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May 30, 2013 Joint Committee on Finance Paper #283

Earned Income Tax Credit
(General Fund Taxes -- Income and Franchise Taxes)

[LFB 2013-15 Budget Summary: Page 173, #8]

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 state EITC is calculated as a percentage of the federal credit. The state, therefore, uses federal definitions and eligibility requirements for purposes of the EITC, except that the state does not provide a credit to individuals without children. Both the federal and state credits are refundable -- if the credit exceeds the amount of tax due, a check is issued for the difference.

The credit is calculated based on family size, filing status, and the amount of earned income (although the credit can also be affected by adjusted gross income). Individuals without earned income are not eligible for the credit.

The income limits and maximum federal credit amounts are adjusted annually for changes in inflation. The maximum federal credit for tax year 2013 is $3,250 for families with one child, $5,372 for families with two children, and $6,044 for families with three or more children. The state credit percentages are: 4% for families with one child; 11% for families with two children; and 34% for families with three or more children. Based on the 2013 federal credit parameters and the state credit percentages, the maximum state credits for 2013 are: $130 for families with one child; $591 for families with two children; and $2,055 for families with three or more children. For filers with one child, the credit is phased out for income between $17,530 and $37,870 (between $22,870 and $43,210 for married couples filing jointly). For filers with two children, the income phase-out range is from $17,530 to $43,038 ($22,870 to $48,378 for married couples filing jointly). For filers with more than two children, the income phase-out range is from $17,530 to $46,227 ($22,870 to $51,567 for married couples filing jointly).

The state EITC is funded with a combination of GPR and PR funding. The program revenue is federal temporary assistance for needy families (TANF) funding transferred from the Department of Children and Families. The GPR portion is provided through a sum sufficient appropriation and covers the balance of the cost of the credit.

GOVERNOR

Increase PR funding for the earned income tax credit (EITC) by $27,000,000 annually and decrease GPR funding by $36,289,000 in 2013-14 and $34,109,000 in 2014-15 to reflect: (a) current law re-estimates (-$7,289,000 in 2013-14 and -$5,109,000 in 2014-15); (b) the proposed increase in PR funding (-$27,000,000 annually); and (c) estimated increases in the denial of fraudulent tax credit claims (-$2,000,000 annually). The estimated increase in finding fraudulent EITC claims is associated with additional funding and positions provided under the proposal to expand DOR's tax fraud enforcement [see "Tax Fraud Enforcement" (DOR -- Tax Administration) Paper #559].

Under these provisions, total funding for the EITC would decrease to $107,011,000 in 2013-14 and $109,191,000 in 2014-15, compared to base funding of $116,300,000. The PR funding would increase from a base level of $43,664,200 to $70,664,200 annually. The estimated GPR sum sufficient portion would be decreased from a base level of $72,635,800 to $36,346,800 in 2013-14 and $38,526,800 in 2014-15.

DISCUSSION POINTS

1. This paper addresses the total funding level of the state EITC and the formula used to calculate the credit. The use of temporary assistance for needy families revenues as a funding source is discussed in a separate paper (#205) and was resolved by the Committee on May 21, 2013. At that meeting, the Committee set the TANF funding for the credit at $62.5 million in 2013-14 and 2014-15. Compared to the Governor's proposal, that action reduces the amount of TANF funding for the credit by $8,164,200 annually and increases the GPR funding component by an identical amount each year.

2. The federal EITC was created in 1975 to offset payroll taxes paid by low-income workers with children. The credit has been characterized as encouraging work because individuals must work to receive the credit, and the amount of the credit increases as earnings increase, until a maximum credit amount is reached. Also, the credit can be viewed as stimulative, since low wage earners spend a greater portion of their income than high income individuals. Finally, the federal credit lifts an estimated six million people out of poverty, half of which are children. The state credit was first offered in 1984.

3. As the parameters for the credit have expanded, participation has also increased, and 27 million claimants received over $60 billion in federal tax credits last year. The average credit was $2,200. At the state level, 268,171 families received the federal and state tax credits in 2011. The state credit is calculated as a percentage of the federal credit and averaged $376.

4. For the 2013-15 biennium, the total cost of the state credit is re-estimated at $106.7 million in 2013-14 and $111.9 million in 2014-15. These amounts include reductions of $2 million annually for fraudulent and reckless claim enforcement, based on the Committee's action on Paper #559. Compared to the estimates in AB 40, the re-estimates are lower by $311,000 in 2013-14 and higher by $2,709,000 in 2014-15, and would require additional GPR funding of $2,398,000 in the biennium. Table 1 reports total state EITC funding for the five preceding fiscal years and total estimated funding for 2012-13 through 2014-15. Fluctuations in spending levels are attributable to federal and state formula changes, changes due to indexing, and participation rates.

