



A Refundable State Credit for Idaho's Working Families

The Federal EITC

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The State EITC

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Why is a State EITC Needed?

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How Will a State EITC Work?

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How Much Would The State EITC Cost?

Introduction

According to the 2006 census, 36.5 million Americans (roughly 1 in 8) live in poverty and 17.4% of those who live in poverty are children. Idaho does not fall far behind the national rate. The 2005 census shows that 13.4% of Idahoans live in poverty and 17.2% of those living in poverty are children. While high poverty rates have historically been a sobering statistic for the wealthiest nation in the world, the Earned Income Tax Credit (EITC) has provided, for over 30 years, a powerful and effective tool in equalizing wealth disparity and reducing poverty among the poor. In 2003, the federal Earned Income Tax Credit lifted 4.8 million people out of poverty including 2.4 million children. If it weren't for the EITC, the rate of poverty would be 25% higher for children.¹

Although the federal EITC has been successful in reducing poverty, wages plus the federal EITC do not lift all working families out of poverty.² This report will show how a state-level EITC will further support and enhance the federal EITC, providing important benefits for working families and stimulating the local and state economy.

The Federal EITC

The federal EITC was enacted in 1975 during the presidency of Gerald Ford and expanded under the Reagan, Clinton, and both Bush Administrations.³ The credit benefits working families because it is a 'refundable credit' and helps offset the burden of high social security payroll taxes for low to moderate income wage earners.

Based on federal EITC guidelines for 2007, a family of four or more making from \$11,750 to \$17,400 would qualify for a maximum credit of \$4,716;

married couples with one child making \$8,350 to \$17,400 would receive up to \$2,853, and an individual or married couple without children making \$5,500 to \$9,000 would receive up to \$428. Families earning moderate wages qualify for smaller credits.

To receive EITC benefits, the maximum income level for a working family, in 2007, with two or more children was \$39,783; for a couple with one child, the maximum was \$35,241, for an individual, \$12,590.⁴ “For families with very low incomes, the size of the credit they are eligible for increases with each dollar of earnings. The credit is reduced gradually for families with higher earnings.”⁵

“The EITC program has not only reduced poverty, but has led to five consecutive years of real wage growth, a reduction in unemployment from 7.5 percent in 1992 to 4.3 percent in 2000, and between 1993 and 2000 the number of people on welfare fell 60 percent - from 14.1 million to 5.6 million.”⁶ Studies show that the federal EITC has moved individuals from welfare to work, and because it has done so, both Democrats and Republicans have worked in many states to incorporate a state-level EITC program.⁷

The State EITC

To date, twenty-three states have enacted a state Earned Income Tax Credit. Those states that have enacted a state-level EITC set the amount of credit as a percentage of the federal EITC, typically ranging from 5 to 30 percent. Idaho is one of the 19 states in the United States with income taxes, but no state Earned Income Tax Credit.

The purpose of the state EITC is to supplement the federal EITC and to provide opportunities for working families that they would not otherwise have, including the ability to acquire assets such as a home or a vehicle, or pursue post-secondary education. Overall, the state-level EITC will provide

States With State-Level EITC

District of Columbia
 Delaware
 Illinois
 Indiana
 Iowa
 Kansas
 Louisiana
 Maine
 Maryland
 Massachusetts
 Minnesota
 Michigan
 Nebraska
 New Jersey
 New Mexico
 New York
 North Carolina
 Oklahoma
 Oregon
 Rhode Island
 Vermont
 Virginia

Source: Tax Credit Resources



the impetus to improve the quality of life for low to moderate wage earners. This additional EITC funding will help improve the social and economic fabric of the nation as recipients invest their funds in local economies and move from welfare to work.

The State Earned Income Tax Credit will do the following:

- Be a refundable credit, much like the federal Earned Income Tax Credit, and will put more money into the hands of working families to help pay for basic needs
- Reduce child poverty, at a time when costs continue to rise
- Encourage individuals and families to build assets and grow wealth
- Inject more money into local economies as working families use these funds to meet their basic needs or on assets such as: appliances, starting a business, or a down payment on a house or vehicle
- Create a greater incentive to work by providing a financial stimulus for low to moderate wage earners
- Make state and local taxes fairer for low-income working families since a disproportionate amount of their earnings are spent on sales, property, and state income taxes

Why is a state EITC needed?

While most people in Idaho maintain regular employment, that does not always translate to financial prosperity. According to the 2000 U.S. Census Bureau, nearly 34 percent of all people in Idaho are living below 200 percent of the poverty level, ranking second worst for states in the Northwest.⁸ This statistic defines the “working poor” and while most of the people in this particular category are working, it is clear that at least one-third of the people in Idaho are struggling to get by and to make ends meet.



