



## Legislative Fiscal Bureau

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Joint Committee on Finance

Paper #205

### **TANF Funds for the Earned Income Tax Credit (Children and Families -- Economic Support and Child Care)**

[LFB 2013-15 Budget Summary: Page 119, #19]

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#### **CURRENT LAW**

The earned income tax credit (EITC) is offered at both the federal and state levels as a means of providing assistance to lower-income workers. The credit provides a supplement to the wages and self-employment income of such families and is intended to offset the impact of the social security tax and other taxes and increase the incentive to work. Both the federal and Wisconsin credit are refundable so individuals with little or no income tax liability may still receive the credit.

The state EITC is currently paid from two sources: (a) a sum sufficient, general purpose revenue (GPR) appropriation; and (b) federal funding from the temporary assistance for needy families (TANF) block grant. Under federal law, TANF funds may be used to support a portion of the cost of the EITC. According to federal TANF regulations, TANF funds may be used to cover the share of the EITC that is refunded to the claimant (rather than used to reduce the claimant's income tax liability). Base TANF funding for the EITC is \$43,664,200.

#### **GOVERNOR**

Provide \$27,000,000 FED annually to pay the refundable portion of the state EITC with TANF funding. Total TANF funding for the EITC would be \$70,664,200 annually.

Total funding for the EITC under the bill is estimated to be \$107,011,000 in 2013-14 and \$109,191,000 in 2014-15.

## DISCUSSION POINTS

### Calculation of Refundable Portion for TANF Expenditures

1. Under a state EITC program, the refundable portion is an allowable TANF expenditure. The refundable portion is the amount that exceeds a family's state income tax liability prior to application of the EITC. Federal regulations further clarify that only the portion of a state EITC that the state refunds to a family and that is above the amount of EITC used as credit towards the family's state income tax liability can be funded with TANF revenues.

2. The following table shows total state EITC payments, the amount of the EITC funded with TANF, the amount of the EITC funded with GPR, and the percent of the overall EITC funded with TANF from 2001-02 through 2011-12.

**TABLE 1**

**Historical State EITC Expenditures (in Millions)  
2001-02 thru 2011-12**

<u>Fiscal Year</u>	<u>TANF</u>	<u>GPR</u>	<u>Total</u>	<u>% TANF</u>
2001-02	\$51.2	\$11.5	\$62.7	81.7%
2002-03	54.2	17.7	71.9	75.4
2003-04	57.9	15.1	73.0	79.3
2004-05	59.5	18.0	77.5	76.8
2005-06	53.2	28.8	82.0	64.9
2006-07	25.2	59.9	85.1	29.6
2007-08	21.1	71.5	92.6	22.8
2008-09	6.7	91.3	98.0	6.8
2009-10	25.9	103.3	129.2	20.0
2010-11	43.7	82.5	126.2	34.6
2011-12	43.7	59.6	103.3	42.3

3. TANF funding was first used for the state EITC in the 1998-99 fiscal year. At that time, data from the Department of Revenue (DOR) indicated that the refundable portion of the credit accounted for approximately 85% of total credit claims. Federal regulations also specify that TANF revenues may not be used to provide benefits to certain legal immigrants. Therefore, in order to provide a cushion to account for potential EITC claims by such immigrants, it was estimated that TANF funds could be used to cover up to 80% of the cost of the EITC. However, over time, the income eligibility limits for the EITC have increased substantially (from a maximum of \$30,095 in tax year 1998 to \$51,569 in tax year 2013). This has caused the refundable share of the state credit to decline, because more claimants have a net state tax liability to offset, before consideration of the credit. The refundable share of the credit is currently estimated at approximately 70%.

4. The U.S. Department of Health and Human Services (DHHS) issued a program instruction (PI) on January 17, 2001 (No. TANF-ACF-PI-01-01) that discussed the treatment of tax

credits for TANF expenditures and maintenance of effort (MOE). In the instruction, "refundable" was defined as the amount that exceeded the tax liability and was also paid to the family. The summation of the policy stated that "to be an allowable expenditure, only the portion of the refundable credit that is actually paid to the family may be claimed."

