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# States Can Adopt or Expand Earned Income Tax Credits to Build a Stronger Future Economy

By Erica Williams

Twenty-six states plus the District of Columbia have enacted their own version of the federal Earned Income Tax Credit (EITC) to help working families earning low wages meet basic needs. State EITCs build on the success of the federal credit by keeping people on the job and reducing hardship for working families and children. This important state support also extends the federal EITC's well-documented long-term positive effects on children, boosting the nation's future economic prospects.

State EITCs provide extensive benefits to children, families, and communities, and are straightforward to administer and to claim. Lawmakers in states without their own EITC should consider enacting one. States that have cut back or eliminated their credits should reverse course, and states that have limited their credits so that they *only* offset income taxes should expand them to help offset the full range of state and local taxes that low-income households pay. This would vastly enhance the credits' impact. By investing in an EITC, states can make a real difference in the lives of low- and moderate-income working families.

## Why Consider an EITC?

Many working families with children struggle to make ends meet on low wages. A full-time job at the federal minimum wage yields about $15,000 — often insufficient income for a family to afford basic necessities. The EITC, a federal tax credit for low- and moderate-income workers and their families, rewards work and improves the outlook for children in low-income households. State lawmakers can build on the proven effectiveness of the federal EITC to address low wages with a state-level credit. Like the federal EITC, state EITCs:

- **Help working families make ends meet.** Many low-wage jobs fail to provide sufficient income on which to live. "Refundable" EITCs, which give working households the full value of the credit they earn even if it exceeds their income tax liability, provide low-income workers with a needed income boost that can help them meet basic needs.
- **Keep families working.** Refundable EITCs help low-wage working families pay for the very things that allow them to continue working, like child care and transportation. They are also structured to encourage the lowest-earning families to work more hours. That extra time and experience in the working world can translate into better opportunities and higher pay over

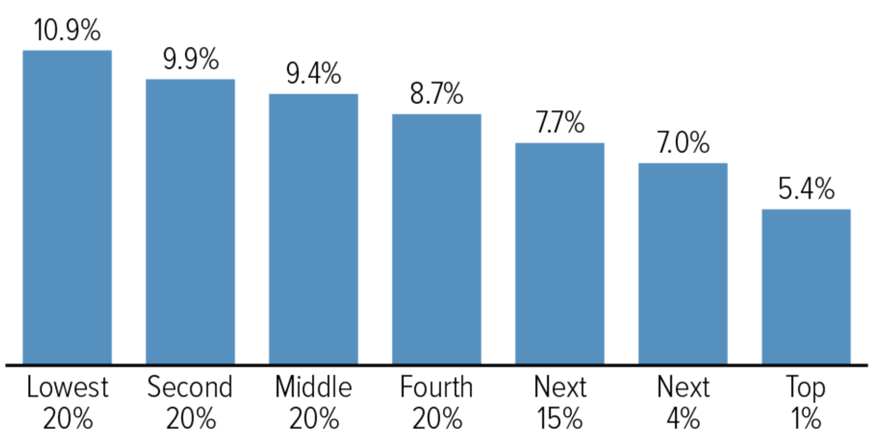
time. Three out of five filers who receive the federal credit use it just temporarily — for just one or two years at a time.[1]

- **Reduce poverty, especially among children.** Nearly 10 million children in working families lived below the official poverty line (about $24,000 for a family of four) in 2015;[2] millions of families modestly above that income level have difficulty affording food, housing, and other necessities. The federal EITC is one of the nation's most effective tools for reducing the struggles of working families and children. It kept 6.5 million people — over half of them children — out of poverty in 2015, and helped many with slightly higher incomes make ends meet. State EITCs build on that record.
- **Have a lasting effect.** A growing body of research finds that young children in low-income families that get an income boost like the EITC provides tend to do better and go farther in school because the additional resources help parents better meet their needs. And because these children attain more skills and education, they tend to work more and earn more as adults. This helps communities and the economy because it means more people and families are on solid ground and fewer need help over the long haul.

