Tax credits provide boost

for low-income families

While the number of U.S. households receiving welfare benefits has declined dramatically since the early 1990s — due in large part to reforms in federal and state welfare systems — many workers still struggle to meet their families' most basic needs. The U.S. Census Bureau reports that in 2001 approximately 7 million children — or nearly one in six — lived in poverty. Yet in 68 percent of households whose incomes were below federal poverty guidelines, at least one adult was employed.[1]

BY DUANE M. ELLING

Earned Income Tax Credits (EITCs) are among the strategies designed to help these working families lift themselves out of poverty. The federal EITC program, approved in 1975 and expanded as recently as 2001, reduces or eliminates the federal income taxes owed by many low- and moderate-income working individuals.[2] In cases where the calculated credit exceeds the tax owed, the federal EITC provides a wage supplement in the form of a tax refund.[3]

More than 19 million people claimed the federal refundable EITC in 1999, helping lift almost 5 million individuals — including 2.6 million children — above the federal poverty line. This success as one of the country's most effective anti-poverty programs — and the largely bipartisan support it has enjoyed — has led to the creation of EITC initiatives in 17 states, which further strengthen the financial stability of eligible households by reducing state income taxes owed. (See chart, page 19.)

Ed Lazere, executive director of the D.C. Fiscal Policy Institute (DCFPI), says supplementing the federal EITC program with similar state initiatives helps low-income families move toward a future that offers more than simply "making ends meet.

"For folks who leave welfare for work, the combined state and federal credits offer a substantial economic boost that can further help them build assets — such as purchasing homes and paying for

[1]The 2003 federal poverty line for a family of four is $18,400 per year. A family of four with two children and one full-time, year-round worker earning about $7 per hour — well above the current federal minimum wage — has annual wages after payroll taxes of approximately $13,600.

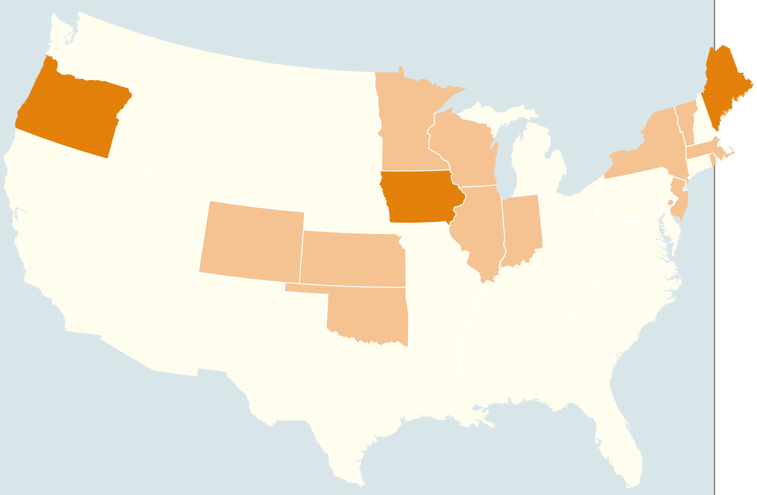
[2]To qualify for the credit in the 2002 tax year, a household's earned and adjusted gross income must have totaled less than $29,201 for a taxpayer with one qualifying child ($30,201 for married filing jointly), $33,178 for a taxpayer with more than one qualifying child ($34,178 for married filing jointly) and $11,060 for a taxpayer with no qualifying children ($12,060 for married filing jointly). The maximum credit was $4,140 and is expected to increase to $4,204 for the 2003 tax year.

[3]Refundable EITC programs generally provide full payment of the qualifying EITC benefit, regardless of tax liability. Non-refundable EITC programs limit a household's credit to the extent of their income tax liability.

REFUNDABLE STATE EITC PROGRAMS

Individual state earned income tax credits (EITCs) are calculated according to a specific percentage of the federal EITC. For example, residents of Massachusetts claiming their state's EITC are currently eligible for up to 15 percent of their federal credit.

State	Percentage of Federal EITC Credit
Colorado *(suspended beginning in 2002 due to state budget constraints)*	10%
District of Columbia	25%
Indiana	6%
Illinois	5%
Kansas	15%
Maryland*	18% in 2003; 20% thereafter
Massachusetts	15%
Minnesota	15% to 46%, depending on earnings
New Jersey *(if gross income is less than $20,000)*	20%
New York	30%
Oklahoma	5%
Rhode Island	25% (partially refundable)
Vermont	32%
Wisconsin	4% - one child 14% - two children 43% - three children



NON-REFUNDABLE STATE EITC PROGRAMS

State	Percentage of Federal EITC Credit
Iowa	6.5%
Maine	5%
Oregon	5%

**Maryland also offers a non-refundable EITC set at 50 percent of the federal credit. Participants may claim only one of the available credits.*

educational opportunities — and improve their families' lives. That can be a very powerful motivating force."

Grants related to the development of state EITCs, totaling more than $4.8 million since 1993, reflect the Mott Foundation's long-standing support of efforts to expand economic opportunities in low-income communities.