5. Under current state law, DOR intercepts tax refunds (including payments of refundable credits) to set off certain debts owed by the individual who would have received the refund. A debt means: (a) an amount owed to a state agency; (b) a delinquent child support or spousal support obligation; or (c) an amount of overpayment of a benefit that may be recovered by the Department of Children and Families (DCF) or the Department of Health Services. The setoff must first be applied to any debt owed to DOR. If there remains a refund in excess of \$10, DOR then sets off the remaining refund against certified debts of other state agencies in the order that the notice of the debt was received by DOR. However, no child support or spousal support obligation of another state may be set off until all debts owed to state agencies have been set off. Any tax refund amount above the debt owed by the individual is paid to the family.

6. As a result, a question has been raised as to whether "only the portion of the refundable credit that is actually paid to the family" would include the amount intercepted or exclude the amount intercepted. Arguably, since the amount intercepted is paying a debt owed by the family, it is paid to the family. The bill would adopt this interpretation of "paid to the family." Therefore, the portion of the EITC paid with TANF under the bill is 66% in 2013-14 and 65% in 2014-15. These amounts include some of the refundable EITC that would be intercepted under the tax intercept program.

7. This office contacted the federal DHHS for its opinion to resolve this question. The question asked was as follows: If a state intercepts a portion of a family's refundable EITC in order to recoup debt owed by the family, may the state consider the full amount of the refund (including the intercepted portion) as a federal TANF or MOE expenditure? A response was provided on April 24, 2013, that indicated the state cannot use TANF for the refundable EITC portion that is intercepted:

No. In this case, where the state is using the intercept to recoup a debt owed to the state, only the portion of the refundable EITC that is actually received by the family may be considered a federal TANF or MOE expenditure.

Please note the language in the PI explaining that a state may not treat foregone revenue as an allowable use of TANF or MOE funds, and that only the portion of the tax credit that the state actually refunds to the taxpayer may be claimed. These principles are also outlined in the federal regulations at 45 CFR 260.30 and 260.33 and the definition of what constitutes an "Expenditure." Since these intercepted funds are being used to repay a debt owed to the state, they do not constitute an expenditure of federal TANF or MOE funds.

8. Based on information provided by DOR, the portion of the refundable EITC paid to families after intercepted amounts are deducted is approximately 60% to 65% of the overall EITC amount. To account for legal immigrants, it is estimated that TANF funds could be used to cover 60% of the cost of the EITC. This office has reestimated the amount of the overall EITC to be \$106.7 million in 2013-14 and \$111.9 million in 2014-15. Therefore the proposed level of TANF

funding for the EITC under AB 40 should be reduced by \$6,644,200 FED in 2013-14 and \$3,524,200 FED in 2014-15 in order to address concerns about the tax intercept program (Alternative 2). A corresponding increase in GPR for the EITC would be needed (\$6,644,200 GPR in 2103-14 and \$3,524,200 GPR in 2014-15).

9. After learning of the opinion by DHSS regarding offsets against the EITC for debts owed by the credit claimant, DOA notified this office that the Department of Revenue will revise the order in which tax credits and refunds are offset to move the EITC from second in the order to last (behind refunds of taxes withheld from wages, the homestead credit, and other refundable credits, most of which are claimed by businesses). This modification may reduce the amount of EITC subject to offset to some extent, but it is unknown whether the decrease would be substantial enough to affect the estimates presented in the preceding paragraph.

### **Level of TANF for the EITC**

10. As shown in Table 1, TANF support for the EITC has ranged from \$6.7 million in 2008-09 to \$59.5 million in 2004-05. When the former aid to families with dependent children (AFDC) program was changed to the TANF program, the caseload dropped, and a surplus of TANF funds accumulated. More TANF supported the EITC during this time. As the TANF surplus declined, fewer TANF dollars supported the EITC in order to support the core TANF programs, such as Wisconsin Works (W-2) and Wisconsin Shares, the state's child care subsidy program.

11. In more recent years, the state has received additional TANF funding through the federal American Recovery and Reinvestment Act and through contingency funds. Contingency funds are available for states in economic downturns. With the additional TANF funding, TANF support for the EITC again increased to \$43.7 million annually during the 2011-13 biennium.

