Massachusetts’ Earned Income Tax Credit and the Current Proposal for Increase and Reform

In Massachusetts – one of only four states boasting the term “commonwealth” in the official state name - we seek to build a thriving state economy that delivers broadly shared prosperity to workers and their families. Unfortunately, since the 1970s, wages have stagnated for low and moderate income workers in Massachusetts and nationally, making it increasingly difficult for many hardworking parents to make ends meet and provide for their children. The state earned income tax credit (EITC) program helps push back against this troubling trend, providing a meaningful boost to the after-tax earnings of low-income working families. When we reward work with policies like the EITC, families benefit over the long-term: children grow up healthier and do better in school, and parents enjoy greater economic security throughout their working years and into retirement.

A strong state EITC, particularly when coupled with a strong minimum wage, moves us closer to being the “commonwealth” declared in our state name. (For more on the interactions between minimum wage and earned income tax credit policies, see MassBudget’s factsheet, Rewarding Work.)

THE EITC DELIVERS LARGEST BENEFITS TO FAMILIES WITH CHILDREN

The state earned income tax credit (EITC) is a refundable tax break provided by the Commonwealth to lower-income workers in order to increase the after-tax rewards to work. It is available only to tax filers with earned income and provides benefits primarily to workers with children (to learn more about this and other programs affecting Massachusetts children, see MassBudget’s Children’s Budget).

The Massachusetts EITC operates under the same eligibility rules as the federal EITC, with the state credit value calculated as a straight 23 percent of the federal EITC amount claimed by the tax filer (this percentage is also called the “match rate”). This match rate was increased on January 1st, 2016 from 15 percent. A tax filer’s federal EITC eligibility and credit value depend on marital status, the amount of income the filer earned during the tax year, and the number of dependent children.

The largest credits are provided to families with three or more children earning between approximately $14,000 and $24,000 a year. The value of the credit declines slowly as income rises, and disappears entirely for families earning more than about $53,000. Far smaller credits are available to very low-income filers who do not have children. For someone receiving the state EITC, their state income tax bill is reduced by the value of the credit. If the value of their credit exceeds the amount they owe in state income tax, the remaining credit value is refunded to them as a direct payment.

In 2016, the maximum value of the Massachusetts EITC will be $1,442. In recent years, between 430,000 and 440,000 filers claim the Massachusetts state EITC annually. With the higher match rate (23 percent), the Department of Revenue projects the annual cost of the program will be about $218 million in FY 2017.
EITC BOOSTS WORK HOURS AND INCOMES, IMPROVES OUTCOMES FOR KIDS

The earned income tax credit leads to a variety of benefits for parents and children, according to a large body of research.

By providing tax credits to people currently in the workforce, the EITC increases employment and encourages people, especially single mothers, to work more hours. Not surprisingly, the EITC therefore boosts recipients’ long-term earnings and future Social Security retirement benefits. The EITC is likewise widely recognized as an extremely important tool in the fight against poverty. In combination with the federal Child Tax Credit (CTC), the federal EITC lifted some 10 million people above the poverty line in 2014, 5 million of them children, and raised the incomes of another 22 million people. In Massachusetts, these two federal tax credits combine to help bring roughly 76,000 Massachusetts kids above the poverty line each year. (In 2014, there were an estimated 440,000 “qualifying children” living in EITC-eligible Massachusetts homes.) Notably, on December 18, 2015, with bi-partisan support from Congress, President Obama signed into law H.R. 2029, a budget bill that includes language making permanent several extensions to the federal EITC and CTC that otherwise were set to expire in 2017 (for more details, see this CBPP report).

Research compiled by the Center on Budget and Policy Priorities (CBPP) shows that because the earnings boost affects families in a variety of ways, the EITC has benefits throughout the life-cycle. Specifically, the EITC:

- **Improves the health of children and mothers.** Researchers have found a strong association between EITC participation and mothers receiving prenatal care. This improves both maternal health (e.g. lower smoking rates) and infant health (e.g. fewer children born at low weights).