TABLE 1

Historical State EITC Expenditures (in Millions)
2007-08 through 2014-15
(million $)

Fiscal Year	Total	Change
2007-08	$92.6	8.8%
2008-09	98.0	5.8
2009-10	129.2	31.8
2010-11	126.2	-2.3
2011-12	103.3	-18.1
2012-13 estimated	102.2	-1.1
2013-14 estimated	106.7	4.4
2014-15 estimated	111.9	4.9

5. The re-estimates reflect increases of 4.4% in 2013-14 and 4.9% in 2014-15. After three years of decreases, the number of state credit claimants is estimated to increase by 1% per year in 2013 and 2014. This reflects an improving job market, as evidenced by the latest (April) employment report from the Bureau of Labor Statistics, U.S. Department of Labor, that indicates the U.S. economy has added nearly 200,000 jobs per month since the beginning of 2013. In addition, parameters for the federal credit are indexed for inflation and change each year. For 2013 calculations, the inflation factor equaled 2.6%, and an inflation adjustment of 2.0% is assumed for the 2014 credit parameters.

6. AB 40 does not contain any provisions that would change the factors for calculating the state EITC. However, the Governor proposes a reduction to the individual income tax by decreasing the marginal tax rates that apply to income that falls within the bottom three income tax brackets, effective in tax year 2013. The Legislative Fiscal Bureau paper on that issue (Paper #280) provides a distributional analysis of the proposal that shows low-AGI taxpayers would receive smaller tax decreases, on average, than other taxpayers. For example, average tax decreases are estimated at $4 for taxpayers with AGI below $15,000, $11 for taxpayers with AGI between $15,000 and $25,000, $38 for taxpayers with AGI between $25,000 and $50,000, and $137 for taxpayers with AGI of $50,000 or more. The average tax decrease for all taxpayers with a decrease is estimated at $83. In addition, only 15% of tax filers with AGI below $15,000 are estimated to receive a tax decrease. The percentages of filers expected to receive a tax decrease are estimated at 77% for filers with AGI between $15,000 and $25,000 and 99% for filers with AGI of $25,000 or

greater.

7. Paper #280 notes that tax relief could be provided to the state's taxpayers in a number of ways other than the Governor's proposal. One alternative would be to expand state tax credits, such as the EITC. Expanding the EITC need not preclude reductions in income tax rates. Pairing a reduction in income tax rates with an expansion of the EITC would reduce some of the disparity in average tax reduction amounts, as reported above.

8. One way to expand the state EITC would be to reverse the reductions to the credit made by 2009 Wisconsin Act 32. The Act reduced the credit rates for claimants with two children from 14% to 11% and for claimants with three or more children from 43% to 34%. Claimants with two or more children comprise about half of all state EITC claimants, but receive 90% of the credits. Reversing the Act 32 changes would cause their average credit in 2013 to increase from $728 to $922, or by 27%. For these two claimant types, Table 2 displays the estimated 2013 distribution of claimants, total credits, and average credits under current law and under an alternative to increase the credit percentages for claimants with two children and with more than two children.

TABLE 2

Estimated Distribution of Claimants, Credits, and Average Credits by AGI For Claimants with Two Children and Claimants with More Than Two Children, Under Current Law and an Alternative to Increase State Credit Percentages Tax Year 2013

		Total Credits (in millions)			Average Credit		
	Claimant Count	Current Law	Alternative to Increase %	Change	Current Law	Alternative to Increase %	Change
Claimants with Two Children							
Under $5,000	5,620	$1.0	$1.3	$0.3	$180	$229	$49
$5,000 to $10,000	8,069	2.7	3.4	0.7	335	426	91
$10,000 to $15,000	11,875	6.1	7.7	1.6	512	651	139
$15,000 to $20,000	12,016	6.8	8.7	1.9	569	724	155
$20,000 to $25,000	10,999	5.3	6.8	1.5	485	617	132
$25,000 to $48,378	32,562	8.2	10.4	2.2	251	319	68
Total	81,141	$30.1	$38.3	$8.2	$371	$473	$102
Claimants with More Than Two Children							
Under $5,000	2,940	$1.9	$2.4	$0.5	$653	$826	$173
$5,000 to $10,000	3,956	4.6	5.8	1.2	1,165	1,474	309
$10,000 to $15,000	6,018	10.7	13.6	2.9	1,783	2,254	471
$15,000 to $20,000	6,410	12.7	16.1	3.4	1,989	2,515	526
$20,000 to $25,000	6,257	11.0	14.0	3.0	1,766	2,233	467
$25,000 to $51,567	23,565	23.6	29.9	6.3	1,003	1,268	265
Total	49,146	$64.5	$81.8	$17.3	$1,316	$1,664	$348

9. Increasing the state percentages from 11% to 14% for claimants with two children

and from 34% to 43% for claimants with more than two children would increase GPR expenditures for the credit by an estimated $26.1 million in 2013-14 and $27.4 million in 2014-15, or by $53.5 million for the biennium. This is in addition to the re-estimates provided above. Total credit expenditures would increase to $132.8 million in 2013-14 and $139.3 million in 2014-15. This is presented as Alternative 2.

