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HOW MUCH WOULD A STATE EARNED INCOME TAX CREDIT COST IN 2009?

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Twenty-three 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 2008 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 The first set is preliminary unpublished Internal Revenue Service data on the total value of federal EITC claims filed by residents of each state.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 2006 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 2008 EITCs will be incurred in federal fiscal year 2009 (which ends in September 2009). Similarly, in most states the cost of tax year 2008 claims will fall in the state fiscal year that ends in 2009.

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 2009 Budget, released in February 2008, suggests that the federal EITC will cost some \$46.5 billion in federal fiscal year 2009, 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.

TABLE 1: PROJECTIONS OF FEDERAL EITC COST

Fiscal Year	Cost (billions)
2007	\$43.3
2008	\$44.7
2009	\$46.5
2010	\$48.7
2011	\$49.3

Sources: Budget of the United States Government - FY 2009, Analytical Perspectives; Center on Budget and Policy Priorities.

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 2006, Alabama EITC claims totaled \$1.10 billion, or 2.55 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 2009 would be 2.55 percent of \$46.5 billion, or \$1.18 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.

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. Some eligible families have the IRS compute their federal credit, and 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 2009 of implementing refundable EITCs for tax year 2008, 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.

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 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.

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.

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

State	Amount of Federal EITC Claims, TY 2006 (\$ millions)	Percent of Total U.S. EITC Claims, TY 2006	Estimated Cost of Federal EITC in FY 2009 (\$ millions)	Estimated Cost of State EITC in FY 2009		
				Set at 5% of Federal Credit*	Set at 10% of Federal Credit*	Set at 20% of Federal Credit*
Alabama	1,103	2.55%	1,183	53	106	213
Alaska	67	0.15%	72	3	6	13
Arizona	796	1.84%	853	38	77	154
Arkansas	583	1.35%	625	28	56	112
California	4,546	10.49%	4,872	219	438	877
Colorado	472	1.09%	506	23	46	91
Connecticut	296	0.68%	317	14	29	57
Delaware**	109	0.25%	117	5	11	21
Florida	3,098	7.15%	3,320	149	299	598
Georgia	1,938	4.47%	2,077	93	187	374
Hawaii	147	0.34%	158	7	14	28
Idaho	192	0.44%	206	9	19	37
Kentucky	669	1.54%	717	32	65	129
Maine**	149	0.34%	160	7	14	29
Mississippi	855	1.97%	916	41	82	165
Missouri	856	1.98%	918	41	83	165
Montana	126	0.29%	135	6	12	24
Nevada	302	0.70%	323	15	29	58
New Hampshire	104	0.24%	111	5	10	20
North Dakota	68	0.16%	73	3	7	13
Ohio	1,523	3.51%	1,633	73	147	294
Pennsylvania	1,414	3.26%	1,516	68	136	273
South Carolina	885	2.04%	949	43	85	171
South Dakota	100	0.23%	107	5	10	19
Tennessee	1,107	2.55%	1,186	53	107	214
Texas	4,849	11.18%	5,197	234	468	935
Utah	261	0.60%	280	13	25	50
Virginia**	924	2.13%	990	45	89	178
Washington	623	1.44%	668	30	60	120
West Virginia	263	0.61%	282	13	25	51
Wyoming	55	0.13%	59	3	5	11
Other	51	0.12%	54	2	5	10
States That Have Enacted Refundable EITCs						
District of Columbia	84	0.19%	90			
Illinois	1,686	3.89%	1,807			
Indiana	841	1.94%	901			
Iowa	309	0.71%	331			
Kansas	324	0.75%	348			
Louisiana	1,110	2.56%	1,190			
Maryland	622	1.43%	666			
Massachusetts	531	1.23%	569			
Michigan	1,288	2.97%	1,381			
Minnesota	463	1.07%	496			
Nebraska	204	0.47%	218			
New Jersey	893	2.06%	957			
New Mexico	379	0.87%	406			
New York	2,790	6.44%	2,990			
North Carolina	1,559	3.60%	1,671			
Oklahoma	610	1.41%	654			
Oregon	394	0.91%	422			
Rhode Island	123	0.28%	132			
Vermont	61	0.14%	65			
Wisconsin	549	1.27%	589			
U.S. Total	43,353	100.00%	46,460			

* 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 Supplemental Earned Income Report, Jan 2008. FY 2009 cost calculated based on OMB data as reported in the 2008 Budget of the United States Government – FY 2009.