- **Boosts academic performance.** Children in families receiving EITC support have shown higher test scores, especially for elementary and middle school students; higher high school graduation rates; and higher college attendance rates. Specifically, “a child in a family eligible for the largest EITC expansion in the early 1990’s would have a 4.8 percentage-point higher probability of completing one or more years of college by age 19—an improvement comparable to the effect of major educational interventions such as reducing classroom size.”

- **Increases the earning potential for future generations.** Long-term studies of kids raised in EITC-supported households find that since they tended to grow up healthier and do better in school, they also tend to earn more when they are working adults. In one study “researchers projected that each dollar of income through tax credits may increase the real value of the child’s future earnings by more than a dollar.”

- **Increases Social Security benefits.** By increasing direct earnings during one’s career, the EITC also leads to stronger retirement benefits, including Social Security benefits, since much retirement earning rises proportionally with income.

STRONGER STATE EITC WOULD HELP HARDWORKING MASSACHUSETTS FAMILIES

A stronger state EITC could provide real, near-term help to hundreds of thousands of struggling families, while also laying the groundwork for a more prosperous Commonwealth down the road.
Recognizing the benefits of a strong state EITC, at least ten other states offer significantly higher match rates than does Massachusetts. Some states offer match rates of 30, 40, or 50 percent of a filer’s federal credit. Several of our neighboring states - including Vermont, Connecticut and New York - offer higher match rates than Massachusetts does.

The Massachusetts Senate Ways and Means Committee (SWM) has proposed raising the match rate by 5 percentage points to 28 percent (see bill S. 2423, section 53). Were this proposal in effect in 2016, the maximum state credit available to a family (one or two parents) with 3 or more children would rise from $1,442 to $1,755, an increase of $313. For a family (one or two parents) with two children, the maximum state credit would rise from $1,282 to $1,560, an increase of $278. Other filers likewise would see meaningful increases. This increase in the match rate (to 28 percent) would increase program costs by about $47 million a year.

At the same time, SWM proposes adjusting the value of the credit that each family would receive based on their official state residency status. Currently, taxpayers who are Massachusetts residents for the entire tax year are entitled to the full value of the Massachusetts EITC for which they are eligible, regardless of which state they earned their income in. For taxpayers who are non-residents for part or all of the year, the final value of their credit currently is prorated based on the share of their total annual income earned in Massachusetts.

Under the SWM’s proposed changes, taxpayers who are residents of Massachusetts for the entire tax year would continue to be eligible for their full state credit. For taxpayers who are non-residents for a portion of the year, their state EITC amount would be prorated based on the percentage of days they are officially residents of Massachusetts during the given tax year (as opposed to prorating credit amounts based on where they earned their income, as is done currently). For example, if a taxpayer is an official state resident for only half the year, she would be eligible only for half of the state EITC for which she would qualify as a full-year resident. (Of the 26 states and DC that offer a state EITC, 5 deny their EITC to part-time residents and 15 deny their EITC to non-residents.) Under the SWM proposal, taxpayers who are non-residents for the entirety of the year would be completely ineligible for the Massachusetts EITC. The Massachusetts Department of Revenue estimates that adjusting credit amounts and eligibility in the ways proposed by SWM would reduce annual program costs by about $9.2 million.

Taking these two changes together – the increase in the match rate to 28 percent and the adjustments to eligibility and credit amounts based on state residency status – the net cost of SWM’s proposal would be approximately an additional $38 million a year ($47 million - $9 million = $38 million), delivering this amount of additional state EITC support to low and moderate income working families in Massachusetts.

SWM proposes paying for a portion of these increased program costs by altering the terms under which short-term rental accommodations are taxed. The Commonwealth applies a number of taxes to hotel and motel room rentals, room rentals in lodging houses, and room rentals in bed and breakfast establishments (that rent out four or more rooms). Among these taxes is a room excise tax of 5.7 percent. SWM proposes extending the application of this tax to other forms of “transient accommodations” such as Airbnb rentals and room rentals in bed and breakfast establishments that rent out fewer than four rooms. (Notably, in 2015, Airbnb launched its Community Compact campaign to work with state and local taxing jurisdictions to help collect and remit applicable room
rental taxes. As of August 1, 2016, the company will collect and remit these taxes for operators of residential rentals in the 11 states where such operators are obligated by law to do so. The company also will collect and remit these taxes for rental operators in Washington D.C. and in select cities or counties in nine additional states, again where residential operators by law must do so. To read more about taxing short-term residential rentals, see MassBudget’s “Airbnb and Taxes: What Other States are Doing and How Much Revenue Might Be Raised in Massachusetts”.

