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HB 529

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Earned Income Tax Credit

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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.

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