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2017 Joint Committee on Finance Paper #287

Earned Income Tax Credit -- Credit Percentage for Claimants with One Child (General Fund Taxes -- Income and Franchise Taxes)

[LFB 2017-19 Budget Summary: Page 176, #2]

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 and is extended to federal credit claimants who have one, two, or three or more children. 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.

GOVERNOR

Modify the percentage used to calculate the EITC by increasing the percentage from 4% to 11% for claimants with one child, beginning in tax year 2018. This would increase the cost of the credit by an estimated $20,800,000 in 2018-19. The proposed credit percentage is the same percentage used for claimants with two children.

DISCUSSION POINTS

1. The federal EITC is calculated as a percentage of earned income. The credit gradually increases until earned income reaches a threshold amount, known as maximum credit income, at which point the claimant receives the maximum allowable credit. The maximum credit is extended to claimants with earned income over this first income threshold and under a second income threshold. After the second income threshold, the credit is gradually reduced until it is eliminated for individuals with earned income or adjusted gross income (AGI) over a third income threshold, or maximum income level. Since 2002, the two income thresholds used to calculate the credit's phaseout have been higher for married claimants than for unmarried claimants, while the credit percentage and the maximum credit income have been the same for both types of claimants.

2. The income thresholds used in the calculations are indexed for inflation each year, and the 2018 EITC parameters that will be used to calculate credits when this proposal takes effect will not be known until next fall. Table 1 displays the estimated parameters for the 2018 federal EITC for single individuals with children. For married claimants, the credit percentages, maximum credit incomes, and maximum credits are identical to those for single claimants. However, married claimants have higher phase-out incomes and maximum incomes. In tax year 2015, single claimants comprised 74% of all claimants for the state EITC.

TABLE 1

Estimated Parameters for Calculating the 2018 Federal EITC for Single Claimants With Children

	One Child	Two Children	3 or More Children
Credit Percentage	34.00%	40.00%	45.00%
Maximum Credit Income	$10,230	$14,370	$14,370
Maximum Credit	3,478	5,748	6,467
Phase-Out Income	18,770	18,770	18,770
Phase-Out Rate	15.98%	21.06%	21.06%
Maximum Income	40,536	46,063	49,475

3. Like 22 other states and the District of Columbia, Wisconsin offers a state EITC, based on the federal credit. Each of the other states, as well as the District of Columbia, employs a single credit rate, where the state credit equals a percentage of the federal credit (although several states employ mechanisms that limit credit amounts under certain circumstances, thereby effectively reducing the credit rate for affected recipients). Wisconsin is unique in extending different credit rates based on the number of qualifying children -- 4% for one child, 11% for two children, and 34% for three or more children. Minnesota offers a working families credit which is based on the federal definition of earned income, and it also utilizes three credit rates.

4. Based on the estimated 2018 maximum federal credits, the current Wisconsin credit rates would produce maximum state credits of $139 for claimants with one child, $632 for claimants with two children, and $2,199 for claimants with three or more children. For the federal credit, the

maximum credit for claimants with two children is 1.65 times larger than the maximum credit for claimants with one child, and the maximum credit for claimants with three or more children is 1.86 times larger than the maximum credit for claimants with one child. For the Wisconsin credit, the maximum credit for claimants with two children is 4.55 times larger than the maximum credit for claimants with one child, and the maximum credit for claimants with three or more children is 15.82 times larger than the maximum credit for claimants with one child. These amounts are displayed in Table 2.

TABLE 2

Comparison of Maximum Credit Amounts for One Child Claimants to Amounts for Claimants with More Than One Child, Federal and State Credits

Number of Children	Maximum Federal Credit	Compared to One Child	Maximum State Credit	Compared to One Child
One	$3,478	1.00	$139	1.00
Two	5,748	1.65	632	4.55
Three or More	6,467	1.86	2,199	15.82

5. Obviously, Wisconsin's lower credit rate for claimants with one child (4%) than for claimants with two children (11%) or with three or more children (34%) is responsible for the higher multipliers. The Governor's proposal would increase the estimated maximum credit for one child claimants by $244, from $139 to $383 in 2018, and the multipliers in the right hand column of Table 2 would drop to 1.65 and 5.74, respectively.

6. The Department of Administration (DOA) indicates that the Governor's proposal to increase the credit rate for one child claimants is based on a desire to bring Wisconsin's credit rate into alignment with rates offered in other states. Further, increasing the credit amounts is intended to "potentially help bring non-working parents into the labor force." Of the 21 states and the District of Columbia where a single credit rate is used to calculate the state credit, 11 states have credit rates below 11%, and 11 states have credit rates above 11% (Table 3). The credit is non-refundable in Delaware, Maine, Maryland, Ohio, and Virginia, so claimants without enough state tax liability to offset the credit experience effective credit rates below the percentages displayed in the table (although Maryland also has a refundable component). Louisiana is the only state with a credit rate below Wisconsin's one-child credit rate.

