Earned Income Tax Credit

The Earned Income Tax Credit (EITC) is the most effective anti-poverty program in America, helping more working parents and children move out of poverty than any other government assistance program.

Earned Income Tax Credit

Summary

- **Nearly one in six American children live in poverty.**
- **The worsening economy will increase rates of poverty among American families.**
- **The federal Earned Income Tax Credit (EITC) was created in 1975 to provide tax relief to low-income workers and is now the most effective anti-poverty program in America.**
- **Most of the federal EITC's benefits are targeted toward families with children.**
- **The EITC has only recently gained momentum at the state level.**
- **State EITCs are good policy, administratively efficient, non-bureaucratic, and enjoy bipartisan support.**
- **State EITCs enhance economic security and promote economic opportunity for low-income working families.**

Nearly one in six American children live in poverty.

While welfare reform has been hailed as a success, former welfare recipients and other low-income Americans often earn wages at or below the poverty level at their new jobs—not nearly enough to support a family. In the current economic downturn, the financial position of low-income families will only worsen.

The federal Earned Income Tax Credit (EITC) was created in 1975 to support low-income workers.

The program was expanded in 1986, 1990, 1993 and most recently in 2001, and has now become a central part of federal efforts to fight poverty and move Americans from welfare to work. Only wage-earners qualify for this program, and the value of the tax credit depends on a worker's income and family size. Workers who earn around the minimum wage benefit the most from EITCs.

Most of the federal EITC's benefits are targeted toward families with children.

In tax year 2003, qualifying families with two or more children could receive up to $4,204 and families with one child up to $2,547. Workers with no dependent children are only eligible to receive a maximum of $382 from the federal EITC.

The federal program is a "refundable" credit. That means that if a credit exceeds a family's total income tax liability, the difference is paid to the family as a refund.

If a family doesn't earn enough to owe income tax, it receives a check based on its annual household income. Twelve states and the District of Columbia offer a refundable credit that is a percentage of the federal EITC, while four states have less effective "non-refundable" EITC statutes. In those states, the credit can erase tax liability, but the poorest wage earners, those with incomes too low to owe any state income taxes, receive no state benefit at all.

The EITC has only recently gained momentum at the state level.

Of the 16 states and the District of Columbia which currently have an EITC, eleven states and DC adopted or substantially increased EITCs since 2000. In 2003, Illinois made its EITC both refundable and permanent.

State EITCs are both good policy and good politics:

■ **EITCs address economic crisis.**

In an economic downturn, low and moderate-income families are the most likely to be hit with layoffs or reductions in work hours. A state EITC provides tax relief to Americans who are most in need.

■ **EITCs are proven to reduce poverty.**

The federal EITC helps more working parents and children move out of poverty than any other government program. According to Census Bureau data, the federal EITC lifts 4.7 million people out of poverty annually, including more than 2.7 million children. Adding a state EITC helps offset the high

costs of health care, child care, housing, and other necessities of life.

■ **EITCs complement welfare reform.**

At its maximum, the federal EITC pays working poor families 40 cents for every dollar earned. State EITCs, combined with federal credits, increase the incentive for individuals to move from welfare to work.

■ **EITCs are finely targeted and effective in reaching the working poor and near-poor.**

The program puts extra dollars directly into the pockets of people who need help the most—those who are working for poverty-level wages. According to one estimate, 85 percent of those eligible for the credit apply for it.

■ **EITCs are administratively simple, efficient and non-bureaucratic.**

Because it is a fairly straightforward tax credit, the EITC is simple to administer. Nearly all of the funds spent on EITC programs go to workers who need the money, rather than government administration costs.

■ **EITCs garner bipartisan support.**

The federal EITC was enacted during the presidency of Gerald Ford and expanded under the Reagan, Clinton and both Bush administrations. Similarly, state EITC programs have been created by governments led by both Democrats and Republicans, and supported by both business groups and social service advocates.

State EITCs enhance economic security and promote economic opportunity for low-income working families.

Emerging research shows that many EITC recipients use their EITC refunds not only to meet day-to-day expenses but also to make the kind of investments that enhance economic security and promote economic opportunity—paying off debt, investing in education, and obtaining decent housing. States are increasingly recognizing the important effects EITCs can have on low-wage workers.

STATE EARNED INCOME TAX CREDITS BASED ON THE FEDERAL EITC

State	Percentage of the Federal EITC
Refundable Credits:	
Colorado	10% (suspended for 2003)
District of Columbia	25%
Illinois	5%
Indiana	6%
Kansas	15%
Maryland*	18% in 2003, 20% thereafter
Massachusetts	15%
Minnesota	Varies with earnings, averages 33%
New Jersey	20% if income is under $20,000
New York	30%
Oklahoma	5%
Vermont	32%
Wisconsin	4% - one child, 14% - two children, 43% - three children
Non-Refundable Credits:	
Iowa	6.5%
Maine	5%
Oregon	5%
Rhode Island**	25%

* Maryland also offers a non-refundable EITC set at 50 percent of the credit. Taxpayers may claim either the refundable credit or the non-refundable credit, but not both.
** A very small portion of the Rhode Island EITC was made refundable effective in 2003.

Source: Center on Budget and Policy Priorities.

This policy summary relies in large part on information from the Center on Budget and Policy Priorities.

Earned Income Tax Credit

For more information...

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Washington, DC 20036
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Internal Revenue Service
1111 Constitution Avenue NW
Washington, DC 20224
202-622-2000
www.irs.gov/individuals/article/0,,id=96456,00.html

Making Wages Work
The Welfare Information Network
1401 New York Avenue NW, Suite 800
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Earned Income Tax Credit Act

Summary: The Earned Income Tax Credit Act would provide low-income workers with a refundable state tax credit based on the federal Earned Income Tax Credit.

SECTION 1. SHORT TITLE

This Act shall be called the "[STATE] Earned Income Tax Credit Act."

SECTION 2. EARNED INCOME TAX CREDIT

Section XXX of the Code is hereby amended by adding the following new section:

EARNED INCOME TAX CREDIT

1. A taxpayer shall be allowed a tax credit equal to 20 percent of the earned income credit allowed under section 32 of the federal Internal Revenue Code, as amended and in effect for the current taxable year.

2. The credit under this subsection shall be allowed against the taxes imposed by this chapter for the taxable year, reduced by other credits permitted by this section. If the credit exceeds the tax as so reduced, the [TAX COMMISSIONER] shall treat such excess as an overpayment, and shall pay the taxpayer, without interest, the amount of such excess.

3. In the case of a husband and wife who file their state tax returns separately, the credit allowed may be applied against the tax of either, or divided between them, as they elect.

4. The [TAX COMMISSIONER] shall make efforts every year to alert taxpayers who may be eligible to receive the credit. In making a determination as to whether a taxpayer may be eligible for such a credit, the [TAX COMMISSIONER] shall use appropriate and available data, including, but not limited to, data available from the U.S. Department of Treasury, the Internal Revenue Service, and state income tax returns from preceding tax years.

5. The [TAX COMMISSIONER] shall prepare an annual report containing statistical information regarding the credits granted for the prior calendar year, including the total amount of revenue expended on the earned income tax credit, the number of credits claimed, and the average value of credits granted to taxpayers whose earned income falls within various income ranges.

SECTION 3. EFFECTIVE DATE

This Act shall take effect for taxable years beginning on or after January 1, 2005.