FIGURE 1

**Lowest-Income Households Pay Highest State and Local Taxes**

Total state and local taxes that non-elderly residents pay as a share of their income in 2015




Income ceilings: $19,000 for bottom 20%; $35,000 for second 20%; $56,000 for middle 20%; $93,000 for fourth 20%; $190,000 for next 15%; $471,000 for next 4%.

Source: Institute on Taxation and Economic Policy

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In addition, low- and moderate-income families in almost all states pay higher state and local taxes as a share of their income than do upper-income families (see Figure 1). This imbalance reflects

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[1] Chuck Marr *et al.,* "Earned Income Tax Credit Promotes Work, Encourages Children's Success at School, Research Finds," CBPP, updated October 1, 2014, http://www.cbpp.org/cms/?fa=view&id=3793.

[2] According to Census' Current Population Survey, 9.8 million poor children had at least one working parent in 2015.

states' heavy reliance on sales, excise, and property taxes, all of which fall more heavily on families with lower incomes. Some states have increased their reliance on these taxes in recent years by shifting their tax systems away from income taxes, pushing an even larger share of the costs of state services to households earning the least.

## States Continue Building on Federal Credit

In recent years, a number of states have made major EITC advances. For example, four states — **California** (2015), **Colorado** (2013), **Connecticut** (2011), and **Ohio** (2013) — enacted EITCs to bolster the wages of struggling families.[3] Many other states improved existing credits (see Box 1).

### Box 1: Many States Have Expanded Their EITCs in Recent Years

**Iowa** doubled its credit to 14 percent of the federal EITC (2013) and then raised it further to 15 percent of the federal credit (2014).

**Maine** made its credit refundable (2015).

**Maryland** raised its credit to 28 percent of the federal EITC from 25 percent, phased in over four years (2014).

**Massachusetts** raised its credit to 23 percent of the federal EITC from 15 percent (2015).

**Minnesota** boosted the total value of its credit by 25 percent (2014).

**New Jersey** raised its credit to 30 percent of the federal EITC from 20 percent (2015) and then to 35 percent in the following year (2016).

**Ohio** enacted a small, nonrefundable EITC (2013) and the next year doubled it to 10 percent of the federal EITC, though it remains nonrefundable (2014).

**Oregon** expanded its credit to 8 percent of the federal EITC from 6 percent (2013) and then expanded the credit to 11 percent for families with very young children (2016).

**Rhode Island** expanded its credit for most recipients by making it fully refundable, though the state also cut the credit to 10 percent of the federal EITC from 25 percent (2014). The next year Rhode Island raised its credit to 12.5 percent of the federal EITC (2015) and then to 15 percent (2016).

**Washington, D.C.** became the first jurisdiction to expand the credit for workers without dependent children in the home, extending the credit's reach to childless workers with somewhat higher incomes and setting its value at 100 percent of the federal credit (2014).

[3] Just prior to the recession, five states enacted new EITCs: Michigan in 2006; North Carolina, Louisiana, and New Mexico in 2007; and Washington State in 2008. Washington State has yet to fund its credit.

Efforts to cut back state credits have been far less prominent. Most recently, in 2016, **Oklahoma** cut its credit by nearly 70 percent, shrinking it to only cover state income tax liability.[4]

