

Montana Budget &  
Policy Center

SENATE TAXATION

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## Investing in Montana's Working Families: A Montana Earned Income Tax Credit (EITC)

In Montana, thousands of families across the state are working but still struggling to make ends meet. Recent economic trends have made it even harder for working families to live above the poverty line. Montana has over 17,000 families that are working but poor.

A state EITC would provide a much-needed economic boost to these hardworking families and their communities. Indeed, the most efficient way to stimulate the Montana economy is to support low-income families who are likely to immediately spend that support in businesses and communities across the state.

*"States that enact EITCs can reduce child poverty, cut taxes, and increase the incentive to work for families struggling to make ends meet."*

Center for Budget and Policy Priorities ("State Earned Income Tax Credits," October 2008).

### Key Points

- Over 17,000 families in Montana live in poverty despite the fact that they work. EITCs supplement the incomes of working families struggling to make ends meet.
- Montana's income tax system is one of the worst in the country in terms of the burden it places on poor and low-income working families.
- Credits targeted at low-income households are an efficient way to boost the economy through increased demand for goods and services.
- The federal EITC has enjoyed bipartisan support since its inception.
- In 2007, over 75,000 low-income working households in Montana received over \$134 million through the federal EITC.
- The federal EITC is the nation's most effective anti-poverty program, lifting over 6 million people, including over 3 million children, out of poverty in 2009 alone.
- The maximum federal benefit in 2011 is \$5,805. A state EITC set at 20% of the federal EITC would result in a maximum benefit of \$1,161 for low-income working families, with a total cost to the state of approximately \$33 million per year.

## Why Does Montana Need a State Earned Income Tax Credit?

- *Montana's Income Tax System Pushes Working Families Further into Poverty.*  
Montana is one of the few states in the country to impose income taxes on working families living in poverty. **We begin taxing a two-parent family with two children at a lower annual income than any other state in the country.**<sup>1</sup> Montana begins taxing a two parent household with two children at \$12,000 in annual income, which is 55% of the poverty level for a family of that size. For a single parent family with two children, income taxes begin at \$9,900 in annual income, which is 58% of the poverty level. By enacting a state EITC, Montana would help cushion the effect of our income tax system on working families living in poverty.
- *Economic Trends Are Making It Even Harder for Montana Families to Make Ends Meet.*  
Economic trends have made it even harder for many working families to make ends meet. In 2010, a full-time working parent earning minimum wage made approximately \$15,080, which is \$6,970 under the federal poverty line for a family of four. **Over 17,000 Montana families (over 7%) are working but poor.**<sup>2</sup> Unfortunately, Montana's income tax system makes it even harder for many of these families to purchase basic necessities. A state EITC would help these families secure housing, groceries, childcare, transportation, and medical care during these economically challenging times.
- *Tax Credits for Low-Income Families Offer Effective Stimulus during Recessions.*  
Putting more money in the hands of low-income families is particularly good policy during an economic downturn. The basic tenets of economic theory uphold that increased demand for goods and services is necessary to bring an economy out of recession. **Credits targeted at low-income households are an efficient way to achieve increased demand for goods and services, because low-income families are likely to spend the entire credit, resulting in an immediate boost to the economy.**<sup>3</sup>

*"Lower-income households are . . . more likely to be among those with the highest propensity to spend. Therefore, policies aimed at lower-income households tend to have greater stimulative effects."*

Congressional Budget Office ("Options for Responding to Short-Term Economic Weakness," January, 2008).

## What is the Federal EITC?

The federal EITC was created in 1975 and has long enjoyed bipartisan support. The federal EITC supplements wages for low-income working families. Only people who work are eligible for the EITC. The maximum benefit in 2011 is \$5,805. The EITC is administered as a refundable tax credit, meaning that recipients receive a refund when their credit amount is greater than their total tax liability. Presidents Reagan, George H.W. Bush, and Clinton all proposed expansions of the federal EITC.

<sup>1</sup> Phil Oliff and Ashali Singham, "The Impact of State Income Taxes on Low-Income Families in 2009," Center On Budget and Policy Priorities, April 26, 2010, <http://www.cbpp.org/files/4-29-10sfp2.pdf>.

