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A HAND UP
How State Earned Income Tax Credits Help Working Families Escape Poverty in 2004

Summary

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Earned Income Tax Credits provide tax reductions and wage supplements for low- and moderate-income working families. The federal tax system has included an EITC since 1975, with major expansions in 1986, 1990, and 1993, and an additional expansion in 2001. In 2002, more than 21 million families and individuals filing federal income tax returns — nearly one out of every six families who file — claim the federal EITC.

The EITC has been widely praised for its success in supporting work and reducing poverty. The federal credit now lifts more children out of poverty than any other government program. Some 4.9 million people, including 2.7 million children, were removed from poverty in 2002 as a result of the federal EITC. The federal EITC also has been proven effective in encouraging work among welfare recipients; studies show it has a large impact in inducing more single mothers to work. Support for the EITC has come from across the political spectrum.

The success of the federal EITC has led a number of states to enact state Earned Income Tax Credits that supplement the federal credit.

- Eighteen states have created state EITCs based on the federal credit. In addition, Montgomery County, Maryland offers a local EITC. Like the federal credit, state EITCs have gained support across the political spectrum. EITCs have been enacted in states led by Republicans, states led by Democrats, and states with bipartisan leadership. The credits are supported by business groups as well as social service advocates.

- Despite the current challenging fiscal environment, when most states have been cutting spending, raising taxes, or both, one state has added an EITC and most states with EITCs have protected or even expanded them. **Virginia** in 2004 enacted a state EITC that families can choose instead of an existing low-income credit. **Indiana** in 2002 created a state EITC based on the federal credit, **Kansas** expanded its existing EITC, and **Illinois** made its temporary EITC permanent and refundable. Other states are considering similar actions. An exception is **Colorado**, which in 2003 for a second consecutive year suspended its EITC. **Maine's** EITC also was reduced slightly in 2003.

- The continuing growth of state EITCs suggests that many state policymakers recognize the continuing importance of an EITC in difficult economic times. At a time of high unemployment and declining wages, state EITCs can help working families stay afloat. And when states are raising taxes in ways that may be burdensome to low-income families, state EITCs can relieve some of that burden.

Why Consider a State EITC?

Several developments explain the popularity of state EITCs, including the continued prevalence of poverty among children, the importance under welfare reform of supporting families' transition from welfare to work, and interest in tax changes that promote tax fairness.

State EITCs Reduce Poverty Among Children

In 2002, the Census Bureau reported that about one child in six still lived in poverty. Most poor children lived in families with a working parent.

- Some 4.9 million families with children in which the parents were not elderly or disabled had incomes below the federal poverty line.[1] In 66 percent of these families, at least one parent was working.
- About 12.6 million people, including 7.2 million children, lived in working poor families. In 2004 dollars, that means living on less than about $15,100 for a family of three or $19,000 for a family of four.
- High unemployment and declining real wages likely have continued to increase poverty among working families in 2003 and 2004.

Earned Income Tax Credits can lift families out of poverty by supplementing their wages.

- For example, a family of four with two children and a full-time, year-round worker earning about $7 per hour (well above minimum wage) has wages after payroll taxes of about $13,600 per year, several thousand dollars below the poverty line.
- Such a family in 2004 qualifies for a federal EITC of $4,300 and a small federal child tax credit of $395, bringing its income close to the poverty line.
- If the family lived in a state that offered a state EITC set at 20 percent of the federal credit, the family would receive an additional $860, for total cash income of $19,130 — slightly above the poverty line. An EITC set at a larger percent of the federal credit could raise the family's income further above the poverty line.

State EITCs Complement Welfare Reform

Although large numbers of welfare recipients have entered the workforce, many cannot make ends meet on their earnings alone. State EITCs support families who enter and remain in the workforce.

- Many welfare recipients who take jobs continue to have very low incomes, often below poverty. Studies show that welfare recipients who find jobs typically earn $2,000 to $3,000 per quarter, or $8,000 to $12,000 per year, well below the poverty line for a family of three. The combination of the federal EITC and a state EITC can close the poverty gap for many welfare recipients as they move into the workforce.
- State EITCs also support the work efforts of low- and moderate-income families who have long since left the welfare rolls or who have never received welfare benefits. EITCs help meet the ongoing expenses associated with working, such as transportation, and may allow families to cope with unforeseen costs that otherwise might drive them onto public assistance.