

### DISCUSSION

For the lowest-paid workers, the federal minimum wage, which has not kept up with inflation, and the federal Earned Income Tax Credit (EITC) are still too low to lift many families out of poverty. Thus, even if a worker who earns the federal minimum wage works close to full-time year-round, the sum of the worker's earnings and the federal EITC will leave many working families below the federal poverty line. Almost all such workers and families end up even further below more realistic measures of an adequate income.

A state EITC can help remedy this problem by supplementing the earnings of lower-wage employees, typically "piggy-backing" on the uniform federal EITC. Ideally, a state's EITC should be constructed so that when the worker's wages, the federal EITC, and the new state EITC are added together, every full-time worker in the state ends up with a total work-based income that exceeds the poverty line.

The federal EITC rewards work by providing a tax credit for low- and moderate-income employees. Passed by Congress in 1975, the federal EITC was designed to help offset the social security tax while providing an incentive to work. Over time the EITC's link with the social security tax ended and the EITC evolved into a general earnings supplement.

The federal EITC is refundable: if the credit for which an income tax filer is eligible exceeds the filer's tax liability, the filer gets a check equal to the difference. The federal EITC also adjusts for family size. Childless adults get a very small credit; families with one child get a bigger credit, and those with two or more children get an even larger tax credit.

Consequently, many states have created their own EITCs to help the working poor and near-poor make ends meet. State EITCs typically provide families with a supplement equal to a percentage of the federal credit for which they are eligible. Such a supplemental, or "piggy-back," state EITC is sometimes a fixed percentage of the federal credit (regardless of family size), or sometimes a variable percentage of the federal credit that rises as the number of dependents increases. One rationale for a variable rather than fixed percentage EITC is that it ensures that full-time work at the minimum wage (whether the federal minimum or a higher state minimum) plus the federal EITC plus the new state EITC exceeds the poverty line. Using a variable percentage in this manner takes into account the fact that the poverty level changes with family size.

Not all existing state EITCs are refundable. With non-refundable EITCs, individuals can only receive a credit up to their tax liability. Even if they qualify for a bigger credit, their actual payment is capped at the size of their income tax liability and they do not receive any payment from the government. A refundable state EITC provides claimants the full benefit of their credit, paying them any portion of the state EITC that exceeds their tax liability.

### About CSI

The Center for State Innovation (CSI) believes every state can achieve shared prosperity, environmental sustainability, and efficient democratic government. We offer evidence-based, outcome-measured, fiscally prudent strategies for doing so.

A non-partisan, not-for-profit institution, CSI provides many types of assistance to state executives interested in implementing progressive policies.

To learn about CSI's Policy Briefings, Strategy Academies, and other services offered at no cost, visit [www.stateinnovation.org](http://www.stateinnovation.org).

As with the federal program, state EITCs have proven to be an effective means of rewarding work. In summary, state Earned Income Tax Credits: (1) Reduce poverty and economic hardship; (2) Encourage the transition from welfare or unemployment to gainful employment in the regular labor market; and (3) Offset taxes that disproportionately burden low-income families.

## COSTS

The Center on Budget and Policy Priorities found that state EITCs are quite affordable. In 2006, refundable state EITCs cost less than 1 percent of state tax revenues in a given year; absolute costs vary depending on the size of a state's economy. State EITCs can be financed in a number of ways:

- Through a state's general fund.
- From revenue generated through tax increases.
- From funds made available by eliminating other less well-targeted tax cuts.
- In the case of refundable EITCs, with funds made available through the federal Temporary Assistance for Needy Families (TANF) block grant. It should be noted, however, that TANF is increasingly becoming a less viable source of funding as surpluses that were available in the late-1990s dwindle.

The reason a state may choose to expend additional money on a refundable EITC is that the program is so well targeted to those who need help the most, reducing indirect but related costs in other programs serving the poor.

## PUBLIC PERCEPTION

The Federal EITC was first enacted by President Ford and has subsequently increased under every president. It has enjoyed long-standing bipartisan support in Congress. State EITCs have generally been well-received, passing in states with both Republican and Democratic leadership. More generally, there is widespread support for helping working families and the working poor by making work pay. A 2003 survey by Every Child Matters found that 70 percent of respondents felt that reducing taxes for working families with children should be a high or top priority (see chart on next page).

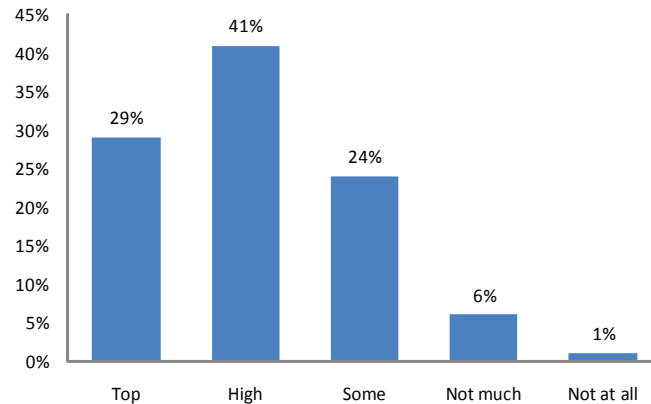
Not only does the public think that reducing the tax burden of working families with children is an important issue, but many individuals are willing to sacrifice to help solve the problem. A 2002 poll reports that 69 percent of respondents said they were in favor of providing additional assistance to working poor families with children, even if it meant providing less tax relief to people like them.

### Federal EITC FACTS

- Each year the federal EITC lifts more than 4 million people out of poverty—equivalent to reducing the population below the poverty line by nearly 11 percent.
- The federal EITC significantly increases the labor force participation of single mothers.
- The federal EITC has been shown to encourage low-income families to build assets through financial and human capital investments.

Source: Center for Budget and Policy Priorities

## CHART

**How much of a priority should reducing taxes for working families with children be?**

Source: Every Child Matters Survey

## TALKING POINTS

### *How is the EITC different from welfare?*

The EITC is for workers, whereas some people may be eligible for welfare even if they do not work. Many TANF recipients do not work and even those that engage in “work activity” seldom get paid wages. The EITC is different. A person can only qualify for the EITC by working at a regular, wage-paying job and paying the same taxes as other workers.

Instead of being compared to welfare, state EITCs are better thought of as a means of ensuring that tax incentives are distributed fairly. Low- and middle-income families are disproportionately affected by income, sales, excise, and property taxes yet derive little benefit from most tax breaks. The EITC is a tax incentive that is specifically targeted for low-income families.

### *Why make the EITC refundable?*

One of the most compelling selling points of the refundable EITC is that the credit structure creates an incentive to work. For workers who qualify for both the federal EITC and a well-designed, supplemental state EITC, the EITC can operate to make work pay more than welfare and more than the poverty line. However, the efficacy of a state EITC – its power to make work more attractive than welfare – is hampered if it is non-refundable and thus arbitrarily limited to the size of the worker’s income tax liability (which for various reasons could be quite small or non-existent). In contrast, a refundable state EITC helps to facilitate the transition away from taxpayer funded welfare and toward rewarding regular work.

### *Aren’t refundable EITCs prone to overpayment?*

The overpayment problem is both overstated and remediable. Most payment errors are attributable to misunderstandings resulting from the complexity of the EITC claim process, rather than attempts to file false claims intentionally. States also have the capacity to reduce overpayment by screening EITC claimants, collaborating with the IRS, adopting consistent across-program eligibility requirements, and supporting initiatives such as the Volunteer Income Tax Assistance (VITA) program, which is meant to help low-income families properly file their taxes. Given that state EITC programs are so closely tied to the administration of the federal EITC, recent attempts to address overpayment at the federal level will carry over to the state level as well.



## WHAT CAN YOU DO?

There are a number of ways in which state executives can promote EITC programs in their state:

### *Introduce new legislation*

- Model Legislation is available.

### *Expand an existing state EITC by:*

- Making it refundable, if it is not already.
- Increasing the credit amount across the board.
- Increasing the credit for larger families based on the number of dependent children.
- Structuring the credit so that it guarantees that full-time work always generates work-based income greater than the poverty line. This means calibrating the state EITC formula so that someone working full-time at the minimum wage (40 hours per week x 52 weeks per year x the applicable federal or, if higher, state minimum wage) + the federal EITC + the state's supplemental EITC exceeds the poverty line for all families with one, two, three, or four members.

### *Increase awareness of both the federal EITC and the state's own EITC*

- The National Governors Association Center for Best Practices offers an outreach kit that can be used by state executives interested in promoting EITC in their state.

### *Publicize and expand free and low-cost tax preparation services such as VITA*

- Use EITC programs as a means of building assets by offering filers financial literacy classes, providing them with information on credit repair, and linking them to opportunities to establish bank accounts.

## RESOURCES

### Policy Reports

National Governors Association Center for Best Practices

- "State Efforts to Support Low-Income Families and Communities Through the Earned Income Tax Credit"  
<http://www.nga.org/Files/pdf/06StateEffortCommunities.pdf>

Center on Budget and Policy Priorities (CBPP)

- The Earned Income Tax Credit  
<http://www.cbpp.org/pubs/eitc.htm>
- "A Hand Up: How State Earned Income Tax Credits Help Working Families Escape Poverty in 2006"  
<http://www.cbpp.org/3-8-06sfp.pdf>
- National Tax Credit Outreach Campaign Website  
<http://www.cbpp.org/eic2009/>
- "A Rising Number of State Earned Income Tax Credits Are Helping Working Families Escape Poverty"  
<http://www.cbpp.org/10-12-06sfp.htm>

- State Earned Income Tax Credits: 2008 Legislative Update  
<http://www.cbpp.org/6-6-08sfp.htm>
- “State Earned Income Tax Credits and the ‘Overpayments’ Issue”  
<http://www.cbpp.org/3-28-07sfp.pdf>
- “Together, State Minimum Wages and State Earned Income Tax Credits Make Work Pay”  
<http://www.cbpp.org/7-12-06sfp.pdf>

#### Economic Policy Institute

- “Improving Work Supports: Closing the Financial Gap for Low-Wage Workers and Their Families”  
<http://www.sharedprosperity.org/bp198/bp198.pdf>

#### Public Opinion Polls

##### Every Child Matters Education Fund, Mason-Dixon Polling and Research

- Budget and Tax Policy Survey (February, 2003)  
<http://www.everychildmatters.org/site/DocServer/Polls/Final%2ONational%2OPoll%20Topline.pdf>

##### The Future of Children

- Public Views on Welfare Reform and Children in the Current Economy Survey (January, 2002)  
[http://www.eric.ed.gov/ERICDocs/data/ericdocs2sql/content\\_storage\\_01/0000019b/80/19/dd/61.pdf](http://www.eric.ed.gov/ERICDocs/data/ericdocs2sql/content_storage_01/0000019b/80/19/dd/61.pdf)

#### Legislation

##### New Jersey

##### The State Of New Jersey, Office of the Governor

- “Governor Corzine Ceremonially Signs Legislation to Help Working Families”  
<http://www.state.nj.us/governor/news/news/2008/approved/20080212.html>

##### New Jersey Legislation

- 2007 New Jersey Chapter 109  
[http://www.njleg.state.nj.us/2006/Bills/PL07/109\\_.PDF](http://www.njleg.state.nj.us/2006/Bills/PL07/109_.PDF)

##### Washington

##### Washington Legislation

- 2008 Washington Chapter 325  
<http://apps.leg.wa.gov/documents/billdocs/2007-08/Pdf/Bills/Session%2OLaw%202008/6809-S.SL.pdf>