<sup>2</sup> U.S. Census Bureau, 2007-2009 American Community Survey.

<sup>3</sup> Chad Stone, "Assistance for Hard-pressed Families is one of the Best Ways to Preserve and Create Jobs: Measures Supported by Some Policymakers Would be Far Less Effective," Center on Budget and Policy Priorities, January 9, 2009, <http://www.cbpp.org/1-9-09bud.htm>

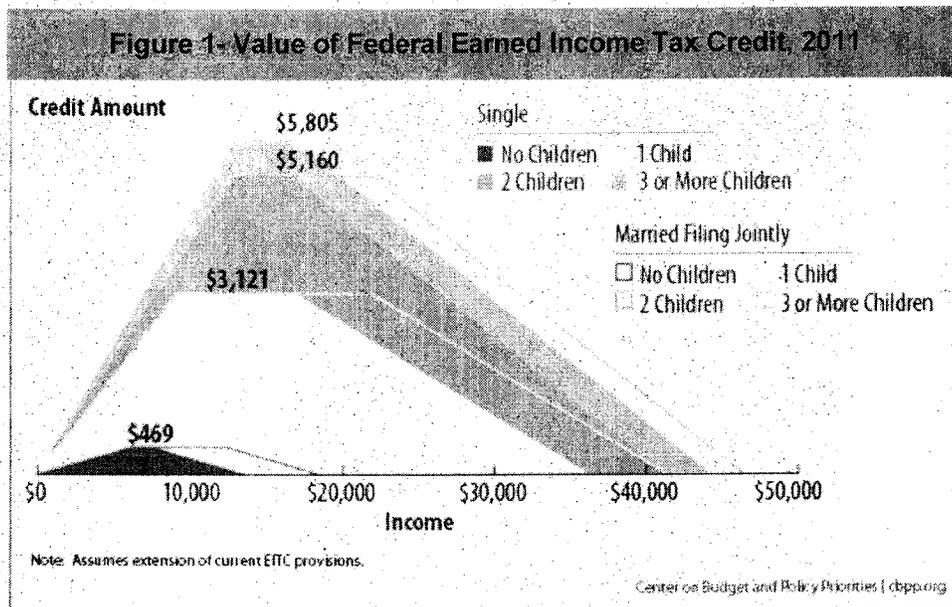
### Has the Federal EITC Worked? Yes.

- **The federal EITC lifted more than 6.5 million people, including 3.3 million children, out of poverty in 2009.**<sup>4</sup>
- Expansions of the federal EITC have been found to increase workplace participation among single parents.<sup>5</sup>
- Research shows that families use the EITC to pay for basic needs, home repairs, commuting expenses, education and training, and other expenditures to improve employability.<sup>6</sup>
- Recognizing the effectiveness of the federal EITC, twenty-four states have enacted refundable state EITCs to further supplement the income of working families.<sup>7</sup>

*"[The EITC is] the best anti-poverty, the best pro-family, the best job creation measure to come out of Congress."*  
-Former President Ronald Reagan

### How Does the Federal Earned Income Tax Credit Work?

Eligibility for the federal EITC is limited to low-income families and individuals with earnings from work. The amount of credit available depends on family size and income. The credit varies with income in three ranges: (1) the phase-in range where EITC benefits increase with earnings; (2) a plateau where the maximum EITC amount remains constant; and (3) the phase-out range where benefits decline as earnings increase (Figure 1). Most families claim their EITC when they file their federal income tax return. A small number of families choose to receive the credit throughout the year as a supplement to their paycheck through the advance payment option.



<sup>4</sup> Erica Williams and Nicholas Johnson, "How Much Would a State Earned Income Tax Credit Cost in Fiscal Year 2012," Center on Budget and Policy Priorities, November 24, 2010, <http://www.cbpp.org/cms/index.cfm?fa=view&id=2992>.