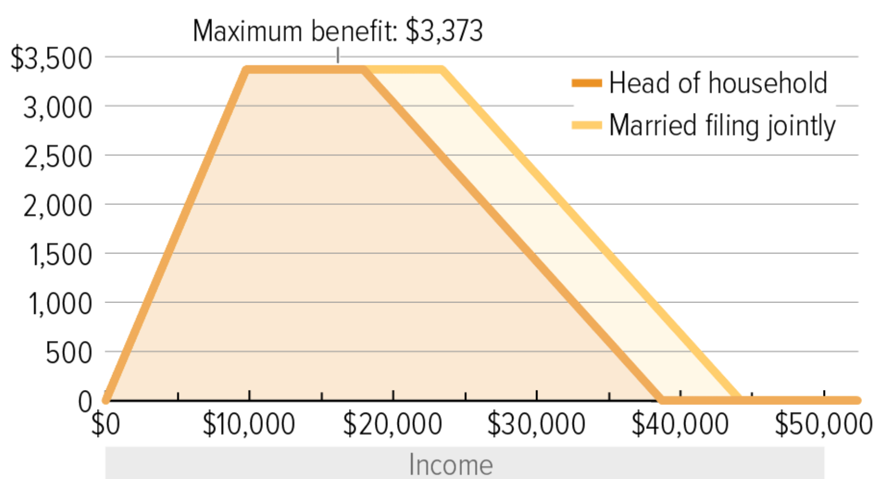
Because state lawmakers have moved to support working families through state EITCs, more than one in three recipients of the federal EITC lives in a state with its own credit, and state EITCs boost the earnings of working families by close to $4 billion annually.

## EITC's Design Rewards Work

The EITC only goes to working families and is designed to reward their effort. For families with very low earnings, the EITC increases as earnings rise, which encourages families to work more hours when possible. Working families with children earning up to about $39,000 to $54,000 (depending on marital status and the number of children in the family) generally can qualify for a state EITC, but the largest benefits go to families with incomes between about $10,000 and $24,000. Workers without children can also qualify in most states, but only if their income is below about $15,000 ($20,000 for a married couple), and the benefit is small.

FIGURE 2

**Earned Income Tax Credit for Households with One Child, 2016**




Note: Assumes all income is from earnings (as opposed to investments, for example).
Source: Internal Revenue Service

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[4] Other recent cuts include: in 2013, North Carolina allowed its EITC to expire and cut it by 10 percent in its final year of existence. In 2011, Michigan cut its credit by 70 percent, Wisconsin cut its credit by 21 percent for families with two or more children, and Connecticut enacted a credit set at 30 percent of the federal EITC but then cut it immediately to 25 percent due to budget problems (the credit now stands at 27.5 percent). In 2010, New Jersey cut its credit to 20 percent of the federal EITC from 25 percent, though it later reversed the cut as noted in the box.

The EITC's design also reflects the reality that larger families face higher living expenses than smaller families: the maximum benefit varies for families with one, two, and three or more children. For example, the maximum federal benefit for families with two children in tax year 2016 is $5,572, compared to $3,373 for families with one child. (As with most other federal tax provisions, the IRS adjusts EITC benefit amounts and eligibility levels each year for inflation.) [5]

Figure 2 shows how the EITC works for a single-mother family with one child earning the minimum wage in 2016 (about $15,000 a year for full-time, year-round work). For every dollar she earns, she gets 34 cents in EITC benefits. The value of the credit continues rising at that rate until her earnings reach $9,920. At that point, she receives the maximum benefit of $3,373. Once her earnings exceed $18,190, the credit shrinks by about 16 cents for each additional dollar of earnings until reaching zero at about $39,000 in earnings.

## Most States Model Their EITCs on Federal Credit

Nearly all state EITCs are modeled directly on the federal EITC: they use federal EITC eligibility rules and are a specified percentage of the federal credit. (The percentages are shown in Table 1.)

A few state credits, however, differ somewhat from the federal credit:

- **Minnesota** uses federal eligibility rules and its credit parallels major elements of the federal structure, but it has its own schedule for the income levels at which the credit phases in and out.
- **Indiana** uses old federal guidelines that exclude recent expansions and improvements to the federal credit.
- **Washington, D.C.'s** expanded EITC for workers without dependent children will phase in following federal guidelines, but the maximum credit will extend to 150 percent of the poverty line (for an individual), and the credit will fully phase out at twice the poverty line.
- **California's** newly enacted EITC is available to just a small portion of workers who claim the federal credit — those with incomes less than $14,000 for the largest family size — and self-employment income cannot be used to qualify for the credit.[6]

Twenty-two states and Washington, D.C. follow the federal practice of offering a *fully refundable* EITC. (See Figure 3.) Without this feature, state EITCs would fail to offset the other substantial state and local taxes families pay. It is the reason that the EITC is so effective at boosting income

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[5] The 2009 Recovery Act included two key provisions to help the EITC go further. First, it expanded "marriage penalty relief" by raising the EITC income eligibility level for married workers by $2,000, thereby extending eligibility for the maximum credit to more married-couple working families with low incomes. Second, it provided, for the first time, a third benefit tier for larger families. Working families with three or more children receive an EITC equal to 45 cents for each dollar earned up to $13,930, for a maximum credit of $6,269 in 2016. The credit completely phases out for single-parent families with three or more children when their income exceeds $47,955 and for *married-couple* families of this size when their income exceeds $53,505. These expansions were extended in 2012 and made permanent at the end of 2015.

[6] The California credit is available to working families and individuals with wage income below about $6,700 to $14,200, depending on family size. The credit is worth 85 percent of household's federal EITC until household income reaches half of the level at which the federal credit is fully phased in; it then begins phasing out at varying rates, depending on family size. In 2016, the maximum credit ranges from just over $200 for workers without dependent children to about $2,700 for workers with three or more children. The value of the credit is set each year by the legislature.

and reducing hardship, because it lets families keep more of what they earn and helps them keep working despite low wages.

### Box 2: Expanding EITC for Workers Not Raising Children Would Improve Equity

Expanding the EITC for workers not raising children in their home would ensure that the credit offers a hand up to *all* workers struggling to get by on low wages.[a] The federal EITC largely leaves out these "childless workers," even though they are integral members of their communities and local economies — and many are non-custodial parents or future parents. The EITC reaches far fewer childless workers than workers with children and offers them a much smaller benefit. Partly as a result, childless workers are the lone group that federal income and payroll taxes push into poverty (or deeper into poverty). Proposals to expand the federal credit for these workers—such as the nearly identical proposals of former President Obama and House Speaker Ryan—would address this problem and reward their hard work.

An expansion also would modestly reduce the income gap between high- and low-income households by boosting incomes at the bottom. Some 13 million workers would benefit from the Obama/Ryan proposals—people who do important but low-paid work in hospitals, schools, office buildings, and construction sites across the country. Just under half of them are women, more than half are under age 35, and more than half are white. People of color would also benefit substantially, since they are likelier than whites to have low incomes.

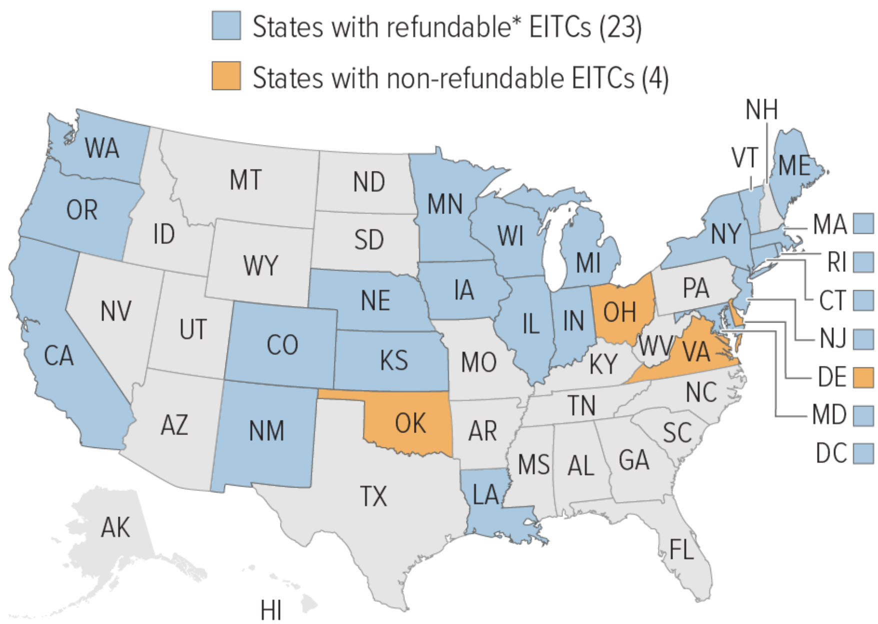
In addition to making work pay and narrowing the income gap, an expansion of the EITC for childless workers would likely produce other benefits. Many researchers posit that it could increase employment rates among workers not raising children, as EITC expansions in the early 1990s did among single mothers. It also could strengthen attachment to the labor force among less-educated, younger workers, whose rates of employment and incomes have fallen over the last couple of decades. And some research suggests that boosting incomes among less-educated, low-wage working men in particular could help increase marriage rates and potentially lower crime rates, thereby improving their life prospects.

States need not wait for an expansion of the federal credit for childless workers. The District of Columbia expanded its own EITC to benefit these workers in 2014 and several other states are considering similar expansions.

[a] See Chuck Marr et al., "Strengthening the EITC for Childless Workers Would Promote Work and Reduce Poverty," CBPP, April 11, 2016, http://www.cbpp.org/research/federal-tax/strengthening-the-eitc-for-childless-workers-would-promote-work-and-reduce.

FIGURE 3

## Twenty-six States and DC Have Enacted EITCs, 2016




*Refundable EITCs give working households the full value of the credit they earn even if it exceeds their income tax liability.

Source: CBPP analysis

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The remaining four state EITCs — in **Delaware, Ohio, Oklahoma,** and **Virginia** — are available only to the extent that they offset a family's state income tax. Thus, while these non-refundable EITCs can reduce *income* taxes for families that owe them, they do not make up for other taxes that working families pay; nor do they do much, if anything, to help keep families working and out of poverty. Ohio's EITC is limited even further, to no more than half of state income taxes owed on taxable income above $20,000.

TABLE 1

## State Earned Income Tax Credits, 2016

| State | Percentage of Federal Credit | Refundable? |
|---|---|---|
| California | 85% of federal credit, up to 50% of the federal phase-in range | Yes |
| Colorado | 10% | Yes |
| Connecticut | 27.5% | Yes |
| Delaware | 20% | No |
| District of Columbia[a] | 40%/ 100% | Yes |
| Illinois | 10% | Yes |
| Indiana[b] | 9% | Yes |
| Iowa | 15% | Yes |
| Kansas | 17% | Yes |
| Louisiana | 3.5% | Yes |
| Maine | 5% | Yes |
| Maryland[c] | 26% | Yes |
| Massachusetts | 23% | Yes |
| Michigan | 6% | Yes |
| Minnesota[d] | Avg. 34% | Yes |
| Nebraska | 10% | Yes |
| New Jersey | 35% | Yes |
| New Mexico | 10% | Yes |
| New York | 30% | Yes |
| Ohio[e] | 5% | No |
| Oklahoma | 5% | No |
| Oregon[f] | 8%/11% | Yes |
| Rhode Island | 15% | Yes |
| Vermont | 32% | Yes |
| Virginia | 20% | No |
| Washington[g] | 10% (when implemented) | Yes |
| Wisconsin | 4%- one child<br>11%- two children<br>34% - three children<br>No credit- childless workers | Yes |

[a] The District of Columbia now offers a credit equal to 100 percent of the federal EITC to adults without dependent children with incomes up to twice the poverty line (for an individual).

[b] Indiana decoupled from federal provisions expanding the EITC for families with three or more children and raising the income phase-out for married couples.

[c] Maryland's refundable EITC will reach 28 percent of the federal credit by tax year 2018. The state also offers a non-refundable EITC set at 50 percent of the federal credit. Taxpayers in effect may claim either the refundable credit or the non-refundable credit, but not both.

[d] Minnesota's credit for families with children, unlike the other credits shown in this table, is structured as a percentage of income rather than a percentage of the federal credit. It does not include the federal EITC's features of a larger credit for families with three or more children or higher income phase-out for married couples. The average given here reflects total projected state spending for the Working Family Credit divided by projected federal spending on the EITC in Minnesota as modeled by Minnesota's House Research Department; this average fluctuates from year to year.