The Department of Revenue estimates this change would deliver approximately $16.7 million in additional annual revenue by 2018, the year when the new EITC match rate (28 percent) first would go into effect. This leaves an estimated $21.3 million in new program costs for which the Senate does not identify a specific new revenue source.

In addition to the SWM proposal, there have been other proposals to raise the state EITC match rate, including a proposal to raise the rate to 50 percent. If such a proposal were in effect in 2016, the maximum state credit available to a family (one or two parents) with 3 or more children would rise from $1,442 (in 2016) to $3,135. For a family (one or two parents) with two children, the maximum state credit would rise from $1,282 to $2,786. Other filers likewise would see meaningful increases.

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1 Center on Budget and Policy Priorities, Policy Basics: The Earned Income Tax Credit (see 2015 interactive chart): http://www.cbpp.org/research/federal-tax/policy-basics-the-earned-income-tax-credit?fa=view&id=2505 (Note: CBPP confirms that income thresholds for maximum credits will change very little from 2015 to 2016.)

EITC Increase Proposal

4 IRS, 2016 EITC Income Limits, etc.: https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/eitc-income-limits-maximum-credit-amounts-next-year
Max. federal EITC = $6,269 * 0.23 = $1,442 max. MA credit
5 Massachusetts Department of Revenue, Statistics of Income (data provided by request to MassBudget).
7 Center on Budget and Policy Priorities, EITC Research Findings, October 2015 (see “encouraging Work” section):
http://www.cbpp.org/cms/index.cfm?fa=view&id=3793
8 Center on Budget and Policy Priorities, EITC Research Findings, October 2015 (see introduction):
http://www.cbpp.org/cms/index.cfm?fa=view&id=3793 This estimate is based on the Supplemental Poverty Measure which accounts for the effects of tax credits and noncash benefits.
9 Brookings Institution analysis of Supplemental Poverty Measure Public Use Data, 2011-2013. This calculation is based on the Supplemental Poverty Measure, rather than what is known as the official poverty measure. The official poverty measure does not include the value of tax credits and noncash transfers in its calculations.
10 Brookings Institution, 2014 Characteristics of EITC Eligible Population by State, County and Metro Region:
http://www.brookings.edu/research/interactives/eitc
11 Govtrack.us: https://www.govtrack.us/congress/bills/114/hr2029
13 All research in this section cited from Center on Budget and Policy Priorities, EITC Research Findings, March 2015:http://www.cbpp.org/cms/index.cfm?fa=view&id=3793
14 National Conference of State Legislators, Tax Credits for Working People, February 2015 (Table 3):
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Total program cost at a 23 percent match rate = $217.7 M * (5 PP/23 PP) = $47.3 M
18 Compare M.G.L. Ch. 62, Section 6(h)
(https://malegislature.gov/Laws/GeneralLaws/PartI/TitleIX/Chapter62/Section6 ) with SWM bill S.2423, Section 53(h) (https://malegislature.gov/Bills/189/Senate/S2423 )
19 A full-year resident is someone who either lives year-round in Massachusetts or maintains a permanent domicile in Massachusetts and spends a total of 183 days a year in-state.
MA DOR Individual Income Tax Guide, Legal and Residency Status:
20 In other words, taxpayers who move to (or from) Massachusetts during the tax year and declare (or terminate) official residence in Massachusetts during the tax year.
MA DOR Individual Income Tax Guide, Legal and Residency Status:
21 SWM bill S.2423, Section 53(h): https://malegislature.gov/Bills/189/Senate/S2423
22 MA DOR Revenue Impact Analysis for H.3901 (redrafted) which the language of S.2423 follows closely on this issue: http://massbudget.org/reports/pdf/Revenue_Impact_Analysis_of_Bill_H3901_7-12-2016.pdf
23 MA DOR Revenue Impact Analysis of H.2645 which the language of S.2423 follows closely on this issue: