
February 1, 2006

HOW MUCH WOULD A STATE EARNED INCOME TAX CREDIT COST?

By Jason A. Levitis

Nineteen 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 2006 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 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 2003 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 2004 EITCs was incurred in federal fiscal year 2005 (which ended in October 2005). Similarly, in most states the cost of tax year 2006 claims will fall in the state fiscal year that ends in 2007.

The second data source is Congressional Budget Office projections of the cost of the federal EITC in future years. For example, CBO projections released in July, 2005, suggest that the federal EITC will cost some \$42.1 billion in federal fiscal year 2007, as shown in Table 1.¹

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 2003, Alabama EITC claims totaled \$981 million, or 2.50 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 2007 would be 2.50 percent of \$42.1 billion, or \$1.05 billion, as shown in the fourth column of Table 2.

¹ The CBO publishes projections for the refundable portion of the EITC only. The full cost of the EITC in future years is estimated here by using U.S. Treasury projections of the ratio of refundable and non-refundable portions of the EITC.

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.² 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.

TABLE 1: PROJECTIONS OF FEDERAL EITC COST	
Fiscal Year	Cost (billions)
2005	\$39.6
2006	\$40.9
2007	\$42.1
2008	\$43.0
2009	\$43.9
2010	\$44.2
Sources: CBO Factsheet: "Earned Income Tax Credit and Child Credit Outlays: July 2005 Baseline," adjusted to account for both refundable and non-refundable portions based on 2005 Budget of the United States Government - FY 2006, Analytical Perspectives; Center on Budget and Policy Priorities.	

The last three columns of Table 2 show the estimated 2007 costs to states of implementing refundable EITCs for tax year 2006, 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 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.

² 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 2003 (\$ millions)	Percent of Total U.S. EITC Claims, TY 2003	Estimated Cost of Federal EITC in FY 2007 (\$ millions)	Estimated Cost of State EITC in FY 2007		
				Set at 5% of Federal Credit* (\$ millions)	Set at 10% of Federal Credit* (\$ millions)	Set at 20% of Federal Credit* (\$ millions)
Alabama	981	2.50%	1,053	47	95	190
Alaska	58	0.15%	62	3	6	11
Arizona	710	1.81%	762	34	69	137
Arkansas	529	1.35%	568	26	51	102
California	4,382	11.18%	4,706	212	424	847
Connecticut	263	0.67%	282	13	25	51
Delaware**	97	0.25%	104	5	9	19
Florida	2,807	7.16%	3,015	136	271	543
Georgia	1,643	4.19%	1,764	79	159	318
Hawaii	133	0.34%	143	6	13	26
Idaho	172	0.44%	184	8	17	33
Iowa**	271	0.69%	291	13	26	52
Kentucky	589	1.50%	632	28	57	114
Louisiana	1,116	2.85%	1,198	54	108	216
Maine**	135	0.35%	145	7	13	26
Michigan	1,102	2.81%	1,183	53	106	213
Mississippi	777	1.98%	834	38	75	150
Missouri	750	1.91%	806	36	73	145
Montana	121	0.31%	130	6	12	23
Nebraska	181	0.46%	195	9	18	35
Nevada	265	0.68%	284	13	26	51
New Hampshire	93	0.24%	100	4	9	18
New Jersey	838	2.14%	900	41	81	162
New Mexico	357	0.91%	383	17	34	69
North Carolina	1,374	3.51%	1,476	66	133	266
North Dakota	63	0.16%	68	3	6	12
Ohio	1,344	3.43%	1,443	65	130	260
Pennsylvania	1,255	3.20%	1,347	61	121	243
South Carolina	790	2.01%	848	38	76	153
South Dakota	90	0.23%	97	4	9	17
Tennessee	988	2.52%	1,061	48	95	191
Texas	4,254	10.86%	4,568	206	411	822
Utah	238	0.61%	255	11	23	46
Virginia**	857	2.19%	920	41	83	166
Washington	573	1.46%	615	28	55	111
West Virginia	243	0.62%	261	12	24	47
Wyoming	55	0.14%	59	3	5	11
Other Areas	59	0.15%	63	3	6	11
States That Have Enacted Refundable EITCs						
Colorado	426	1.09%	457			
District of Columbia	87	0.22%	93			
Illinois	1,501	3.83%	1,612			
Indiana	718	1.83%	771			
Kansas	295	0.75%	317			
Maryland	586	1.50%	629			
Massachusetts	468	1.20%	503			
Minnesota	397	1.01%	426			
New York	2,601	6.64%	2,794			
Oklahoma	567	1.45%	609			
Oregon	360	0.92%	387			
Rhode Island	108	0.27%	116			
Vermont	56	0.14%	61			
Wisconsin	465	1.19%	499			
U.S. Total	39,186	100.00%	42,082			

* 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 Statistics on Income 2005 Spring Bulletin; Congressional Budget Office Factsheet: "Earned Income Tax Credit and Child Credit Outlays: July 2005 Baseline"; 2005 Budget of the United States Government - FY 2006, Analytical Perspectives; Center on Budget and Policy Priorities.