A state-level EITC would greatly benefit people who fall into this financial classification and would help to supplement the federal EITC, strengthening many families across Idaho. In 2006, the federal EITC refunded \$192 million to working families.⁹

If policy makers enact a refundable state-level EITC, Idaho can stimulate the positive effects of the federal EITC at a state level by further reducing poverty, creating an incentive to work, encouraging asset building, decreasing the burden of state and local taxes, and stimulating the economy.

According to the Northwest Federation of Community Organizations, the living wage for a household with a single parent and two children is \$23.44 an hour \$48,750 a year; however, over 88% of Idaho families of this household size earn less than that amount. With the addition of the state-level EITC, an Idaho family will rise above the poverty level by approximately \$2,873 for a family of three, assuming at least one member of the family works 40 hours per week and earns \$7.25 an hour.

Not only would a state EITC provide more disposable income for essential purchases needed to simply maintain a reasonable standard of living, it would also provide the opportunity for families to use their EITC refund to make investments and create assets that may, over the long term, reduce their dependence on government assistance. For example, in 1996, a team of researchers from Syracuse University and the Center for Law and Human Services surveyed close to 1,000 EITC recipients. “Over half of those surveyed spent some or all of their EITC refunds on financial investments or human capital investments, including paying for tuition or other education expenses, increasing access to jobs through car repairs and other transportation improvements, moving to a new neighborhood, or putting money in a savings account.”¹⁰



An Idaho EITC set at 30% of the federal credit would infuse an additional \$58 million back to the county, state, and national economy. Research shows that recipients invest these funds on much needed assets such as college tuition, household appliances, starting a business, or a down payment on a house or vehicle. In essence, a state-level EITC will allow Idaho families to build assets, decrease their reliance on government assistance, and become more financially independent.

A study by the Society for Social Work and Research found that states that have enacted state-level EITC programs have a lower population of welfare recipients and poverty rates, which results in an increase in the workforce.¹¹ A major goal of the EITC is to “make work pay” and to reward low wage earners by reducing their income taxes and by increasing their yearly income, ultimately providing low to moderate wage earners with a yearly income high enough to support their family. The following example illustrates how other states have used the state EITC as a tool for reducing unemployment and strengthening the local labor pool. In 1994, the State of New York enacted a state EITC and the unemployment rate fell by 1.3%, starting at 6.3% in 1995 and dropping to 5% in 2005. The increase in labor can be contributed to the enactment of the EITC.¹² Clearly, a state EITC would have similar benefits in Idaho.

Improving the standard of living through supplementing the federal EITC would work to reduce unemployment and would provide a more robust labor pool.

In Idaho, unfortunately, many low-income workers pay a higher percentage of their income to payroll and sales tax than do high-income earning individuals. “The federal EITC offsets only federal taxes but many low-income workers pay a disproportionate share of their income in state and local taxes.”¹³ Enacting a state EITC would further reduce the tax burden on low-income workers.



A study completed by the Institute on Taxation and Economic Policy found that when all Idaho taxes are totaled:

- The state and local tax rate on the wealthiest one percent of Idaho families with average incomes of \$765,000—is 8.7% before accounting for the tax savings from federal itemized deductions. After the federal offset, the effective tax rate is 6.1%
- The average tax rate on families in the middle of the income distribution—those earning between \$25,000 and \$42,000—is 9.3% before and 9.0% after the federal offset, one half more than the effective rate on the wealthiest Idahoans
- But the average tax rate on Idaho families in the lowest of the income distribution—earning less than \$14,000—is the highest of all. At 9.7% it is more than half again higher than the effective rate of the wealthiest Idahoans

How will a state EITC work?

A State Earned Income Tax Credit provides low to moderate wage earners with a refundable state tax credit based on a percentage of the federal Earned Income Tax Credit. “If a credit exceeds a family’s total income tax liability, the difference is paid to the family as a tax refund. If a family doesn’t earn enough to owe income tax, it receives a check based on its annual household income.”¹⁵ Like the federal credit, the amount of credit increases with the number of children a family has, although the EITC is available to filers without children, both at the state and federal level.

The credit is increased every year to compensate for the impact of inflation. While a state-level EITC can typically range from 5 to 30 percent of the federal EITC (depending on the state), families can expect to increase their yearly incomes by approximately \$236 to \$1,413 with the state EITC alone, assuming the employee is paid \$7.25/ hr. and works 40 hours a week.



How much would the state EITC cost?

