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

In Montana, thousands of families still struggle to make ends meet. One of the most promising policy opportunities to support working families and boost our economy is the enactment of a state Earned Income Tax Credit (EITC). Recently, the Great Recession and other economic trends have made it harder for Montana's families to live above the poverty line. In fact, Montana currently has over 33,000 families that are working but below or near the poverty line. A sluggish economic recovery has increased the struggles for low-income families. In addition, the Montana Income Tax system taxes families at an annual income far below the poverty line, pushing them further into poverty. The federal EITC program has been the most effective anti-poverty program in history, and a state-level credit could provide the same benefits to Montana.[1]

> *"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).

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 only a 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.**[2] Taxation begins for these families at $12,000 in annual income, which is 55% of the Federal Poverty Level (FPL) for a family of that size. Likewise, the state begins taxing a single parent with two children at $9,900 in annual income (58% of FPL). Enacting a state EITC would help to mitigate the impact these low taxation starting points have on Montana's families and prevent them from being driven into poverty.

Economic Trends Contribute to Families' Struggles

Recent economic trends have made it even more challenging for many of Montana's working families to make ends meet. In 2010, a parent working full-time for minimum wage would earn approximately $15,080. That's $6,970 below the Federal Poverty Line for a family of four. **Over 33,000 Montana families are working, but poor or near poor.**[3] Thirty-seven percent of Montana's children live in working, near-poor families. Unfortunately, Montana's income tax makes it even harder for many of these families to purchase basic necessities.

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

What is the Federal EITC?

The federal EITC is a refundable tax credit that was created by Congress in 1975. The federal EITC serves as a supplement to the wages of low-income working families across the nation. Only individuals who work and pay taxes are eligible for the EITC.[4] In 2012, the maximum benefit for the EITC is $5,891.[5] The EITC is not a handout or a tax loophole. Instead, it is a way for families to work their way out of poverty.

The Federal EITC is Effective.

- **In 2010, the federal EITC lifted more than 6.3 million people, including 3.3 million children out of poverty.**[6]
- Expansions of the federal EITC have been found to increase workplace participation among single parents.[7]
- The EITC is largely used on a temporary basis; 60% of recipients move off of the program in one or two years.[8]
- Recognizing the effectiveness of the federal EITC, twenty-four states have enacted state EITCs to further supplement the income of working families.[9]
- Children who are lifted out of poverty by programs such as the EITC perform better in school and are more likely to attend college. Additionally, these children earn 17% more as adults than similar children who did not receive the credit.[10]
- 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.
- Because the EITC is spent on meeting immediate needs, there is a great economic benefit to local communities. One estimate projects that for every dollar increase of the EITC, $1.58 in local economic activity is generated.[11]

How Does the Federal Earned Income Tax Credit Work?

Only low-income families and individuals with earnings from work are eligible for the federal EITC. The size of the credit depends on family size and income and is divided into three benefit 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 in a lump sum when they file their federal income tax return. Alternatively, a small number of families choose the advance payment option, which allows them to receive the credit throughout the year as a supplement to their paycheck.

How Would a State EITC Work?

Most states model their EITCs after the federal credit (see Table 1 for details about other states' EITCs). The best option for a state EITC is to offer workers a refundable tax credit that is equal to a fixed percentage of the federal credit. For example, Montana could offer an EITC equal to 20% of the federal credit. Linking state and federal eligibility makes the process far easier for Montana. The state can take advantage of federal compliance efforts and coordinated efforts to publicize the credit to eligible families.

Like the federal EITC, the state EITC could only be claimed by people who are working and paying taxes. The process to claim the credit is simple and would have powerful effects for Montana's working families. The EITC is first used to reduce a family's tax liability, and any remainder is returned to the family in the form of a refund.[12] **In Montana, a state EITC set at 20% of the federal credit would result in a maximum benefit of $1,178 for low- income working families, with a total cost to the state of approximately $27 million per year.**[13]