TABLE 3

Credit Rates for Other States Offering a State EITC

States With Credit Rates Below 11% State	Credit Rate	States With Credit Rates Above 11% State	Credit Rate
Colorado	10.0%	Connecticut	27.5%
Illinois	10.0	Delaware*	20.0
Louisiana	3.5	District of Columbia	40.0
Maine*	5.0	Iowa	15.0
Michigan	6.0	Kansas	17.0
Nebraska	10.0	Maryland*	50.0
New Mexico	10.0	Massachusetts	15.0
Ohio*	10.0	New Jersey	30.0
Oklahoma	5.0	New York	30.0
Oregon	8.0	Vermont	32.0
Rhode Island	10.0	Virginia*	20.0

* The state credit is non-refundable.

7. Table 4 compares combined maximum federal and state tax credits under current law and under the Governor's proposal. Although the combined amounts would increase by only $244, that amount of additional income could be important to low-income households. Claimants with one child are eligible for the maximum federal and state credits if they have earned income of $18,770. That income level falls significantly below the income level that is necessary to meet the basic needs for a household comprised of a single individual with one child. Based on federal data, a model developed by the Massachusetts Institute of Technology calculates that income amount in Wisconsin at $47,825, on a pre-tax basis. That income level is $29,055 above the estimated 2018 EITC phase-out income level ($18,770) at which claimants qualify for the maximum federal credit. The amount of the income gap filled by the combined credits in Table 4 would increase from 12.4% under current law to 13.3% under the Governor's proposal.

TABLE 4

Estimated Federal and State Maximum EITC for One Child Claimants Under Current Law and Under the Governor's Proposal and Comparison to Estimated Income Gap, 2018

	Current Law	Proposed	Change
Federal	$3,478	$3,478	
State	139	383	
Combined	$3,617	$3,861	$244
Income Gap	29,055	29,055	
Credits as % of Gap	12.4%	13.3%	0.9%

8. Based on the reestimate of current law provisions presented in an earlier budget paper, approving the Governor's proposal to increase the credit rate would decrease expenditures by an estimated $600,000 GPR in 2018-19, relative to the amounts in the bill (Alternative 1). If the Committee wants to increase credits for one child claimants but is concerned about the proposal's cost, the credit rate could be set at a level between 4% and 11%. For example, an 8% credit rate would increase expenditures over the base funding level by an estimated $11.5 million in 2018-19, as opposed to $20.2 million under the Governor's proposal (Alternative 2). Table 5 reports estimated 2018 credit amounts at various income levels under current law, the Governor's proposal, and an 8% credit rate. Under the three alternatives, the average 2018 credits for one child claimants are estimated at $89 under current law, $178 under an 8% credit rate, and $245 under an 11% credit rate.

TABLE 5

Estimated 2018 State EITC Amounts for One Child Claimants at Various Income Levels Based on Different Credit Rates

	Single Claimants			Married Claimants		
Income	4%	8%	11%	4%	8%	11%
$0	$0	$0	$0	$0	$0	$0
2,000	27	54	75	27	54	75
4,000	54	109	150	54	109	150
6,000	82	163	224	82	163	224
8,000	109	218	299	109	218	299
10,000	136	272	374	136	272	374
12,000	139	278	383	139	278	383
14,000	139	278	383	139	278	383
16,000	139	278	383	139	278	383
18,000	139	278	383	139	278	383
20,000	131	263	361	139	278	383
22,000	118	237	326	139	278	383
24,000	106	211	291	139	278	383
26,000	93	186	256	129	259	356
28,000	80	160	220	117	233	321
30,000	67	135	185	104	208	286
32,000	55	109	150	91	182	251
34,000	42	84	115	78	157	215
36,000	29	58	80	66	131	180
38,000	16	32	45	53	106	145
40,000	3	7	9	40	80	110
42,000	0	0	0	27	54	75
44,000	0	0	0	14	29	40
46,000	0	0	0	2	3	4

9. Table 6 reports the estimated 2018 distribution of claimants, total credits, and average credits by AGI for claimants with one child under current law, under an 8% credit rate, and under an 11% credit rate (Governor's proposal). For each income class, the percent change in total credits and

average credits equals the percentage change in the credit rate -- +100% under the 8% credit rate and +175% under the 11% credit rate. Estimated credit increases average $89 under the 8% credit rate and $156 under the 11% credit rate. Within each of the credit rate increases, the table illustrates how the change in average credit would increase until AGI reaches the maximum credit income level and how the change in average credit would decrease after AGI exceeds the phase-out income threshold. Under each alternative, an estimated 127,520 families with one child would receive a larger credit.