<sup>5</sup> Nada Eissa and J.B. Liebman, "Labor Supply Response to the Earned Income Tax Credit," *Quarterly Journal of Economics*, Vol. 111 No. 2 (May 1996) pp. 605-637.

<sup>6</sup> Timothy M. Smeeding, K.R. Phillips and M. O'Connor, "The EITC: Expectation, Knowledge, Use and Economic and Social Mobility," *The National Tax Journal*, Vol. 53, No. 4, Part 12 (December 2000) pp1187-1210.

<sup>7</sup> Erica Williams and Nicholas Johnson, "How Much Would a State Earned Income Tax Credit Cost in Fiscal Year 2012," Center on Budget and Policy Priorities, November 24, 2010, <http://www.cbpp.org/cms/index.cfm?fa=view&id=2992>.

## How Would a State EITC Work?

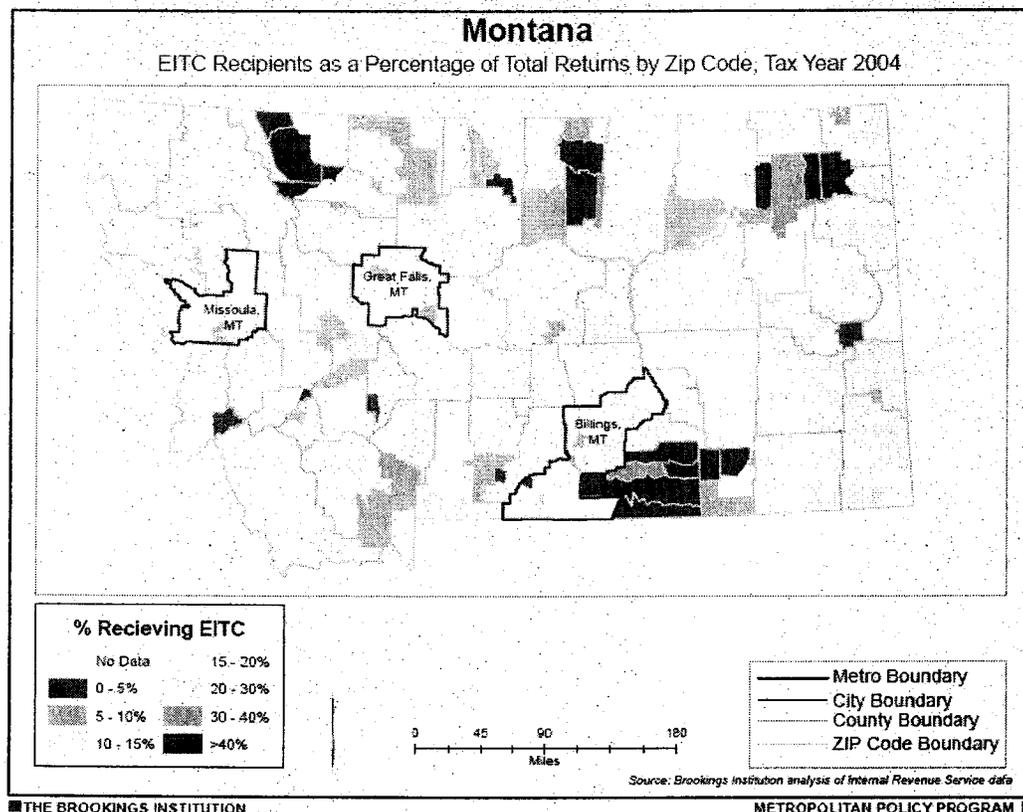
Most state EITCs are patterned after the federal credit (see Appendix A for detail about other states' EITCs). A state EITC would give workers a refundable tax credit equal to a percentage of the federal EITC. By linking state eligibility rules to those of the federal credit, Montana can take advantage of federal compliance efforts and coordinated efforts to publicize the availability of the credit so that families receive the benefits for which they are eligible. Refundability is a key feature of the EITC. Refundable tax credits are paid to families regardless of whether or not they owe income tax. The EITC is first used to reduce a family's tax liability, with any remainder returned to the family in the form of a refund. Montana begins taxing income well below the poverty level. In addition, low-income families pay payroll, excise, and property taxes. **A state EITC set at 20% of the federal EITC would result in a maximum benefit of \$1,161 for low-income working families, with a total cost to the state of approximately \$33 million per year.**