Figure 1- Value of Federal Earned Income

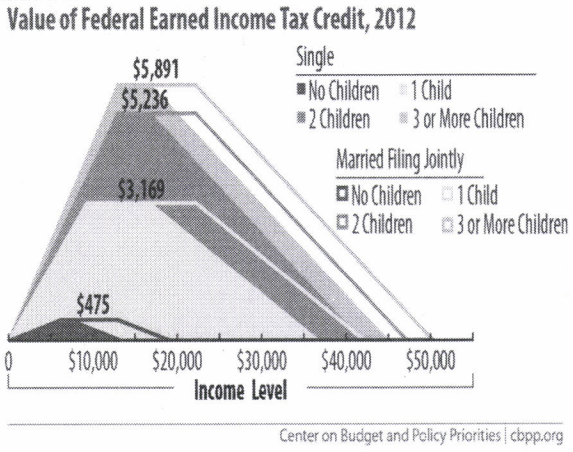


Table 1		
State Earned Income Tax Credits Based on the Federal EITC		
State	Percentage of Federal Credit (Tax Year 2010- Except as Noted)	Refundable
Delaware	20%	No
District of Columbia	40%	Yes
Illinois	5%	Yes
Indiana	9%	Yes
Iowa	7%	Yes
Kansas	18%	Yes
Louisiana	3.5%	Yes
Maine	5%	No
Maryland[a]	25%	Yes
Massachusetts	15%	Yes
Michigan	20%[f]	Yes
Minnesota[b]	Average 33%	Yes
Nebraska	10%	Yes
New Jersey	20%	Yes
New Mexico	10%	Yes
New York[c]	30%	Yes
North Carolina[d]	5%	Yes
Oklahoma	5%	Yes
Oregon[e]	6%	Yes
Rhode Island	25%	Partially[g]
Vermont	32%	Yes
Virginia	20%	No
Washington	Not yet implemented; scheduled to go 10% in 2012[f]	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 if sufficient revenues exist, rebates will resume. A new law passed in 2010, however, would prioritize EITC refunds over rebates and use of surplus revenues to fund an income tax cut also scheduled for 2011.

[a] 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.

[b] 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.

[c] 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.

[d] North Carolina's EITC is scheduled to expire in 2013.

[e] Oregon's EITC is scheduled to expire at the end of 2013.

[f] Washington's EITC is worth 10 percent of the federal EITC or $50, whichever is greater.

[g] 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)

Who Would Benefit from a Montana EITC?

Individuals and Families

Appendices A and B show detailed information about the federal EITC by state Senate and House districts. Over 218,000 Montanans, including almost 100,000 children, received the federal EITC in 2010.[14] If Montana passed a state EITC, these same families would benefit from a state EITC. Only families that work, such as military families and single mothers, qualify for the EITC. The EITC could help to supplement their wages and help them meet their families' needs.

A family of four that is supported by a full-time, $8.00/hour worker still falls below the poverty level. However, a combination of the state and federal EITC would raise that family out of poverty (Table 2). The increase in income from the federal and state EITC is equivalent to a wage increase of $2.90/hour.

Table 2
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 2008 Poverty Guideline	Equivalent Per Hour Raise
Family of Four Supported by:							
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

Children

Children are one of the most important beneficiaries of the EITC. The federal EITC is the nation's most successful anti-poverty program for children. Without this program, the number of children living in poverty would be 25% higher than it is today.[15] The benefits are long lasting as well. Children who move out of poverty in early childhood tend to perform better in school, receive more schooling later in life, work more hours, and have higher earnings.[16]

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 makes work pay by boosting wages. The federal EITC combined with a state EITC is equivalent to a $2.91/hour raise for a minimum wage worker (Table 2). This effective increase in pay also helps make work possible for families by helping low-wage employees afford essentials such as transportation and childcare.

Rural Areas and Small Towns

While nationally most beneficiaries live in large cities, rural areas and small towns receive a disproportionate amount of the benefits relative to population size. In the Montana, 65% (47,683) of EITC recipients in 2005 resided in rural areas. The federal EITC brought over $82 million to their communities, supporting families, small businesses, and the economy.[17]

The Economy

In 2011, the federal EITC injected $161 million into the Montana economy.[18] A state EITC at 20% of the federal would contribute an additional $27 million into Montana's communities. EITC recipients will spend their additional income at the grocery store, the gas stations and other businesses. 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

A state EITC is an incredible opportunity for Montana to improve the lives of low-wage workers and their families across the state. However, the EITC benefits far more than the state's low-income workers. The credit boosts the economy, protects children, and helps keep costs down for employers.

By encouraging people to work and supplementing their wages, the federal EITC program has been the most successful anti-poverty program in history. Montana should take this opportunity to help make work pay. Our families, communities, and economy will be stronger as a result.