TABLE 6

Estimated Distribution of Claimants, Credit, and Average Credits by AGI
Under Two Alternatives to Increase the Credit Rate for One-Child Claimants, 2018

	Claimant	Total Credits (in millions)			Average Credit		
AGI	Count	Current	8%	Change	Current	8%	Change
Under $5,000	8,692	$0.5	$1.0	$0.5	$56	$112	$56
$5,000 to $10,000	15,829	1.8	3.5	1.7	110	220	110
$10,000 to $15,000	18,951	2.6	5.2	2.6	139	278	139
$15,000 to $20,000	19,218	2.6	5.2	2.6	134	268	134
$20,000 to $25,000	19,262	2.1	4.2	2.1	110	220	110
Over $25,000	45,568	1.8	3.6	1.8	39	79	39
Total	127,520	$11.4	$22.8	$11.4	$89	$178	$89

	Claimant	Total Credits (in millions)			Average Credit		
AGI	Count	Current	11%	Change	Current	11%	Change
Under $5,000	8,692	$0.5	$1.3	$0.8	$56	$154	$98
$5,000 to $10,000	15,829	1.8	4.8	3.1	110	303	193
$10,000 to $15,000	18,951	2.6	7.2	4.6	139	382	243
$15,000 to $20,000	19,218	2.6	7.1	4.5	134	370	236
$20,000 to $25,000	19,262	2.1	5.8	3.7	110	304	194
Over $25,000	45,568	1.8	4.9	3.1	39	108	69
Total	127,520	$11.4	$31.3	$19.9	$89	$245	$156

10. Under federal law, the refundable portion of a state's EITC is an allowable expenditure of temporary assistance for needy families (TANF) block grant funding, and part of Wisconsin's EITC is funded with a PR transfer of TANF funding. Data from the Department of Revenue indicates that approximately 65% to 70% of Wisconsin's EITC can be funded with the transfer. This range would allow for some cushion to ensure that Wisconsin remains below the federal limitation.

11. The Governor proposes to increase PR funding for the EITC by $13.0 million in 2018-19. If the Committee does not adopt the Governor's proposal to increase the credit rate for one child claimants, the state could violate the federal limitation unless the proposed PR funding is also

reduced. However, with the proposed increase in the credit rate for one child claimants, the proposed PR funding level should comply with the federal limitation. If the Committee votes to remove the Governor's proposed increase in the one child credit rate from the bill, the Committee should also remove the proposed $13.0 million increase in PR funding in 2018-19.

12. Finally, if the Committee decides to approve the Governor's proposal, there are sufficient amounts in the TANF balance to extend the 11% credit rate to one child claimants in tax year 2017. This alternative (Alternative 3) would increase expenditures in 2017-18 by an estimated $15,500,000 ($6,300,000 GPR and $9,200,000 PR) over the base year funding level.

ALTERNATIVES

The change amounts in the following alternatives are net of the change amounts in the budget paper entitled, "Earned Income Tax Credit -- Current Law Sum Sufficient Reestimate."

1. Approve the Governor's recommendation to increase the state EITC credit rate for one child claimants from 4% to 11% beginning in tax year 2018, and reestimate the cost of the credit at $124,900,000 in 2018-19. This represents an increase of $20,200,000 compared to base level funding and a decrease of $600,000 compared to the amount in the bill. In 2018-19, set the amount of TANF funding at $82,700,000 and estimate the amount of GPR funding at $42,200,000.

ALT 1	**Change to**	
	Base	**Bill**
Shared Revenue		
GPR	$7,200,000	- $600,000
PR	13,000,000	0
Total	$20,200,000	- $600,000
Children & Families		
FED	$13,000,000	$0

2. Modify the Governor's proposal by reducing the proposed increase in the credit rate for one child claimants from 11% to 8% in tax year 2018 and reestimate the amount of the credit at $116,200,000 in 2018-19. This represents an increase of $11,500,000 compared to base level funding and a decrease of $9,300,000 compared to the amount in the bill. In 2018-19, set the amount of TANF funding at $76,900,000 and estimate the amount of GPR funding at $39,300,000.

ALT 2	**Change to**	
	Base	**Bill**
Shared Revenue		
GPR	$4,300,000	-$3,500,000
PR	7,200,000	- 5,800,000
Total	$11,500,000	- $9,300,000
Children & Families		
FED	$7,200,000	- $5,800,000

3. Modify the Governor's proposal by extending the proposed increase in the credit rate

for one child claimants beginning in tax year 2017, rather than 2018, and reestimate the amount of the credit at $119,100,000 in 2017-18 and $124,900,000 in 2018-19. These amounts represent increases of $19,300,000 in 2017-18 and $20,200,000 in 2018-19 compared to base level funding and an increase of $19,300,000 in 2017-18 and a decrease of $600,000 in 2018-19 compared to the amounts in the bill. Set the amount of TANF funding at $78,900,000 in 2017-18 and $82,700,000 in 2018-19, and estimate the amount of GPR funding at $40,200,000 in 2017-18 and $42,200,000 in 2018-19.

ALT 3	**Change to**	
	Base	**Bill**
Shared Revenue		
GPR	$17,300,000	$9,500,000
PR	22,200,000	9,200,000
Total	$39,500,000	$18,700,000
Children & Families		
FED	$22,200,000	$9,200,000

4. Delete the Governor's proposal, and decrease 2018-19 GPR expenditures by $7,800,000 and TANF expenditures by $13,000,000, relative to the amounts in the bill.

ALT 4	**Change to**	
	Base	**Bill**
Shared Revenue		
GPR	$0	- $7,800,000
PR	0	- 13,000,000
Total	$0	- $20,800,000
Children & Families		
FED	$0	- $13,000,000

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