## Who Would Benefit from a Montana EITC?

### *Individuals and Families*

Figure 2 maps the recipients of the federal EITC. Appendices B and C show detailed information about the federal EITC by Montana Senate and House districts. Over 75,000 Montana households (15%) received the federal EITC in 2007 and would therefore benefit from a state EITC. Child care workers, paramedics, preschool teachers, school bus drivers, firefighters, elementary school teachers, licensed practical nurses, and workers in numerous other occupations would be eligible for the EITC based on the average starting salary for these professions (see Figure 3). As these workers move up the pay scale, they may no longer be eligible for the credit.

Figure 2- Montana EITC Recipients



The income of a family of four supported by a full-time worker earning \$8.00/hour still falls below the poverty level. The same family would be raised out of poverty by the combination of a state and federal EITC (Table 1). The increase in income from the federal and state EITC is equivalent to a wage increase of \$2.90/hour.

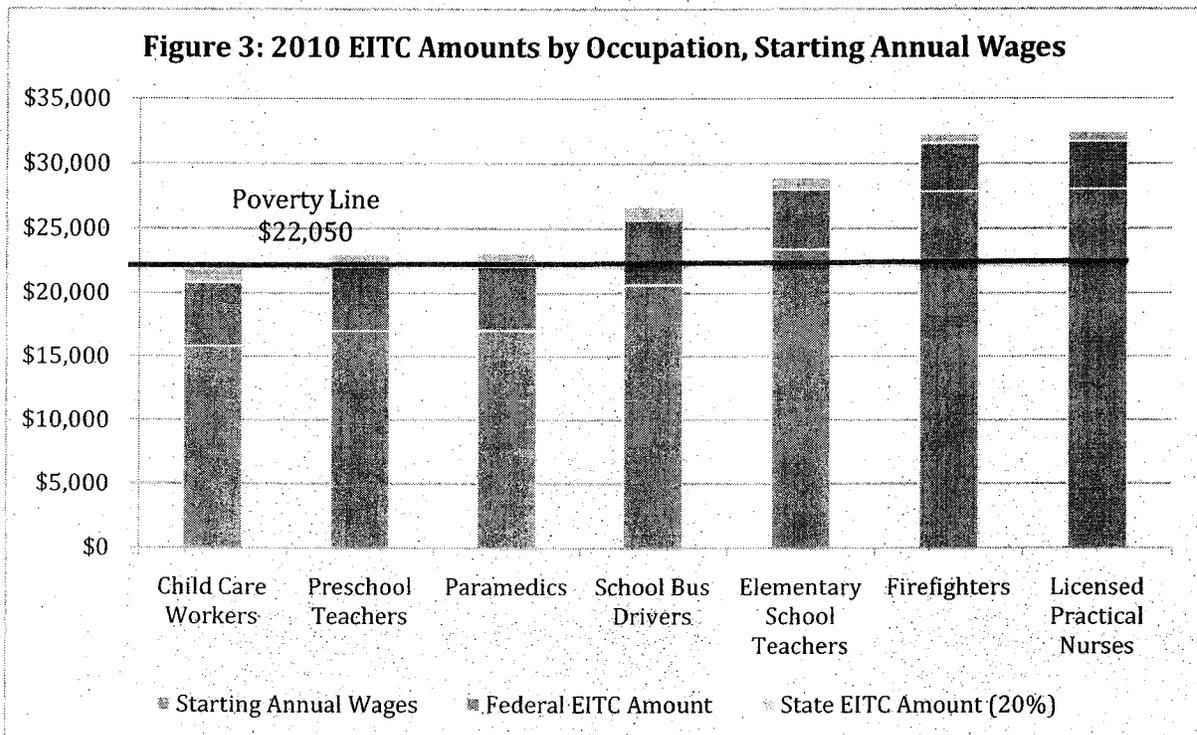
**Table 1**  
**How would a State Earned Income Tax Credit**  
**Help a Family Supported by a Low-Wage Earner?**

	Gross Earnings	Percent of 2010 Poverty Guideline	2010 Federal EITC	State EITC Equal to 20% of Federal Credit	Sum of Earning, Federal and State EITCs	Percent of 2010 Poverty Guideline	Equivalent Per Hour Raise
<b>Family of Four Supported by:</b>							
One full-time minimum wage worker	\$15,080	68%	\$5,036	\$1,007	\$21,123	96%	\$2.91
Two full-time minimum wage workers	\$30,576	139%	\$3,116	\$623	\$34,315	156%	\$1.80
One full-time worker earning \$8.00/hour	\$16,640	75%	\$5,026	\$1,005	\$22,671	103%	\$2.90
One full-time worker earning \$12/hour	\$24,960	113%	\$4,296	\$859	\$30,115	137%	\$2.48

*Source: Health and Human Services Poverty Guideline, IRS and Author's Calculations*

### Employers

The EITC serves as a wage supplement, helping businesses find labor at affordable rates while workers earn enough to save, pay for housing, and plan for the future. In short, the EITC is a wage supplement that makes work pay. The federal EITC combined with a state EITC is equivalent to a \$2.91/hour raise for a minimum wage worker (see Table 1).



### Rural Areas and Small Towns

Although nationally most beneficiaries are in large cities, rural areas and small towns get a disproportionate amount of the benefits per capita compared to urban populations. In Montana, 65%(47,683) of EITC recipients in 2005 resided in rural areas, bringing over \$82 million to their communities.<sup>8</sup>

<sup>8</sup> Elizabeth Kneebone, "Bridging the Gap: Refundable Tax Credits in Metropolitan and Rural America," The Brookings Institute: Metropolitan Policy Program, 2008

### *The Economy*

The Federal EITC is expected to bring \$151 million into the Montana economy in 2012. A state EITC at 20% of the federal would pump more than \$30 million into Montana's communities.<sup>9</sup> By placing the money in the hands of the people most likely to spend it, a state EITC would increase demand for goods and services and boost the economy.

### **Conclusion**

The state of Montana has the opportunity to improve the lives of low-wage workers across the state by enacting a state EITC. In addition, a state EITC would benefit employers, the economy, and rural communities. Montana should join the majority of other states with income tax systems who have recognized these benefits and enacted state-level EITCs.

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<sup>9</sup> Erica Williams and Nicholas Johnson, "How Much Would a State Earned Income Tax Credit Cost in Fiscal Year 2012," Center on Budget and Policy Priorities, November 24, 2010, <http://www.cbpp.org/cms/index.cfm?fa=view&id=2992>.

## Appendix A

### State Earned Income Tax Credits Based on the Federal EITC

State	Percentage of Federal Credit (Tax Year 2010 Except as Noted)	Refundable?
Delaware	20%	No
District of Columbia	40%	Yes
Indiana	9%	Yes
Illinois	5%	Yes
Iowa	7%	Yes
Kansas	18%	Yes
Louisiana	3.5%	Yes
Maine	5%	No
Maryland <sup>a</sup>	25%	Yes
Massachusetts	15%	Yes
Michigan	20%	Yes
Minnesota <sup>b</sup>	Average 33%	Yes
Nebraska	10%	Yes
New Jersey	20%	Yes
New York <sup>c</sup>	30%	Yes
North Carolina <sup>d</sup>	5%	Yes
Oklahoma	5%	Yes
Oregon <sup>e</sup>	6%	Yes
Rhode Island	25%	Partially <sup>g</sup>
Vermont	32%	Yes
Virginia	20%	No
Washington	Not yet implemented; scheduled to be 10% in 2012 <sup>f</sup>	Yes
Wisconsin	4% — one child 14% — two children 43% — three children	Yes

Notes: From 1999 to 2001, Colorado offered a 10% refundable EITC financed from required rebates under the state's "TABOR" amendment. Those rebates, and hence the EITC, were suspended beginning in 2002 due to lack of funds and again in 2005 as a result of a voter-approved five-year suspension of TABOR. In 2011 when the TABOR suspension expires and given sufficient revenues, rebates will resume. A new law passed in 2010, however, would prioritize EITC refunds over rebates and over use of surplus revenues to fund an income tax cut also scheduled for 2011.

