



## Legislative Fiscal Bureau

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Joint Committee on Finance

Paper #289

### **Earned Income Tax Credit -- Credit for Noncustodial Parents (General Fund Taxes -- Income and Franchise Taxes)**

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

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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 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.

#### **GOVERNOR**

Beginning in tax year 2018, create a refundable credit, funded from the current law EITC appropriations, for noncustodial parents, not otherwise eligible for the EITC. Set the credit equal to 7.5% of the amount the individual would be eligible to receive under the federal EITC, if the individual's noncustodial child meets the definition of qualifying child under the federal credit. To be eligible to receive the state credit, specify that the individual claiming the credit must: (a) not claim the state credit authorized under current law; (b) be a full-year resident of Wisconsin; (c) be at least 18 years old at any point during the tax year for which the claim relates; (d) be the parent of at least one child who did not have the same principal place of abode as the claimant; (e) have been required under a court order for at least one-half of the tax year to make child

support payments for the noncustodial child for which the claim relates; and (f) have paid in full all amounts of court-ordered child support payments for the noncustodial child. In addition, specify that the court-ordered payments must be verified by the Department of Revenue (DOR) as having been made by the claimant. Authorize the Department of Children and Families (DCF) and county child support agencies to assist DOR in verifying the payment of court-ordered child support payments. Under this provision, the cost of the credit would increase by an estimated \$230,000 in 2018-19.

## **DISCUSSION POINTS**

1. The Department of Administration (DOA) indicates that this provision is intended to "address child support nonpayment issues by noncustodial parents while also providing them with a work incentive." It is a component of the Governor's welfare reform package named "Wisconsin Works for Everyone" which is based on the "principle that work is dignifying and connects individuals to society and to its values." While this component of the package is intended to reward work, other components are intended to connect people to employment, strengthen offender reentry to society, prepare the homeless for employment, reduce barriers to employment, and help workers advance. Still other components are intended to strengthen families, prioritize education, and enhance the integrity and effectiveness of existing welfare programs.

2. The proposed credit is modeled after New York State's noncustodial parent earned income credit, which is available to the parent of a minor child who does not reside with the claimant, has a child support order payable through a New York State Support Collection Unit, and is current in his or her payments as required by court order. The credit is equal to the greater of 20% of the federal EITC that could be claimed by a single claimant if the noncustodial child had been a qualifying child or 2.5 times the federal EITC that could be claimed by single claimants with no qualifying children. Claimants must be at least 18 years of age and full-year residents of the state. New York's credit is refundable.

3. DOA indicates that "evidence from New York suggests that the program has had some success in increasing the proportion of noncustodial parents paying their child support in full." A 2012 study sponsored by the Urban Institute examined program participation between 2006, the credit's first year, and 2009. The study found that the credit increased the number of noncustodial parents paying their child support in full. The increase was estimated at 1% for all noncustodial parents and at 2% for parents with low child support orders, defined as less than \$3,000 per year. Low child support orders are associated with low incomes, and the study found that the credit increased these individuals' participation in the work force by 1.6%.

4. Between 2006 and 2009, the number of individuals claiming New York's credit for noncustodial parents increased 50%, from 5,100 to 7,700 credit recipients. For 2009, the study calculated median measures of the claimants' age (36), income (\$20,717), and level of child support (\$3,628), and found that nearly 60% of the recipients owe support for just one child. Similar characteristics of claimants might be expected in Wisconsin if this proposal is enacted.

5. Over the four years covered by the Urban Institute study, the average credit increased

from \$392 in 2006 to \$451 in 2009. Compared to New York's 20% credit rate, the budget proposal would establish a rate of only 7.5%. As a result, a smaller average credit under the proposal is expected, estimated at \$170 in 2018. Because the proposed credit is expected to be lower than the New York credit, the proposal could have a lesser effect on noncustodial parents paying their child support in full and on participation in the work force, than was found in the Urban Institute study.

6. Based on New York's experience, DOR estimates that the number of credit recipients in Wisconsin will increase from 1,300 in 2018 to more than 1,500 in 2020. Over the same period, an increase in the total amount of credits is also estimated, from \$230,000 to \$290,000. Table 1 reports the total amount of credit payments and average credit amounts estimated under the Governor's proposal and under three other credit rates, which are presented as options under Alternative 1.

