%	1,489	67	134	268
Pennsylvania	1,348	3.26%	1,398	63	126	252
South Carolina	844	2.04%	875	39	79	157
South Dakota	95	0.23%	98	4	9	18
Tennessee	1,048	2.53%	1,087	49	98	196
Texas	4,684	11.32%	4,858	219	437	874
Utah	255	0.62%	264	12	24	48
Virginia**	888	2.15%	921	41	83	166
Washington	604	1.46%	626	28	56	113
West Virginia	256	0.62%	266	12	24	48
Wyoming	55	0.13%	57	3	5	10
Other Areas	52	0.13%	54	2	5	10
States That Have Enacted Refundable EITCs						
District of Columbia	82	0.20%	85			
Illinois	1,599	3.87%	1,659			
Indiana	789	1.91%	818			
Kansas	312	0.75%	324			
Maryland	596	1.44%	619			
Massachusetts	507	1.23%	526			
Michigan	1,199	2.90%	1,244			
Minnesota	431	1.04%	447			
Nebraska	194	0.47%	201			
New Jersey	857	2.07%	889			
New York	2,652	6.41%	2,751			
Oklahoma	595	1.44%	617			
Oregon	380	0.92%	394			
Rhode Island	116	0.28%	120			
Vermont	59	0.14%	61			
Wisconsin	514	1.24%	533			
U.S. Total	41,376	100.00%	42,913			

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

**For Delaware, Iowa, Maine, and Virginia, 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 Supplemental Earned Income Report, January 2007; 2007 Budget of the United States Government - FY 2008, Analytical Perspectives; Center on Budget and Policy Priorities.