12. The Committee may wish to further reduce the level of TANF funding for the EITC. As indicated in LFB Paper #195, there is a structural deficit of \$38.5 million in the TANF program. In order to partially address this structural deficit or provide additional funding for other TANF programs, such as W-2 benefits or Wisconsin Shares for child care provider reimbursement rates, the Committee could reduce the level of TANF funding for the EITC.

13. The Committee could provide TANF funding for the EITC of \$25.9 million annually (Alternative 3). This amount is similar to the level of TANF funding provided for the EITC in three of the last six years (\$25.2 million in 2006-07, \$21.1 million in 2007-08, and \$25.9 million in 2009-10). Compared to the bill, TANF funding for the EITC would be reduced by \$44,764,200 FED annually. These funds could be used to address the shortfall in the W-2 program for benefits, provide an increase to child care provider reimbursement rate under the Wisconsin Shares program, provide funding to other TANF-related programs, or add to the TANF balance that would be carried over into the 2015-17 biennium to address the structural deficit in the TANF program. However, an additional \$44,764,200 GPR annually would also be needed to support the EITC to compensate for the reduction in TANF support.

14. Alternatively, the Committee could provide base TANF funding for the EITC of \$43,664,200 FED annually (Alternative 4). Compared to the bill, TANF funding for the EITC

would be reduced by \$27,000,000 FED annually. This amount of funding could be used to fund the shortfall in W-2 benefits or increase reimbursement rates for child care providers who participate in the Wisconsin Shares program. Any remaining funds would be carried over into the 2015-17 biennium to partially offset the structural deficit. However, additional GPR of \$27,000,000 annually would be required to fund the EITC to compensate for the reduction in TANF support.

15. Finally, the Committee could choose some other level of TANF funding to support the EITC (Alternative 5). As noted in paragraph #9, the maximum amount of TANF that could be used to support the EITC would be \$68,100,000 in 2013-14 and \$70,500,000 in 2014-15. The amount of TANF funding for the EITC could be set at any amount below this level. However, additional GPR, in the same amount that the level of TANF funding for the EITC is reduced by, would be needed to fully fund the EITC.

16. The figures shown in the previous paragraph, as well as the calculation of the maximum level of TANF that could be used for the EITC in Alternative 1, are based on more recent estimates of the EITC in the 2013-15 biennium under AB 40. If changes are made to the state EITC by the Committee, the maximum amount of TANF that could be provided to support the EITC would need to be adjusted based on the new estimates of the EITC under the changes made to the credit.

## ALTERNATIVES

1. Approve the Governor's proposal to provide an additional \$27,000,000 FED annually in TANF funding for the EITC. Total TANF funding for the EITC would be \$70,664,200 annually.

2. Modify the Governor's proposed level of TANF funding for the EITC to 60% of the overall EITC costs pursuant to federal laws and regulations. Compared to the bill, reduce funding by \$6,644,200 FED in 2013-14 and \$3,524,200 FED in 2014-15 and increase funding by \$6,644,200 GPR in 2013-14 and \$3,524,200 GPR in 2014-15. Total TANF funding for the EITC would be \$64,020,000 in 2013-14 and \$67,140,000 in 2014-15.

<b>ALT 2</b>	<b>Change to Bill Funding</b>
GPR	\$10,168,400
FED	<u>- 10,168,400</u>
Total	\$0

3. Modify the Governor's proposed level of TANF funding for the EITC to provide \$25,900,000 FED annually in TANF funds. Compared to the bill, reduce funding by \$44,764,200 FED annually and increase funding by \$44,764,200 GPR annually.

<b>ALT 3</b>	<b>Change to Bill Funding</b>
GPR	\$89,528,400
FED	<u>- 89,528,400</u>
Total	\$0

4. Modify the Governor's proposed level of TANF funding for the EITC to provide \$43,664,200 FED annually in TANF funds. Compared to the bill, reduce funding by \$27,000,000 FED annually and increase funding by \$27,000,000 GPR annually.

<b>ALT 4</b>	<b>Change to Bill Funding</b>
GPR	\$54,000,000
FED	<u>- 54,000,000</u>
Total	\$0

5. Modify the Governor's proposed level of TANF funding for the EITC to provide a level chosen by the Committee. TANF funding would be reduced by this amount, and GPR funding would increase by a corresponding amount.

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