<sup>a</sup> Maryland also offers a non-refundable EITC set at 50 percent of the federal credit. Taxpayers in effect may claim either the refundable credit or the non-refundable credit, but not both.

<sup>b</sup> Minnesota's credit for families with children, unlike the other credits shown in this table, is not expressly structured as a percentage of the federal credit. Depending on income level, the credit for families with children may range from 25 percent to 45 percent of the federal credit; taxpayers without children may receive a 25 percent credit.

<sup>c</sup> Should the federal government reduce New York's share of the TANF block grant, the New York credit would be reduced automatically to the 1999 level of 20 percent.

<sup>d</sup> North Carolina's EITC is scheduled to expire in 2013.

<sup>e</sup> Oregon's EITC is scheduled to expire at the end of 2013.

<sup>f</sup> Washington's EITC will likely be worth 10 percent of the federal credit or \$50, whichever is greater.

<sup>g</sup> Rhode Island made a very small portion of its EITC refundable effective in TY 2003. In 2006, the refundable portion was increased from 10 percent to 15 percent of the nonrefundable credit (i.e., 3.75 percent of the federal EITC).

## Appendix B

### CHARACTERISTICS OF EITC-ELIGIBLE TAXPAYERS, 2007

STATE:

**Montana**

The Metropolitan Policy Program at Brookings

#### EITC-ELIGIBLE POPULATION

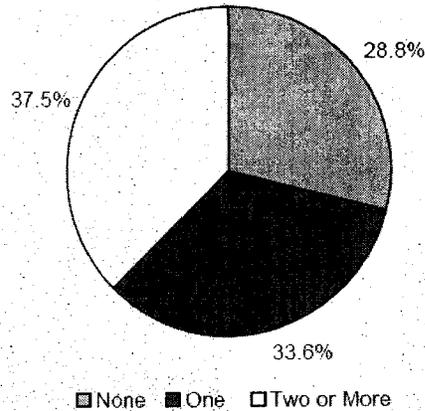
Total EITC-Eligible Tax Units	86,493	Total Population in EITC-Eligible Units	233,444
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#### EITC-ELIGIBLE FILING UNIT CHARACTERISTICS

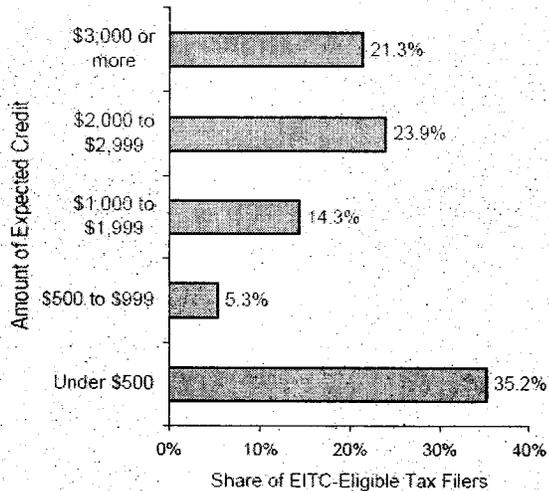
##### Filing Status

Married, Filing Jointly	25.6%
Head of Household	49.4%
Single	25.0%

##### Number of Qualifying Children



##### Size of Expected Earned Income Tax Credit

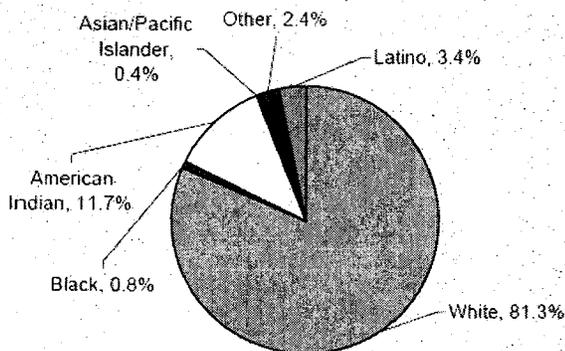


##### Adjusted Gross Income

\$1 to \$4,999	18.7%
\$5,000 to \$9,999	19.5%
\$10,000 to \$14,999	19.4%
\$15,000 to \$19,999	12.6%
\$20,000 to \$24,999	11.1%
\$25,000 to \$29,999	7.3%
\$30,000 to \$39,999	11.4%