The Center on Budget and Policy Priorities estimates that in 2009 a state-level EITC will cost \$9 million if it were set at 5% of the federal EITC, \$19 million at 10% of the federal EITC, \$37 million at 20% of the federal EITC and \$58 million at 30% of the federal EITC. “State EITCs are financed in whole or in part from funds available in a state’s general fund or through the state’s surplus of funds from the federal Temporary Assistance to Needy Families block grant.”¹⁶ According to Levitis and Koulisch, “existing refundable state EITCs cost less than 1 percent of state tax revenues each year, though their dollar cost varies considerably from state to state because of differences in the size of state economies.” Although there would be a financial investment and commitment from the State of Idaho in terms of establishing a state-level EITC, the social and economic impact would certainly outweigh the cost.

Conclusions

Policy makers should understand that a state EITC will have benefits well beyond the amount of money refunded to low to moderate wage earners. A state EITC will provide additional benefits that will positively impact our citizens and communities for years to come. These additional benefits include:

- ***Lifting children and their families out of poverty*** and allowing parents to support their children at a level above the poverty line
- ***Creating a greater incentive to work, increasing the number of people entering the workforce, encouraging asset building and self-sufficiency*** and ultimately ***decreasing welfare utilization*** as shown in other states
- ***Providing a more fair and equitable state and local tax structure*** for low to moderate wage earners
- ***Bolstering our local, state and national economy*** through the infusion of additional state EITC dollars



U.S. Representative Harold Ford (D-Tenn.) refers to the EITC as one of the biggest bipartisan success stories in our nation's history. For over 30 years, both Republicans and Democrats, through the enactment and multiple expansions of the EITC, have shown their support for the need to "make work pay". As President Ronald Reagan stated, "the Earned Income Tax Credit is the best anti-poverty, the best pro-family, the best job creation program to come out of Congress." Idaho has the opportunity to build on the success of the EITC through the creation of a state EITC policy that will not only create greater tax equalization for those living in poverty, but will also provide a stronger, healthier, and more effective workforce, family unit, and state economy.

We strongly urge all elected officials in Idaho to begin the dialogue about how we can "make work pay" for all Idahoans through enacting a state-level EITC. For more information about Partners for Prosperity and our work to promote a state EITC for Idaho, please contact us at (208) 785-0059.

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END NOTES

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³"Earned Income Tax Credit," *Center for Policy Alternatives*, 2007, 2 June 2008 <<http://www.cpa.org/issues/issue.cfm/issue/EITC.xml>>.

⁴Christine Vastal, "More states give tax credits to working poor," 16 April 2008, 6 Jun. 2008 <<http://www.stateline.org/live/printable/story?contentId=301177>>.

⁵Robert Greenstein, "The Earned Income Tax Credit: Boosting Employment, Aiding the Working Poor," *Center on Budget and Policy Priorities*, 17 Aug. 2005, 21 May 2008 <<http://cbpp.org/7-19-05eic.htm>>.

⁶Harold Ford Jr., "Expand the EITC," *Ideas Primary: The Presidential Election as a Battle of Ideas*, 15 Oct. 2007, 4 Jun. 2007 <<http://www.ideasprimary.com/?p=343>>.

⁷Earned Income Tax Credit.

⁸"Getting out and staying out of poverty: The complex causes of and responses to poverty in the Northwest," *Northwest Area Foundation* Feb. 8 2006, 8 July 2008 <www.nwaf.org>.

⁹Jeremy Koulisch and Jason Levitis, "How Much Would A State Earned Income Tax Credit Cost in 2009?" *Center on Budget and Policy Priorities*, March 2008.

¹⁰Timothy M. Smeeding, Katherin E. Ross, and Michael O'Conner, "The EITC: Expectation, Knowledge, Use, and Economic and Social Mobility," *National Tax Journal*, December 2000.

¹¹Younghee Lim, PhD, "Can State Earned Income Tax Credits Explain Changes in Welfare Caseload and Poverty among Children?," *Society for Social Work and Research*, 11-14 Jan. 2007, 12 Jun. 08 <<http://sswr.confex.com/sswr/2007/techprogram/P5843.HTM>>. Younghee found that, "States that enacted their own state EITC on top of the federal EITC show a greater decline in welfare caseload rates and child poverty rates, respectively, than states that do not have state EITCs. Results of this study indicated that, holding other factors constant, the states with a state EITC are associated with a 0.25 percent greater caseload reduction rates than states without. States with a state EITC are also associated with a 0.17 percent greater reduction in child poverty rates than states without. When additional analyses were conducted, the combined effect of both federal EITC and state EITCs on welfare caseload reduction and child poverty reduction was greater than the effect of state EITCs alone."

¹²"After Welfare: Your State of Welfare."

¹³Dr. Rima Shore, "Reducing the Child Poverty Rate," *The Annie E. Casey Foundation* (2003): 10.

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¹⁶Jason Levitis and Jeremy Koulisch.

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