



## Legislative Fiscal Bureau

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Joint Committee on Finance

Paper #1151

### **Earned Income Tax Credit -- Use of Additional TANF Funds (General Fund Taxes)**

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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 and the state uses federal definitions and eligibility requirements for purposes of the EITC, except that the state does not provide a credit to individuals without children or advance payments of the credit. The state credit percentages are: 4% for families with one child; 14% for families with two children; and 43% for families with three or more children. Both the federal and state credits are refundable. If the credit exceeds the amount of income tax due, a check is issued for the difference.

Unlike most individual income tax provisions, the state EITC is automatically updated for federal law changes. Under the federal Economic Growth and Tax Relief Reconciliation Act of 2001, the federal credit was simplified and expanded for tax years starting after December 31, 2001. Among the changes was an increase in the thresholds for the credit phase-out income ranges for married couples filing joint returns over those that apply for single filers, which was intended to reduce the marriage penalty on married EITC claimants.

The state EITC is paid from two sources: (a) a sum sufficient, GPR appropriation; and (b) federal temporary assistance for needy families (TANF) block grant funding transferred from the Department of Workforce Development (DWD) to pay the portion of the EITC refunded to individuals who are eligible for TANF. [The TANF funding is budgeted as FED in DWD and as PR-S under Shared Revenue and Tax Relief.] The TANF portion is based on the assumption that approximately 80% of EITC payments will be refunded to TANF-eligible individuals.

Under 2001 Wisconsin Act 16 (the 2001-03 biennial budget), total EITC expenditures were estimated at \$63,500,000 in 2001-02 (\$12,255,500 GPR and \$51,244,500 PR) and \$64,700,000 in 2002-03 (\$12,500,000 GPR and \$52,200,000 PR). Based on the changes in federal law described above, total EITC expenditures for 2002-03 were reestimated in January, 2002, at \$68,400,000 (\$16,200,000 GPR and \$52,200,000 PR), which is \$3,700,000 more than the total figure under Act 16.

**GOVERNOR**

No provision.

**DISCUSSION POINTS**

1. The refundable portion of the state EITC is an eligible expenditure under the TANF block grant. An estimated 80% of the additional \$3,700,000 provided for the EITC for 2002-03 is eligible to be funded by TANF. However, because the TANF funding is provided through an annual, sum-certain appropriation, any change in TANF funding for the EITC would require legislative action. As a result, the January, 2002, estimate of \$3,700,000 in increased cost in 2002-03 was reflected entirely in the sum sufficient GPR appropriation.

2. There is projected to be sufficient TANF funding to cover the eligible portion of the increase in the estimated EITC costs as discussed below. Therefore, an option would be to increase the TANF funding for the EITC by \$2,960,000, which is 80% of the \$3,700,000 increase, and to decrease the GPR appropriation by the same amount.

3. The amount of TANF funding available in 2001-03 is estimated at approximately \$43.09 million, as shown in Table 1. This includes: (a) unappropriated TANF funds; (b) funds placed in unallotted reserve in Act 16; (c) a contingency fund for W-2 cash benefits created in Act 16; and (d) a contingency fund for W-2 cash benefits in the Joint Committee on Finance’s federal program supplements appropriation.

**TABLE 1**

**Projected TANF Funds Available in 2001-03  
(In Millions)**

Unappropriated TANF Funds	\$17.44
Unallotted Reserve	0.65
Contingency Fund Created by Act 16	10.00
Contingency Fund in Joint Finance Appropriation	<u>15.00</u>
 Total	 \$43.09

4. The amount of TANF funds that are unappropriated and in unallotted reserve was last reported to the Committee on December 17, 2001, to be \$4.87 million. Under current projections, these two revenue sources total \$18.09 million. Changes include: (a) the Governor's budget reform bill would transfer \$0.17 million GPR from the TANF program to DHFS to be used for community aids; (b) DWD determined that 2000-01 direct child care expenditures were overstated by \$6.54 million; (c) DWD was awarded \$1.93 million in additional federal child care revenues in the federal fiscal year 2002 budget; and (d) DWD has determined that it has sufficient eligible matching expenditures to draw down an additional \$4.93 million in federal child care matching funds. In addition to the amounts shown in Table 1, there may also be savings in various TANF programs during the biennium. For example, the Badger Challenge program has been discontinued due to implementation of the 5% cuts mandated in Act 16, which will result in TANF program savings of \$93,400. There may also be savings identified in April, 2002, from contracts that ended in December, 2001. In addition, DWD is currently reviewing direct child care expenditures for fiscal years 1997-98 through 1999-00 to determine the magnitude of any overstated expenditures, which will increase the amount of TANF funds available.

5. While TANF funding is available to cover a portion of the projected increase in the EITC, there are other demands on TANF funding that should be considered. The W-2 caseload has been rising since January, 2001. The cash benefit caseload has increased by 2,458 (37%) from January, 2001, to January, 2002, after being stable in calendar year 2000. The cash benefits caseload in January, 2002, was 9,137. However, based on average monthly expenditures per case in the last W-2 contract period, the funding in Act 16 for W-2 agency contracts starting on January 1, 2002, will only provide sufficient funding for an average of 7,862 cases per month. As shown in Table 1, two contingency funds totaling approximately \$25 million have been created to address possible expenditure increases due to the rising caseload. This contingency funding would enable the state to support approximately 2,657 additional cases per month through June 30, 2003, for a total of 10,519 cases per month. Note that the final amount of the contingency fund created in Act 16 will not be known until community reinvestment expenditures are reconciled in April, 2002. Whether the funds set aside for caseload increases will be sufficient will depend on the length and severity of the current economic downturn and the speed of recovery. In addition to the W-2 caseload, the caretaker supplement program is currently projected to have an \$8.4 million deficit in 2001-03.

6. Another factor to consider is the TANF structural deficit. Ongoing expenditures significantly exceed ongoing revenues in the TANF program. For the 2003-05 biennium, the structural deficit is estimated at \$107 million annually. This estimate assumes that the amount of the state's TANF grant will not change when TANF is reauthorized at the federal level by September, 2002. Assuming no additional federal funds will be provided, the structural deficit will have to be addressed in the 2003-05 budget process by reducing program expenditures or providing additional state funding. Any available TANF funds not spent in 2001-03 would help mitigate this problem.

**ALTERNATIVES TO BILL**

1. Utilize TANF funding for the eligible portion of the projected increase in the cost of the EITC in 2002-03 by: (a) providing \$2,960,000 in additional TANF funds in 2002-03; and (b) reducing estimated expenditures from the GPR sum sufficient EITC appropriation by \$2,960,000 in that year. [The TANF funds would be budgeted as FED in DWD and also as PR-S under Shared Revenue and Tax Relief.]

<u>Alternative 1</u>	<u>GPR</u>	<u>FED</u>	<u>PR</u>	<u>TOTAL</u>
2001-03 FUNDING	- \$2,960,000	\$2,960,000	\$2,960,000	\$2,960,000

2. Maintain current law.

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