Appendix A

2010 Profile of the EITC-Eligible Population

Metropolitan Policy Program at BROOKINGS

Montana

EITC-eligible population

TOTAL POP. IN EITC-ELIGIBLE UNITS

218,275

TOTAL CHILDREN IN EITC-ELIGIBLE UNITS

98,508

EITC-eligible tax unit characteristics

FILING STATUS

29.2% Married filing jointly

41.3% Head of household

29.5% Single

MEDIAN ADJUSTED GROSS INCOME

$13,099

SHARE RECEIVING FOOD STAMPS/SNAP

28.9%

EITC-eligible tax filer characteristics

HIGHEST LEVEL OF EDUCATION

- HIGH SCHOOL OR LESS 47.4%
- SOME COLLEGE OR ASSOCIATE'S 35.4
- BACHELOR'S OR HIGHER 17.2

TOP LANGUAGES SPOKEN

- ENGLISH 93.9%
- OTHER 6.1

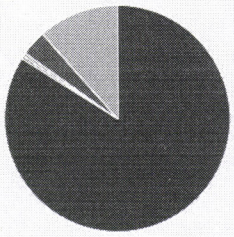
TOP FIVE INDUSTRIES

- HEALTH CARE 13.5%
- CONSTRUCTION 12.2
- RETAIL TRADE 12.0
- ACCOMODATION, FOOD SERVICES 10.5
- FORESTRY, AGRICULTURE 6.1

TOP FIVE OCCUPATIONS

- CONSTRUCTION, EXTRACTION 12.3%
- OFFICE AND ADMINISTRATIVE 11.1
- SALES 10.2
- BUILDING & GROUNDS CLEANING & MAINT. 9.1
- FOOD PREP. AND REL. SERVICE OCCUPATIONS 8.0

RACE AND ETHNICITY OF TAX FILER



- WHITE 84.0%
- BLACK 0.4
- ASIAN/PACIFIC ISLANDER 0.5
- HISPANIC 3.6
- OTHER 11.5

NOTES AND SOURCES

Source: MetroTax model estimates based on 2010 American Community Survey microdata.

For more details, visit brookings.edu/eitc-profiles to see the Profiles User Guide.

Appendix B

EITC returns by Montana State Senate District, 2010 tax year				
Senate District	Total Returns	EITC Returns	Percent of total returns with EITC	EITC Amount
District 1	7,426	1,615	22%	$ 3,331,778.00
District 2	10,030	1,919	19%	$ 3,630,165.00
District 3	9,403	1,893	20%	$ 3,794,155.00
District 4	7,807	1,627	21%	$ 3,327,106.00
District 5	11,919	2,431	20%	$ 4,809,235.00
District 6	8,059	2,044	25%	$ 4,456,686.00
District 7	8,208	1,736	21%	$ 3,487,176.00
District 8	7,195	2,816	39%	$ 6,605,847.00
District 9	8,061	1,264	16%	$ 2,469,773.00
District 10	8,971	1,699	19%	$ 3,539,475.00
District 11	9,041	1,981	22%	$ 3,866,586.00
District 12	6,358	1,410	22%	$ 2,843,421.00
District 13	8,930	1,469	16%	$ 2,965,960.00
District 14	8,338	1,261	15%	$ 2,662,173.00
District 15	7,619	1,324	17%	$ 2,506,340.00
District 16	6,397	2,429	38%	$ 5,951,772.00
District 17	7,745	1,496	19%	$ 3,137,744.00
District 18	8,078	1,248	15%	$ 2,568,893.00
District 19	8,774	1,237	14%	$ 2,473,820.00
District 20	8,139	1,372	17%	$ 2,720,729.00
District 21	6,176	2,516	41%	$ 6,252,903.00
District 22	8,072	1,503	19%	$ 3,080,782.00
District 23	9,410	1,438	15%	$ 2,946,551.00
District 24	9,794	1,581	16%	$ 3,351,240.00
District 25	8,343	1,493	18%	$ 2,909,067.00
District 26	9,003	1,750	19%	$ 3,400,147.00
District 27	8,523	1,602	19%	$ 3,102,881.00
District 28	9,590	1,301	14%	$ 2,465,715.00
District 29	9,363	1,231	13%	$ 2,391,012.00
District 30	8,021	1,193	15%	$ 2,244,120.00
District 31	8,345	1,518	18%	$ 2,675,571.00
District 32	10,407	1,390	13%	$ 1,978,772.00
District 33	8,464	1,116	13%	$ 1,551,743.00
District 34	11,307	1,861	16%	$ 3,397,603.00
District 35	11,932	1,820	15%	$ 3,175,588.00
District 36	8,363	1,488	18%	$ 2,856,778.00
District 37	7,673	1,474	19%	$ 2,875,767.00
District 38	7,503	1,452	19%	$ 2,813,081.00
District 39	9,067	1,341	15%	$ 2,624,139.00
District 40	10,021	1,542	15%	$ 2,841,734.00
District 41	7,983	1,231	15%	$ 2,236,575.00
District 42	8,739	1,381	16%	$ 2,674,120.00

District 43	6,844	1,337	20%	$ 2,577,287.00
District 44	8,227	1,764	21%	$ 3,631,039.00
District 45	8,249	1,565	19%	$ 3,130,716.00
District 46	7,826	1,539	20%	$ 2,598,337.00
District 47	8,120	1,391	17%	$ 2,206,578.00
District 48	9,550	1,783	19%	$ 2,846,951.00
District 49	11,174	2,117	19%	$ 3,608,053.00
District 50	10,019	1,881	19%	$ 3,357,351.00
Source: Brookings Institute, Metropolitan Policy Program				

Appendix C

EITC returns by Montana State House District, 2010 tax year				
House District	Total Returns	EITC Returns	Percent of Returns with EITC	EITC Amount
District 1	3,440	729	21%	1,540,868
District 2	3,986	886	22%	1,790,910
District 3	5,414	1,135	21%	2,290,818
District 4	4,616	784	17%	1,339,347
District 5	4,310	888	21%	1,832,734
District 6	5,093	1,004	20%	1,961,420
District 7	3,788	789	21%	1,614,204
District 8	4,019	837	21%	1,712,902
District 9	4,401	826	19%	1,580,397
District 10	7,518	1,605	21%	3,228,838
District 11	4,286	981	23%	2,055,474
District 12	3,772	1,064	28%	2,401,212
District 13	3,846	878	23%	1,781,281
District 14	4,362	858	20%	1,705,895
District 15	3,985	1,536	39%	3,555,948
District 16	3,210	1,280	40%	3,049,899
District 17	3,766	569	15%	1,042,541
District 18	4,295	695	16%	1,427,232
District 19	4,548	766	17%	1,574,641
District 20	4,423	933	21%	1,964,834
District 21	4,379	913	21%	1,898,420
District 22	4,662	1,069	23%	1,968,167
District 23	3,587	796	22%	1,566,001
District 24	2,771	614	22%	1,277,419
District 25	4,567	726	16%	1,462,378
District 26	4,363	743	17%	1,503,583
District 27	4,657	723	16%	1,560,738
District 28	3,681	538	15%	1,101,435
District 29	3,528	599	17%	1,114,042
District 30	4,091	725	18%	1,392,298
District 31	3,240	1,236	38%	3,102,285
District 32	3,157	1,193	38%	2,849,487
District 33	3,903	686	18%	1,425,009
District 34	3,842	810	21%	1,712,734
District 35	4,029	693	17%	1,434,625
District 36	4,049	555	14%	1,134,268
District 37	4,890	647	13%	1,294,279
District 38	3,884	590	15%	1,179,541
District 39	3,744	555	15%	1,054,311
District 40	4,395	817	19%	1,666,418
District 41	2,981	1,219	41%	2,961,473
District 42	3,195	1,297	41%	3,291,430
District 43	4,313	617	14%	1,318,153