10. Currently, 23 states and the District of Columbia have enacted laws creating state earned income tax credits. Wisconsin is unique in that it offers more than one reimbursement percentage, based on number of children. Relative to the credit percentage of 11% that Wisconsin extends to claimants with two children, 11 states offer credits of 10%, or less, and 11 other states offer credits of 15%, or more. Recently, the Iowa Legislature voted to increase the percentage for the Iowa EITC from 7% to 14% for tax year 2013 and 15% for tax year 2014 and thereafter. Except for the District of Columbia where the credit is set equal to 40%, no state offers a credit at a percentage that is higher than 34%, Wisconsin's credit percentage for claimants with more than two children. Table 3 displays the 2013 credit percentages for 21 states, and the District of Columbia, where the state credit is calculated as a percent of the federal credit. Unlike other states, Minnesota's credit is not expressly structured as a percentage of the federal credit.

TABLE 3

2013 State Earned Income Tax Credit Percentages, Percent of Federal Credit

Louisiana	3.5%	Indiana	9.0%	Virginia	20.0%
Illinois	5.0	Nebraska	10.0	Maryland	25.0
Maine	5.0	New Mexico	10.0	Rhode Island	25.0
North Carolina	5.0	Massachusetts	15.0	Connecticut	30.0
Oklahoma	5.0	Kansas	18.0	New York	30.0
Michigan	6.0	Delaware	20.0	Vermont	32.0
Oregon	6.0	New Jersey	20.0	District of Col.	40.0
Iowa	7.0				

Source: Center on Budget and Policy Priorities, Minnesota and Wisconsin not included.

11. Increasing the state percentages from 11% to 14% for claimants with two children but not changing the credit percentage for claimants with more than two children would increase GPR expenditures for the credit by an estimated $8.4 million in 2013-14 and $8.9 million in 2014-15, or by $17.3 million for the biennium. Total credit expenditures would increase to $115.1 million in 2013-14 and $120.8 million in 2014-15. This is presented as Alternative 3.

ALTERNATIVES

1. Decrease estimated expenditures for the credit by $311,000 GPR in 2013-14 and increase estimated expenditures for the credit by $2,709,000 GPR in 2014-15 to reflect re-estimates of the cost of the credit in the 2013-15 biennium under current law provisions. Total expenditures for the credit are estimated at $106,700,000 ($44,200,000 GPR and $62,500,000 PR) in 2013-14

and $111,900,000 ($49,400,000 GPR and $62,500,000 PR) in 2014-15.

ALT 1	**Change to Bill** Funding
GPR	$2,398,000

2. Increase the percentages used to calculate state credits from 11% to 14% for claimants with two children and from 34% to 43% for claimants with more than two children. Increase estimated expenditures for the credit by $25,789,000 GPR in 2013-14 and $30,109,000 GPR in 2014-15 to reflect: (a) current law re-estimates (-$311,000 in 2013-14 and $2,709,000 in 2014-15) and (b) the proposed increase in the state tax credit percentages ($26,100,000 in 2013-14 and $27,400,000 in 2014-15). Total expenditures for the credit are estimated at $132,800,000 ($70,300,000 GPR and $62,500,000 PR) in 2013-14 and $139,300,000 ($76,800,000 GPR and $62,500,000 PR) in 2014-15.

ALT 2	**Change to Bill** Funding
GPR	$55,898,000

3. Increase the percentage used to calculate state credits from 11% to 14% for claimants with two children. Increase estimated expenditures for the credit by $8,089,000 GPR in 2013-14 and $11,609,000 GPR in 2014-15 to reflect: (a) current law re-estimates (-$311,000 in 2013-14 and $2,709,000 in 2014-15) and (b) the proposed increase in the state tax credit percentage ($8,400,000 in 2013-14 and $8,900,000 in 2014-15). Total expenditures for the credit are estimated at $115,100,000 ($52,600,000 GPR and $62,500,000 PR) in 2013-14 and $120,800,000 ($58,300,000 GPR and $62,500,000 PR) in 2014-15.

ALT 3	**Change to Bill** Funding
GPR	$19,698,000

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