**TABLE 1**

**Estimated Funding Levels and Average Credit Amounts  
Under Three Credit Percentages, Tax Years 2018 - 2020**

	<u>2018</u>	<u>2019</u>	<u>2020</u>
<b>5.0%</b>			
Credit Funding	\$150,000	\$160,000	\$190,000
Average Credit	112	118	123
<b>7.5% (Governor)</b>			
Credit Funding	\$230,000	\$240,000	\$290,000
Average Credit	170	179	185
<b>10.0%</b>			
Credit Funding	\$310,000	\$330,000	\$380,000
Average Credit	232	243	246
<b>20.0%</b>			
Credit Funding	\$610,000	\$650,000	\$760,000
Average Credit	456	478	493

7. Under the formula used to calculate the federal EITC, the amount of the credit depends on the amount of the claimant's income. For claimants with little income, the credit increases as the claimant's earned income increases. Once a claimant's income reaches an initial income threshold, the credit flattens out until the claimant's income reaches a second income threshold. As income exceeds this second threshold, the credit phases out. Table 2 reports estimated 2018 credit amounts under the Governor's proposed credit for unmarried noncustodial parents and under three alternate credit rates at various categories of earned income. If the noncustodial parent marries an individual who is not the other parent, the noncustodial parent would presumably be able to claim the credit using the parameters for married claimants. Those parameters offer higher credit phaseout levels than for single claimants, resulting in larger credits for claimants with incomes in the phaseout ranges. However, DOA has indicated that the intent was to limit the calculation to the parameters for unmarried individuals. The proposal would need to be modified to achieve this intent.

**TABLE 2**

**Estimated Credits for Unmarried Noncustodial Parents At Various Income Levels Under Four Alternatives, 2018**

Earned Income	5% Credit Rate			7.5% Credit Rate			10% Credit Rate			20% Credit Rate		
	Number Children			Number Children			Number Children			Number Children		
	1	2	≥2	1	2	≥2	1	2	≥2	1	2	≥2
\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
2,000	34	40	45	51	60	68	68	80	90	136	160	180
4,000	68	80	90	102	120	135	136	160	180	272	320	360
6,000	102	120	135	153	180	203	204	240	270	408	480	240
8,000	136	160	180	204	240	270	272	320	360	544	640	720
10,000	170	200	225	255	300	338	340	400	450	680	800	900
12,000	174	240	270	261	360	405	348	480	540	696	960	1,080
14,000	174	280	315	261	420	473	348	560	630	696	1,120	1,260
16,000	174	287	323	261	431	485	348	575	647	696	1,150	1,293
18,000	174	287	323	261	431	485	348	575	647	696	1,150	1,293
20,000	164	274	310	246	412	466	328	549	621	656	1,098	1,241
22,000	148	253	289	222	380	434	296	507	579	592	1,014	1,157
24,000	132	232	268	198	348	402	264	465	537	528	929	1,073
26,000	116	211	247	174	317	371	232	423	494	465	845	989
28,000	100	190	226	150	285	339	200	380	452	401	761	905
30,000	84	169	205	126	254	308	168	338	410	337	677	820
32,000	68	148	184	102	222	276	136	296	368	273	592	736
34,000	52	127	163	78	191	244	104	254	326	209	508	652
36,000	36	106	142	54	159	213	72	212	284	145	424	568
38,000	20	85	121	30	127	181	41	170	242	81	340	483
40,000	4	64	100	6	96	150	9	128	200	17	255	399
42,000	0	43	79	0	64	118	0	86	157	0	171	315
44,000	0	22	58	0	33	86	0	43	115	0	87	231
46,000	0	1	37	0	1	55	0	1	73	0	3	146
48,000	0	0	16	0	0	23	0	0	31	0	0	62

8. In Wisconsin, the Department of Children and Families (DCF) is responsible for collecting and disbursing child support payments. A DCF administrative rule establishes the amount of child support a noncustodial parent is required to pay based on that parent's income and the number of children to be supported. The percentage of income ranges from 17% for one child to 34% for five or more children. For low-income parents (income below \$17,508 annually), the DCF rule establishes lower payment rates. However, child support payments are mandated through court order, and the court may deviate from the rule.