District 44	3,759	886	24%	1,762,628
District 45	3,566	670	19%	1,374,624
District 46	5,844	768	13%	1,571,927
District 47	4,606	745	16%	1,578,207
District 48	5,188	837	16%	1,773,033
District 49	4,558	955	21%	1,884,663
District 50	3,785	538	14%	1,024,404
District 51	4,996	1,054	21%	2,047,892
District 52	4,007	696	17%	1,352,254
District 53	3,860	701	18%	1,366,404
District 54	4,662	901	19%	1,736,478
District 55	4,942	673	14%	1,274,703
District 56	4,648	629	14%	1,191,012
District 57	4,986	572	11%	1,092,899
District 58	4,377	659	15%	1,298,113
District 59	3,918	631	16%	1,176,393
District 60	4,103	561	14%	1,067,727
District 61	4,832	826	17%	1,456,649
District 62	3,512	692	20%	1,218,922
District 63	4,205	555	13%	746,700
District 64	6,201	836	13%	1,232,071
District 65	2,843	377	13%	493,557
District 66	5,621	740	13%	1,058,186
District 67	7,022	1,153	16%	2,092,587
District 68	4,285	708	17%	1,305,016
District 69	6,305	1,047	17%	2,029,360
District 70	5,628	773	14%	1,146,228
District 71	4,450	739	17%	1,403,724
District 72	3,914	749	19%	1,453,054
District 73	4,091	780	19%	1,512,555
District 74	3,582	695	19%	1,363,212
District 75	3,596	698	19%	1,369,094
District 76	3,907	755	19%	1,443,987
District 77	4,019	479	12%	906,983
District 78	5,048	862	17%	1,717,157
District 79	5,446	843	15%	1,518,497
District 80	4,575	699	15%	1,323,237
District 81	3,794	594	16%	1,051,475
District 82	4,189	638	15%	1,185,100
District 83	4,303	706	16%	1,306,806
District 84	4,436	674	15%	1,367,314
District 85	3,018	649	22%	1,205,163
District 86	3,826	687	18%	1,372,124
District 87	3,714	764	21%	1,492,909
District 88	4,514	1,000	22%	2,138,130
District 89	4,113	867	21%	1,753,513

District 90	4,137	699	17%	1,377,203
District 91	3,745	738	20%	1,291,535
District 92	4,080	801	20%	1,306,802
District 93	3,953	670	17%	1,066,146
District 94	4,166	720	17%	1,140,432
District 95	5,307	975	18%	1,591,245
District 96	4,243	808	19%	1,255,706
District 97	4,554	885	19%	1,431,071
District 98	6,621	1,232	19%	2,176,982
District 99	5,914	1,166	20%	1,900,033
District 100	4,105	715	17%	1,457,317
Source: Brookings Institute, Metropolitan Policy Program				

Endnotes

[1] Ami Nagle and Nicholas Johnson, "A Hand Up: How State Earned Income Tax Credits Help Working Families Escape Poverty in 2006," http://www.cbpp.org/cms/?fa=view&id=164, March 2006.

[2] 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.

[3] Near poor is defined as earning less than 200% of poverty. Working Families Project analysis of U.S. Census Bureau, 2010 American Community Survey.

[4] All working recipients of the EITC pay payroll taxes.

[5] Some EITC recipients may receive a refund greater than their total tax liability. Center on Budget and Policy Priorities, "Policy Basics: The Earned Income Tax Credit," http://www.cbpp.org/files/policybasics-eitc.pdf, February 22, 2012.

[6] Center on Budget and Policy Priorities, "Policy Basics: The Earned Income Tax Credit," http://www.cbpp.org/files/policybasics-eitc.pdf, February 22, 2012.

[7] 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.

[8] Tim Dowd and John B. Horowitz, "Income Mobility and the Earned Income Tax Credit: Short-Term Safety Net or Long-Term Income Support," Public Finance Review, September 2011.

[9] 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.

[10] Jimmy Charite, Indivar Dutta-Gupta, and Chuck Marr, " Studies Show Earned Income Tax Credit Encourages Work and Success in School and Reduces Poverty," Center on Budget and Policy Priorities, June 26, 2012.

[11] Alan Berube, "Using the Earned Income Tax Credit to Stimulate Local Economies," http://www.brookings.edu/~/media/research/files/reports/2006/11/childrenfamilies%20berube/berube20061101eitc.pdf, November 2006.

[12] Refundable tax credits are paid to families regardless of whether or not they owe income tax. Some families may receive an EITC larger than their tax liability.

[13] Johnson, Nicholas and Williams, Erica, "A Hand Up: How State Earned Income Tax Credits Help Working Families Escape Poverty in 2011," Center on Budget and Policy Priorities, April 18, 2011, http://www.cbpp.org/cms/index.cfm?fa=view&id=3474.

[14] Brookings, "2010 Profile of the EITC-Eligible Population," Metropolitan Policy Program at Brookings, http://www.brookings.edu/~/media/Programs/metro/EITC/states%202012/MT.pdf, 2012.

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