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2017 Joint Committee on Finance Paper #288

Earned Income Tax Credit -- Credit Calculation for Claimants Who Become Married (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. 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, authorize claimants who become married in a year to claim the greater of the credit calculated as a married claimant or the credit claimed in the prior year when the claimant was unmarried. In the succeeding two years, authorize the claimant to claim the greater of the credit calculated as a married claimant for that year or the credit claimed in the year prior to the year the claimant became married. The proposed change would increase the cost of the credit by an estimated $1,500,000 in 2018-19. Because the provision would first apply in tax year 2018 and extend for the initial three years of the claimant's marriage, the cost of the provision is estimated to increase to $3,500,000 in 2019-20 and $5,500,000 in 2020-21.

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.

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 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.

TABLE 1

Estimated Parameters for Calculating the 2018 Federal EITC for 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 Rate	15.98%	21.06%	21.06%
Single Claimants			
- Phase-Out Income	$18,770	$18,770	$18,770
- Maximum Income	40,536	46,063	49,475
Married Claimants			
- Phase-Out Income	$24,490	$24,490	$24,490
- Maximum Income	46,256	51,783	55,195

3. The higher income phaseout for married claimants and the higher credit rate for claimants with three or more children are intended to address the credit's marriage penalty, which occurs when claimants receive a lower credit when married than the combined credit amounts that would result if the claimants were single. A higher income phase-out was first authorized under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). The American Recovery and Reinvestment Act of 2009 (ARRA) increased the higher income phase-out and created a higher

credit rate for claimants with three or more children. Both enhancements were enacted on a temporary basis, but were made permanent in the Consolidated Appropriations Act of 2016.

4. If married claimants were subject to the phaseout thresholds for single filers, married claimants would be penalized under the formula because they must combine their incomes. This causes married claimants to reach the phase-out thresholds more quickly than would occur if they were single. Without the higher credit rate for claimants with three or more children, claimants with more than two dependent children who marry would not be able to claim a credit for each of their children.

5. While the two changes address the marriage penalty associated with the EITC, the changes do not eliminate the penalty because the federal credit rates do not increase proportionally with the number of children. Because the state EITC is based on the federal EITC, Wisconsin's ability to address the marriage penalty is limited. One way Wisconsin has addressed the marriage penalty is by creating higher credit rates for households with more children (4% for one, 11% for two, and 34% for three or more). Nonetheless, there are instances where claimants receive a smaller state credit when married than the combined credits of two single claimants. A marriage penalty would always occur when a single parent claimant marries a childless individual, and combining the persons' incomes causes the claimant's income to increase between the two phase-out thresholds or to exceed the maximum income threshold. For two single parent claimants who marry, the outcome is less certain.

6. Table 2 reports federal and state credit information for three sets of hypothetical claimants. In the first example, the claimants have income below the phase-out income thresholds before and after becoming married. Their combined federal credits of $6,956 would decrease to $5,748, or by $1,208, if they became married. Because the state employs a higher credit rate for two-children households than for households with one child, the state credit would increase by $354, from a combined $278 if single to $632 if married. In the second example, each claimant's income is below the phase-out income threshold, but the claimants' combined income would exceed the threshold. Their combined federal credits of $9,226 when single would decrease to $4,674 if married, resulting in a federal marriage penalty of $4,552. However, like the couple in the first example, the combined state credits when single, estimated at $771, would increase if the couple became married to an estimated $1,589, producing a "marriage bonus" of $818.

7. The hypothetical claimants in example 3 illustrate how a state marriage penalty could occur. Both claimants have income over the phase-out income threshold when single, and if married, their combined income would approach the maximum income threshold where the federal and state credits phase out. Their combined state credits of $198 when single would decrease to $41, or by $157, if they became married. For this couple, a federal marriage penalty of $4,590 is estimated, as the combined single credits of $4,966 would decrease to $376 if the couple became married.

TABLE 2

Comparison of Federal and State Tax Credits for Hypothetical Single and Married Claimants Under Estimated 2018 Credit Parameters

Status	Single	Single	Combined	Married	Difference
Example 1					
Income	$12,000	$12,000		$24,000	
No. Children	1	1		2	
Federal EITC	$3,478	$3,478	$6,956	$5,748	-$1,208
Wis. Credit Rate	4%	4%		11%	
Wis. EITC	$139	$139	$278	$632	$354
Example 2					
Income	$15,000	$18,000		$33,000	
No. Children	1	2		3	
Federal EITC	$3,478	$5,748	$9,226	$4,674	-$4,552
Wis. Credit Rate	4%	11%		34%	
Wis. EITC	$139	$632	$771	$1,589	$818
Example 3					
Income	$25,000	$25,000		$50,000	
No. Children	1	1		2	
Federal EITC	$2,483	$2,483	$4,966	$376	-$4,590
Wis. Credit Rate	4%	4%		11%	
Wis. EITC	$99	$99	$198	$41	-$157

