

# Boosting Incomes and Improving Tax Equity with State Earned Income Tax Credits in 2019

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## OVERVIEW

The Earned Income Tax Credit (EITC) is a policy designed to bolster the incomes of low-wage workers and offset some of the taxes they pay, providing the opportunity for families struggling to afford the high cost of living to step up and out of poverty toward meaningful economic security. The federal EITC has kept millions of Americans out of poverty since its enactment in the mid-1970s. Over the past several decades, the effectiveness of the EITC has been magnified as many states have enacted and later expanded their own credits.

The continued expansion of the EITC is as important as ever given the continuing challenges facing our country's growing class of low-wage workers. Despite a decently performing economy, too many workers are facing low and slow-growing wages, while simultaneously feeling the squeeze of the growing costs of food, housing, child care, and other basic household expenses. To make matters worse, in 46 states low-income households pay a higher share of their incomes in state and local taxes than the richest households.<sup>1</sup> This leaves working families with even fewer resources to make ends meet and contributes to ever growing income inequality.

The effectiveness of the federal EITC as an anti-poverty policy can be increased by expanding the credit at both the federal and state levels. To this end, this policy brief provides an overview of the federal and state EITCs and highlights recent trends to strengthen these credits.

## THE FEDERAL EARNED INCOME TAX CREDIT

The federal EITC has been supplementing and boosting the income of low-wage workers since it was introduced in 1975. Since that time, the EITC has been improved to lift and keep more working families out of poverty. The most recent improvements enhanced the credit for families with three or more children and for married couples. First enacted temporarily as part of the American Recovery and Reinvestment Act (ARRA) in 2009, these changes were made permanent in late 2015.

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The federal EITC delivered nearly \$65 billion to 27 million working families and individuals in 2017.<sup>2</sup> Used mostly as a source of temporary support, the EITC helps millions of families each year—including veterans making their way back into the civilian workforce—cope with job loss, reduced hours, or reduced pay. Recognized widely as an effective anti-poverty tool, the federal EITC also lifted an estimated 5.7 million people, including more about three million children, out of poverty in 2017, according to data from the Census Bureau.

The EITC is based on earned income, such as salaries and wages. For example, for each dollar earned up to \$14,570 in 2019, families with three or more children will receive a tax credit equal to 45 percent of those earnings, up to a maximum credit of \$6,557. Because the credit is designed to boost incomes for low- and moderate-income workers, there are income limits that restrict eligibility for the credit. Families continue to be eligible for the maximum credit until income reaches \$19,030 for single heads of household. Above this income level, the value of the credit is gradually reduced to zero and is unavailable when family income exceeds the maximum eligibility level. The credit is entirely unavailable to families with three or more children earning more than \$50,162 for single parents and \$55,952 if married. For taxpayers without children, the credit is much less generous: the maximum credit is \$529 and single filers earning more than \$15,570 (or \$21,370 for married couples without children) are ineligible.

## STATE EARNED INCOME TAX CREDITS

In addition to helping working families afford child care, health care, housing, food and other basic necessities, EITCs at the state level play a very important function in improving the equity of upside-down state and local tax systems. Unlike federal taxes, state and local taxes are regressive, requiring low- and moderate-income families to pay more of their income in taxes than wealthier taxpayers. According to ITEP's 2018 *Who Pays?* report, the poorest 20 percent of Americans pay 11.4 percent of their incomes in state and local taxes. By contrast, middle-income taxpayers pay 9.9 percent and the wealthiest one percent of taxpayers pay just 7.4 percent of their incomes in state and local taxes. Heavy use of regressive sales and property taxes (all of which working families pay) drive the high state and local tax rates faced by the poorest households. A refundable state EITC is among the most effective and targeted tax reduction strategies to help offset these regressive taxes.

Refundability is key to the EITC's success, especially at the state level. If a credit is refundable, taxpayers receive a refund for the portion of the credit that exceeds their income tax bill. Refundable credits can therefore be used to help offset all taxes paid, not just income taxes, thereby offsetting some of the regressive effects of state and local sales, excise, and property taxes.

To date, nearly two-thirds of the states (29 states plus D.C.) offer state EITCs based on the federal credit (see Appendix). All of the states except Minnesota allow taxpayers to calculate their EITC as a percentage of the federal credit (Minnesota's credit is structured as a percentage of income rather than a percent of federal credit). This approach makes the credit easy for state taxpayers to claim (since they have already calculated the amount of their federal credit) and straightforward for state tax administrators. However, states vary dramatically in the generosity of their credits. The EITC provided by the District of Columbia, for example, amounts to 40 percent of the federal credit (100 percent for workers without dependents in the home), while five states have credits that are worth less than 10 percent of the federal credit. Six states (Delaware, Hawaii, Ohio, Oklahoma, South Carolina and Virginia) allow only a non-refundable credit, limiting the ability of the credit to offset regressive state and local taxes.

## NEW TRENDS AND FORWARD MOMENTUM

There have been a number of advancements in EITC policy at the state and federal level in recent years. 2017 saw the addition of EITCs in Hawaii, Montana and South Carolina. Montana enacted a refundable credit at 3 percent of the federal credit. Hawaii's non-refundable credit, which is set to expire at the end of tax year 2022, is set at 20 percent of the federal credit. South Carolina's non-refundable credit is set to 125 percent of the federal credit, but because of the way the South Carolina credit is constructed much less of the credit will be taken up.

Louisiana, Massachusetts, New Jersey and Vermont all increased the size of their EITCs in 2018. Louisiana upped its state's EITC from 3.5 percent to 5 percent of the federal credit for tax years 2019 through 2025. Massachusetts increased its EITC from 23 percent to 30 percent of the federal credit, up from 15 percent in 2015. In New Jersey, lawmakers enacted an EITC increase from 35 percent to 40 percent of the federal credit to be phased in by 2020. And lawmakers in Vermont increased their EITC, currently at 32 percent of the federal credit, to 36 percent. California, Maine, Minnesota, New Mexico, Ohio, and Oregon all enacted expansions to their credits in 2019. Delaware and Virginia lawmakers have also advanced legislation to make their credits refundable, but the change has not been enacted.

There have also been some recent efforts to expand the EITC for workers without children in the home. While the federal EITC provides a great deal of help for families with children, its impact is quite limited for those without children; the maximum credit is much smaller and the income limits are more restrictive. For instance, under current law, a worker without dependent children in the home who is working full-time at the federal minimum wage is ineligible for the EITC. Yet, if the same worker had children they would receive the maximum EITC. Under the current system, these low-wage workers continue to be taxed deeper into poverty.

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At the state level, the District of Columbia led the way. Since January 2015, more childless workers qualify for DC's EITC (and receive a larger credit) thanks to higher income eligibility thresholds and a credit expanded to 100 percent of federal (up from 40 percent). California, Maryland and Minnesota joined the District of Columbia in their recent expansion of the credit to younger workers in 2018. California eliminated the age requirement for its EITC for workers without dependents in the home. This action expanded the EITC to young workers between 18 and 24, and workers over 65. California also adjusted its state-level EITC income limits to reflect the state's minimum wage increase to ensure that those working full-time for minimum wage are eligible to receive the credit. Maryland and Minnesota legislators also removed the state EITC's minimum age requirement by using some of the revenue gained from the federal tax cut. In 2019, Maine lawmakers lowered the minimum age to 18 and increased the share of the federal credit workers without dependents in the home receive to 25 percent of the federal.

Oregon and California have also enacted recent changes to the credit to give a boost to families with young children in the home. Oregon's credit for families with young children is equal to 12 percent of the federal (as opposed to 9 percent for other EITC eligible homes) and California EITC eligible families with a child under 6 will receive an additional \$1,000 credit. Lawmakers in a number of states have also discussed extending the EITC to immigrant workers who file taxing using an ITIN (Individual Taxpayer

Identification Number), but to date no legislation has been enacted. A few localities also have their own version of an EITC, most notably New York City and Montgomery County, Maryland, proving that a local level credit could also be powerful.

## **IMPROVING TAX EQUITY WITH STATE EITCS**

Whether enacting an EITC in states that do not yet have one or expanding an existing credit to more workers trying to get by on low wages, lawmakers would be wise to continue the positive trend of strengthening and enacting state EITCs and, as a result, improving the equity of state and local taxes, rewarding work and helping families meet their basic needs.