9. Wisconsin employs a number of measures to ensure that child support payments are made on a timely basis. Over 70% of all payments are made through income withholding where child support is automatically withheld from a parent's paycheck or other income source when the individual is paid. Federal law provides that any individual entitled to a federal income tax refund who owes past due child support may have his or her refund check intercepted and applied to past-due support. Wisconsin also provides for interception of state income tax refunds, Wisconsin lottery winnings of \$1,000 or more, court judgments and settlements, and lump sum retirement benefits.

10. Thus far in federal fiscal year 2017, DCF reports that 74.5% of all required child support payments was collected in the period when it became due. That percentage has risen in each of the six previous federal fiscal years. The last year when data for interstate comparisons is available is 2014, when Wisconsin ranked fourth among all states, at 73.0%, in the percentage of child support that was current. New York ranked 15<sup>th</sup> at 65.7%. New York's lower percentage may suggest that Wisconsin might not be able to realize a similar level of increase in on-time child support payments that New York experienced when it initiated its credit for non-custodial parents. Further, employing a lower credit rate (7.5%) than authorized in New York (20%) could increase that likelihood.

11. Currently, claiming Wisconsin's EITC is not complicated. Claimants are required to report the number of their qualifying children and the amount of their federal credit, which is multiplied by a state credit rate, depending on the number of children, to yield the state credit. Calculating the federal credit is more complex requiring eight pages of instructions, nine pages of tables, and a separate schedule where claimants report each qualifying child's name, social security number, date of birth, educational status, relationship to the claimant, and number of months lived with the claimant. Since the noncustodial parents targeted under this proposal do not receive a federal credit, DOR would need to create instructions and a schedule similar to that used by the Internal Revenue Service for the federal EITC to implement this proposal. The schedule used to claim New York's credit for noncustodial parents is slightly over two pages in length. With an average credit estimated at \$170, the administrative burden of claiming the proposed credit could discourage some individuals from claiming the credit.

12. In an errata submission, DOA has requested that the provision requiring DOR to verify that the claimant has paid in full all amounts of court-ordered child support payments be modified to specify that DCF has provided such verification to DOR. In addition, DCF would be required to provide verification for eligibility for the credit by January 15 of each year. In the same errata, DOA recommends modifying a cross reference to the Internal Revenue Code provision authorizing the federal EITC and a second cross reference in state law to the state EITC, as modified under the bill.

## **ALTERNATIVES**

1. Approve the Governor's proposal to extend the state earned income tax credit to noncustodial parents beginning in tax year 2018. In addition, modify the proposed eligibility requirement relating to child support payments to specify that DCF must verify that the claimant has paid in full all amounts of court-ordered child support payments. Require DCF to provide that verification to DOR by January 15 of each year. Modify the proposal to specify that the credit would be calculated using the federal parameters for unmarried individuals. Also, modify a cross reference to the Internal Revenue Code's authorization of the federal EITC to reflect current provisions and modify a cross reference to the state EITC, provided the Committee approves the Governor's recommendation to increase the credit rate for claimants with one child and to create a marriage penalty adjustment. In addition:

a. Set the credit rate at 5% and increase funding by \$150,000 in 2018-19, relative to current law;

ALT 1.a.	Change to	
	Base	Bill
GPR	\$150,000	- \$80,000

b. Set the credit rate at 7.5% and increase funding by \$230,000 in 2018-19, relative to current law;

ALT 1.b.	Change to	
	Base	Bill
GPR	\$230,000	\$0

c. Set the credit rate at 10% and increase funding by \$310,000 in 2018-19, relative to current law; or

ALT 1.c.	Change to	
	Base	Bill
GPR	\$310,000	\$80,000

d. Set the credit rate at 20% and increase funding by \$610,000 in 2018-19, relative to current law.

ALT 1.d.	Change to	
	Base	Bill
GPR	\$610,000	\$380,000

2. Delete the Governor's proposal to extend the state earned income tax credit to noncustodial parents beginning in tax year 2018.

ALT 2	Change to	
	Base	Bill
GPR	\$0	- \$230,000

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