8. A separate provision in the bill would increase the state's credit rate for one-child claimants from 4% to 11% of the federal credit, beginning in tax year 2018. Since the state's graduated credit rates have a mitigating effect on the marriage penalty, adopting a higher state credit rate for one-child claimants would cause more claimants to experience a marriage penalty. Relative to the examples in Table 2, Table 3 indicates that the claimants in the first example would experience a marriage penalty of $133 under the proposed rate change, as opposed to a marriage bonus of $354 under current law, and the marriage penalty for the claimants in the third example would increase from $157 to $505. The marriage bonus for claimants in the second example would decrease from $818 under current law to $574 under the 11% credit rate for one-child households.

TABLE 3

Comparison of Estimated 2018 State Tax Credits for Hypothetical Claimants Under Governor's Proposal to Increase the Credit Rate for One-Child Claimants

	Single	Single	Combined	Married	Difference
Example 1	$383	$383	$765	$632	-$133
Example 2	383	632	1,015	1,589	574
Example 3	273	273	546	41	-505

9. In instances where both married partners claimed a state EITC when single, a marriage penalty is most likely to occur when the claimants' combined income rises above the phase-out income threshold. The Department of Administration (DOA) indicates that the Governor's proposal is intended to address instances where couples receive the credit before marrying, "but whose combined income would cause one or both to lose their credit or see it significantly reduced." In such instances, the Governor's proposal would allow claimants to claim the greater of their credit as a married couple or the credit claimed in the year immediately before the claimants' marriage. This treatment would be allowed for the three years after the claimants' marriage. Based on an analysis of 2013 and 2014 credits, the Department of Revenue (DOR) has identified approximately 6,000 married couples who would benefit from the Governor's proposal and receive credits that are higher by $250, on average. If the proposal to increase the credit rate for claimants with one child to 11% is also enacted, the change in the average credit would increase to $335.

10. The proposal would add minimal complexity to the administration of the state income tax. Married claimants would calculate their state EITC and compare that amount to their credit in the year before their marriage for the first three years of their marriage. Nonetheless, two provisions could be clarified to reflect the Governor's intent. First, the bill could be modified to specify that claimants would compare their combined credits when single to their current year credit as married claimants. Second, the bill could be modified to specify that when married couples have a combined income above the maximum income threshold but one or both partners received a credit in the year prior to their marriage, the couple could claim the proposed adjustment in the first three years of their marriage. Due to the late date that these issues were identified, they were not included in DOA's errata submission.

11. For tax year 2018, the maximum income threshold for married claimants is estimated to range between $46,256 and $55,195 depending on the number of children. While it might be reasonable to provide a marriage penalty adjustment for couples with incomes slightly above the threshold, an adjustment becomes less reasonable at higher income levels. If the Committee is concerned about couples with higher incomes claiming the proposed adjustment, the Committee could limit the adjustment to couples with federal AGI below a certain level. For example, the limitation could be set at the maximum income threshold for the federal credit, depending on the claimant's number of children, plus $20,000. The additional increment of income could be set at other levels, as well.

12. If the Committee wants to address the marriage penalty in the state EITC, it could approve the Governor's proposal with modifications addressing the two issues identified above (Alternative 1). Another option would be for the Committee to modify the Governor's proposal by limiting the adjustment to claimants with federal AGI below a certain level (Alternative 2). If the Committee believes the proposed adjustment would not offer meaningful relief to credit claimants, it could delete the Governor's proposal (Alternative 3).

ALTERNATIVES

1. Approve the Governor's proposal to provide a marriage penalty adjustment, beginning in tax year 2018, under the state earned income tax credit, except modify the proposal to specify: (a)

that the marriage penalty adjustment is calculated by comparing the combined credits of each spouse in the year prior to their marriage to their state credit, if any, in the current tax year and (b) that married couples are eligible for the adjustment even if they do not otherwise qualify for the state credit in the current tax year.

ALT 1	Change to Base	Change to Bill
GPR	$1,500,000	$0

2. Modify the Governor's proposal, as described in Alternative 1, to limit the marriage penalty adjustment to claimants whose federal adjusted gross income in the current tax year is less than the federal maximum income threshold for claimants with the same number of children and same filing status plus $20,000.

ALT 2	Change to Base	Change to Bill
GPR	$1,500,000	$0

3. Delete the Governor's proposal to provide a marriage penalty adjustment for claimants of the state earned income tax credit.

ALT 3	Change to Base	Change to Bill
GPR	$0	- $1,500,000

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