Those receiving Mott support for EITC-related work include members of the State Fiscal Analysis Initiative (SFAI), a network of state-level organizations working to impact regional economic and related social issues,[4] and the D.C.-based Center on Budget and Policy Priorities (CBPP), which coordinates the SFAI and provides technical assistance to members through its State Fiscal Project. Grantees also include DCFPI and the Massachusetts Budget and Policy Center (MBPC), both SFAI members.

[4]The SFAI — founded in 1993 by the Mott, Ford and Annie E. Casey foundations — helps members offer credible, timely and understandable budget and tax analyses to policymakers and the public, and awareness building activities about the impact of state fiscal policies on long-term economic vitality and at-risk populations. It also strengthens its members' capacity for policy analysis and advocacy, and nurtures positive relationships among state- and grassroots-level organizations. A detailed overview of the SFAI is available in the June 2003 issue of *Mott Mosaic*, available online at www.mott.org.

Lazere notes that, during the economic boom of the 1990s, many low-income working families around the country saw a significant portion of their incomes go toward state and local income taxes and sales taxes. He believes that state EITC programs help offset such "regressive" tax structures and the economic burdens they place on poor workers.

Nick Johnson, director of the CBPP's State Fiscal Project, agrees with Lazere and points out that state EITCs are increasingly recognized as being integral to states' anti-poverty efforts.

"A successful anti-poverty campaign has to include connecting low-income families to affordable housing and child care, as well as making living-wage jobs both available and accessible. But it must also incorporate income supports like the state EITC, which play a key role in helping poor families actually work their way out of poverty."

Many organizations are calling for the creation and/or expansion of state EITC programs throughout the country, as well as for coordinated outreach efforts in low-income communities, to raise awareness of the credit's availability.

Noah Berger, executive director of MBPC, notes that EITC programs like the one found in

Massachusetts must continue to grow if they are to reach their true potential for reducing income inequality.

"Even with the current federal and state EITC programs, some low-income people are working full-time or more than full-time and still don't earn enough to support their families adequately. Raising the state EITC benefits would be a direct way to address that problem by providing additional income to people who work hard, play by the rules and still have trouble getting by."

Of particular challenge to the creation and expansion of state-level EITC programs is the current fiscal crisis being experienced in many states. The downturn over the past several years in the nation's financial markets has reverberated throughout the national economy, resulting in falling state revenues and, increasingly, proposed cuts to support programs such as health care, child care and job training utilized by low-income working families.

Even those states with an interest in creating or expanding EITC programs have found themselves with limited resources for funding such efforts.

In addition, proponents of state EITC programs — including MBPC — have watched and participated in the debate regarding changes recently proposed by the U.S. Internal Revenue Service in the administration of the federal EITC program. Those regulations, advocated by the IRS as a means of ensuring proper use of the credit, will require certain low-income families — specifically single fathers and non-biological guardians — to "certify" their eligibility by proving that any child claimed in relation to the credit lived with them for more than half the year in question.

The IRS' announcement this spring of the proposed certification process met with criticism from members of Congress, low-income advocacy groups, and tax practitioners who believed the regulations would create new barriers for families claiming the EITC and subject them to a level of scrutiny not faced by other taxpayers.

In August, following a 30-day public comment period, the IRS announced several changes to the certification process, including moving the planned August launch of a pilot test of the new guidelines to early 2004, when tax professionals are more readily available to help families accurately file their claims. In addition, the number of households expected to participate in the pilot test was reduced from 45,000 to 25,000.

Jeff McLynch, a policy analyst at MBPC, believes that the outcry from the public, private and non-profit sectors helped bring about the changes to the proposed guidelines. He also notes that revising certification documentation and a thorough evaluation of the planned certification test pilot remain vitally important tasks for the IRS.

"There is still great concern that many eligible people could be confused or discouraged by the new regulations and may not apply for the federal EITC. In the case of Massachusetts, if they don't claim the federal credit, they can't claim the state credit, so the potentially negative outcome could be compounded."

Despite these challenges, many in the field remain confident that the demonstrated success of both the federal and state EITC programs will ensure their future role in anti-poverty efforts. Proponents note that many states continue to make progress on their EITC programs, even in the face of tight budgets. In 2003 both Illinois and Rhode Island incorporated refundable components into their previously non-refundable EITC programs, while Indiana launched its own refund-based program in 2002.

EITCs provide crucial income for thousands of families in their respective states, income that proponents note ultimately can help invigorate communities through the households' increased economic stability and purchasing power.

"The money that EITCs bring in helps support the cities and neighborhoods that these families live in; in essence, it is a form of neighborhood and community development," Lazere said.

hotlinks:where on the web

Center on Budget and Policy Priorities: www.cbpp.org

D.C. Fiscal Policy Institute: www.dcfpi.org

Massachusetts Budget and Policy Center: www.massbudget.org

National Tax Assistance for Working Families Campaign: www.eitc.info
(A project funded by the Annie E. Casey Foundation that provides information and resources on topics related to EITC programs)

State EITC Online Resource Center: www.stateeitc.org
(A Mott-funded project that offers access to research and resources related to state EITC programs)

U.S. Internal Revenue Service: www.irs.gov