## ENDNOTES

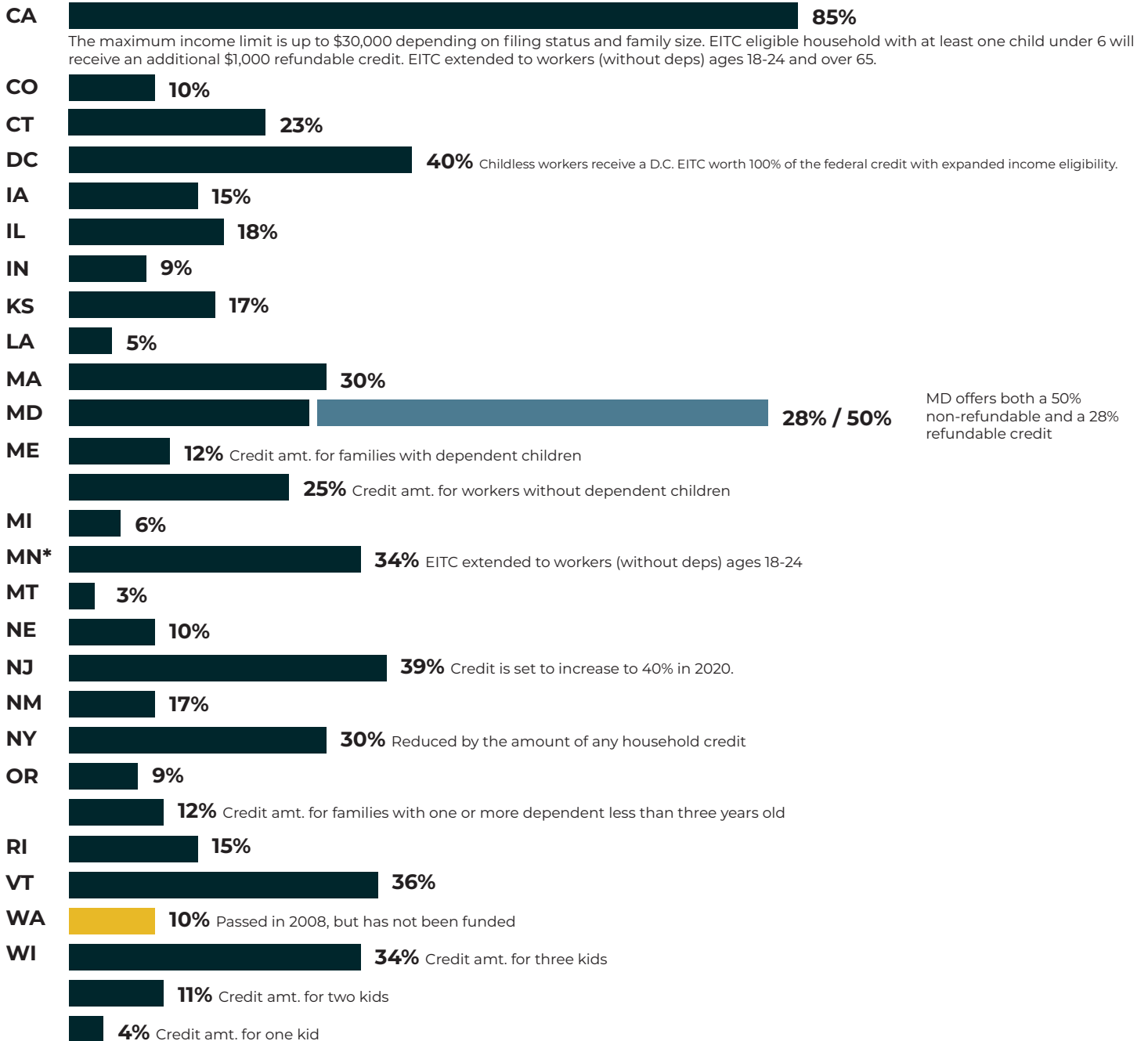
- 1 Wiehe, Meg, Carl Davis, Aidan Davis, Matt Gardner, Lisa Christensen Gee, Dylan Grundman, and Misha Hill “Who Pays? A Distributional Analysis of the Tax System in All Fifty States, 6th Edition,” Institute on Taxation and Economic Policy, October 2018. [www.whopays.org](http://www.whopays.org).
- 2 Internal Revenue Service. “Statistics for Tax Returns with EITC,” December 2017. <https://www.etc.irs.gov/EI-TC-Central/etcstats>

# APPENDIX A

## State Earned Income Tax Credits in 2019

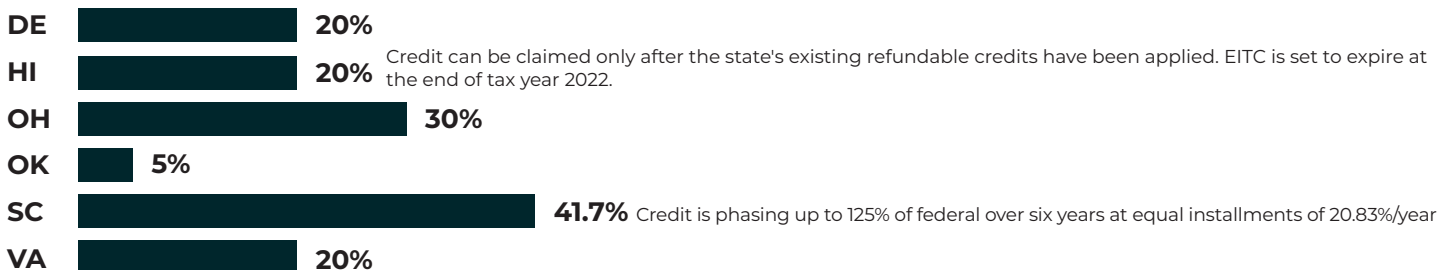
### REFUNDABLE CREDITS

Refundable credits are one of the most effective and targeted tax reduction strategies. Taxpayers receive a refund for the portion of the credit that exceeds their income tax bill, offsetting some of the regressive effects of state and local sales, excise, and property taxes.



### NON-REFUNDABLE CREDITS

Non-refundable credits limit the usefulness of the EITC to low-income families. Taxpayers earning too little to owe state income tax will receive no benefit from the credit, despite the upside-down nature of state and local tax systems.



Note: Washington's credit was passed in 2008, but has not yet been funded. Indiana's credit is not tied to the federal expansions made permanent in 2015; Wisconsin's credit is dependent on family size.

\*MN's credit for families with children 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 a 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.