[e] Ohio's EITC is non-refundable and limited to half of income taxes owed on income above $20,000.

[f] Oregon's EITC is set to expire at the end of tax year 2019. In 2016, lawmakers increased the credit for workers with children 3 years and younger to 11 percent of the federal credit.

[g] Washington's EITC has never been implemented, but would likely be worth 10 percent of the federal credit or $50, whichever is greater.

## State EITCs Are Easy to Administer and Less Expensive Than Many Other Tax Cuts

State EITCs are easy to administer and claim. States incur virtually no costs for determining eligibility for their credit because in most cases, families eligible for the federal credit also are eligible for the state credit. And because state credits typically are set at a fixed percentage of the federal credit, state revenue departments need only add one line to a state's income tax form. State EITCs are easy to claim because filers need only multiply their federal EITC by a specified rate to determine their state credit.

State EITCs also offer a good value to states. Existing refundable EITCs in states with income taxes cost less than 2 percent of state tax revenues each year.[7] Because state EITCs are well targeted to low- and moderate-income working families, the cost is more modest than other tax cuts that states often consider.[8] Though low-income households tend to comprise a substantial share of all taxpayers, they account for a smaller share of tax revenue. A few hundred dollars for each family makes a big difference to the family's ability to make ends meet without making a major dent in a state's treasury.

States can also use an EITC to help make low-income families whole again after raising a regressive tax, like the sales tax or gas tax, by setting aside part of the resulting revenue to finance an EITC.

States finance their EITCs in whole or part from their general fund. Federal regulations allow states to finance the refundable part of a credit going to families with children from a state's share of the federal Temporary Assistance for Needy Families (TANF) block grant. Most states, however, have few such funds, because the value of the TANF block grant — which does not adjust for inflation each year — has eroded over time. No matter how it is financed, an EITC can complement a state's welfare program by assisting low-income working families with children as they transition from welfare to work.

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[7] Four factors affect the cost of a state EITC: the number of families that claim the federal credit, the percentage of the federal credit at which the state credit is set, whether the state credit is refundable, and how many state residents who receive the federal credit also claim the state credit.

[8] For further information about estimating the cost of a state EITC, see Erica Williams and Michael Leachman, "How Much Would a State Earned Income Tax Credit Cost in Fiscal Year 2017?" CBPP, updated January 12, 2016, http://www.cbpp.org/cms/index.cfm?fa=view&id=2992.

### Box 3: Even States Without an Income Tax Could Offer a State EITC

Like the federal EITC, state EITCs have a long, successful history of using the income tax to improve the economic security of low-income working families. Some question whether a state with no income tax could offer similar assistance, since state revenue departments in these states do not typically collect the information about family income and structure needed to determine EITC eligibility. The example of Washington State's Working Families Tax Rebate, however, illustrates how states without an income tax could work with the IRS to provide a state credit.[a]

To confirm eligibility, Washington State will use data on federal EITC claimants provided by the IRS to state revenue departments under a data-sharing arrangement. Piggybacking on federal efforts saves administrative costs for the state. When the credit is fully phased in, state officials estimate that administration will constitute only about 4 percent of the cost of the EITC.[b] If the state were to increase the size of the credit, this share would be even smaller.

The other states without a broad-based income tax (Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, and Wyoming) could follow Washington State's lead. State EITCs could be particularly helpful in these states because their tax systems rely heavily on excise taxes, property taxes, and in most cases sales taxes. Because of this reliance, low- and moderate-income families in these states pay a higher share of their income in taxes than wealthier families.

[a] The Washington State credit was scheduled to take effect in tax year 2009, but — in large part because of the recession and resulting revenue shortfalls — policymakers have not yet financed the credit.

[b] Fiscal note for Washington ESSB 6809. Note that administrative costs in states that already have an income tax are substantially lower, typically well below 1 percent of the credit's value.