#### EITC-ELIGIBLE TAX FILER CHARACTERISTICS

##### Race and Ethnicity of Taxpayer



##### Age of Taxpayer

Under 25 years	11.7%
25 to 34 years	32.8%
35 to 44 years	22.7%
45 to 54 years	20.2%
55 years and over	12.6%

**Appendix C: EITC returns by Montana State Senate District, 2007 tax year**

Senate District	Total returns	EITC returns	Percent of Returns with EITC	EITC amt
1	9859	1606	16%	\$2,906,548
2	12453	1742	14%	\$3,029,547
3	10233	1485	15%	\$2,654,002
4	10531	1535	15%	\$2,758,433
5	14001	2076	15%	\$3,619,279
6	9789	1920	20%	\$3,781,035
7	10478	1664	16%	\$3,086,256
8	8558	2919	34%	\$6,371,022
9	9120	1139	12%	\$1,974,840
10	9823	1522	15%	\$2,835,589
11	10638	1924	18%	\$3,506,726
12	7275	1384	19%	\$2,485,943
13	9845	1304	13%	\$2,395,682
14	9417	1179	13%	\$2,096,471
15	9345	1338	14%	\$2,339,409
16	7391	2587	35%	\$5,529,843
17	8647	1442	17%	\$2,751,760
18	9358	1370	15%	\$2,469,866
19	9714	1141	12%	\$2,028,876
20	9777	1351	14%	\$2,377,286
21	7022	2595	37%	\$5,823,509
22	8756	1395	16%	\$2,512,993
23	9855	1227	12%	\$2,160,621
24	10778	1340	12%	\$2,465,966
25	10432	1535	15%	\$2,687,187
26	11216	1794	16%	\$3,132,125
27	10150	1545	15%	\$2,695,419
28	9686	1005	10%	\$1,717,235
29	10577	1123	11%	\$1,961,003
30	9686	1132	12%	\$1,894,548
31	10340	1436	14%	\$2,292,940
32	10404	1015	10%	\$1,411,272
33	10306	1004	10%	\$1,335,233
34	13396	1638	12%	\$2,834,191
35	13179	1448	11%	\$2,265,284
36	9829	1405	14%	\$2,395,607
37	8629	1327	15%	\$2,324,253
38	9038	1383	15%	\$2,412,949
39	9703	1193	12%	\$2,124,505
40	11742	1435	12%	\$2,370,183
41	9450	1176	12%	\$1,921,711
42	9367	1158	12%	\$2,068,038
43	8469	1255	15%	\$2,172,306
44	10047	1647	16%	\$2,970,623
45	9772	1445	15%	\$2,628,381
46	9232	1480	16%	\$2,404,738
47	8920	1216	14%	\$1,910,041
48	11459	1665	15%	\$2,591,045
49	11593	1727	15%	\$2,765,691
50	11756	1792	15%	\$2,918,975

### EITC Returns by Montana State House District, 2007 tax year

House District	Total returns	EITC returns	Percent of		EITC amt (\$)
			Returns with EITC		
1	4723	785	17%		\$1,487,954
2	5136	821	16%		\$1,418,594
3	6808	1058	16%		\$1,958,791
4	5622	681	12%		\$1,064,838
5	5038	749	15%		\$1,387,924
6	5201	737	14%		\$1,267,602
7	4888	712	15%		\$1,280,308
8	5654	824	15%		\$1,481,113
9	5355	684	13%		\$1,169,064
10	8650	1393	16%		\$2,451,498
11	5348	911	17%		\$1,779,508
12	4442	1010	23%		\$2,001,649
13	5032	831	17%		\$1,488,038
14	5447	832	15%		\$1,598,218
15	4688	1525	33%		\$3,245,759
16	3870	1394	36%		\$3,125,263
17	4379	519	12%		\$846,976
18	4741	620	13%		\$1,127,864
19	4775	644	13%		\$1,156,769
20	5049	878	17%		\$1,678,820
21	5104	879	17%		\$1,668,277
22	5535	1045	19%		\$1,838,449
23	4056	799	20%		\$1,396,534
24	3219	586	18%		\$1,089,409
25	4645	605	13%		\$1,107,200
26	5200	699	13%		\$1,288,482
27	5118	667	13%		\$1,205,713
28	4300	514	12%		\$890,758
29	4401	613	14%		\$1,046,856
30	4944	725	15%		\$1,292,553
31	3819	1285	34%		\$2,748,813
32	3570	1303	36%		\$2,780,726
33	4302	645	15%		\$1,212,667
34	4344	797	18%		\$1,539,092
35	4813	749	16%		\$1,306,186
36	4547	621	14%		\$1,163,984
37	5157	564	11%		\$996,827
38	4556	577	13%		\$1,031,947
39	4490	560	12%		\$964,499
40	5288	791	15%		\$1,412,889
41	3295	1224	37%		\$2,725,939
42	3727	1371	37%		\$3,097,570
43	4858	606	12%		\$1,106,528
44	3898	789	20%		\$1,406,465
45	4286	631	15%		\$1,095,161
46	5473	582	11%		\$1,042,516
47	5144	640	12%		\$1,178,319
48	5737	713	12%		\$1,311,141
49	5703	1015	18%		\$1,794,038

50	4728	520	11%	\$893,150
51	6337	1107	17%	\$1,933,797
52	4880	686	14%	\$1,198,328
53	4754	703	15%	\$1,230,664
54	5396	841	16%	\$1,464,755
55	4839	504	10%	\$861,669
56	4848	501	10%	\$855,630
57	5789	507	9%	\$873,429
58	4780	616	13%	\$1,086,962
59	4891	624	13%	\$1,065,392
60	4795	508	11%	\$829,156
61	5419	714	13%	\$1,116,381
62	4921	722	15%	\$1,176,559
63	4332	412	10%	\$541,853
64	6080	603	10%	\$870,395
65	3651	348	10%	\$436,764
66	6663	657	10%	\$899,379
67	7806	942	12%	\$1,635,371
68	5574	695	12%	\$1,196,897
69	5971	676	11%	\$1,200,618
70	7208	772	11%	\$1,064,703
71	5388	715	13%	\$1,215,071
72	4441	690	16%	\$1,180,536
73	4713	729	15%	\$1,274,173
74	3916	598	15%	\$1,050,080
75	4287	655	15%	\$1,149,488
76	4751	727	15%	\$1,263,461
77	4579	459	10%	\$765,055
78	5124	734	14%	\$1,359,450
79	6743	825	12%	\$1,343,581
80	4999	611	12%	\$1,026,601
81	4706	598	13%	\$957,129
82	4744	578	12%	\$964,582
83	4829	621	13%	\$1,100,322
84	4538	536	12%	\$967,716
85	3647	577	16%	\$973,471
86	4822	678	14%	\$1,198,835
87	4465	702	16%	\$1,218,518
88	5579	944	17%	\$1,751,345
89	4929	782	16%	\$1,463,892
90	4846	664	14%	\$1,165,249
91	4566	725	16%	\$1,209,033
92	4666	755	16%	\$1,195,705
93	3751	519	14%	\$811,808
94	5169	696	13%	\$1,098,233
95	6628	941	14%	\$1,481,392
96	4833	725	15%	\$1,109,653
97	5146	768	15%	\$1,181,924
98	6447	959	15%	\$1,583,767
99	6685	1080	16%	\$1,636,465
100	5071	712	14%	\$1,282,511

Source: Brookings Institute, Metropolitan Policy Program