

Thoughtful Analysis...Responsible Policy

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Fair Taxes for Low-Income Working Families: A Georgia Earned Income Tax Credit

Background

In 2003, the federal earned income tax credit (EITC) enabled 4.4 million people to rise from poverty through income tax relief and wage supplements.⁴ Commonly described as a work incentive, the federal EITC reduces or eliminates income taxes for low-income working families and provides a refund for the remaining amount of the credit. The refund acts as a wage supplement that offsets other payroll taxes such as Social Security and can bring working families out of poverty.

Since its inception in 1975, the federal EITC has received enhancements under the Reagan, Bush, and Clinton administrations. Following the example set by the federal government, eighteen states and the District of Columbia have enacted state-level earned income tax credits. In 2005, Delaware created a new EITC, while Indiana, Oregon, Rhode Island, and the District of Columbia expanded their existing EITC programs. As other states have learned, linking to this federal program can improve tax fairness and provide wage enhancements for low-income working families.

The Earned Income Tax Credit is:

“the best anti-poverty, the best pro-family, the best job creation measure to come out of Congress”
-President Reagan¹

“a proven federal tool that reduces poverty, rewards work, strengthens rural and neighborhood economies and needs little bureaucracy to implement”
-Bruce Katz, Brookings Institution²

“a powerful force in dramatically raising the employment of low-income women in recent years”
-Committee for Economic Development³

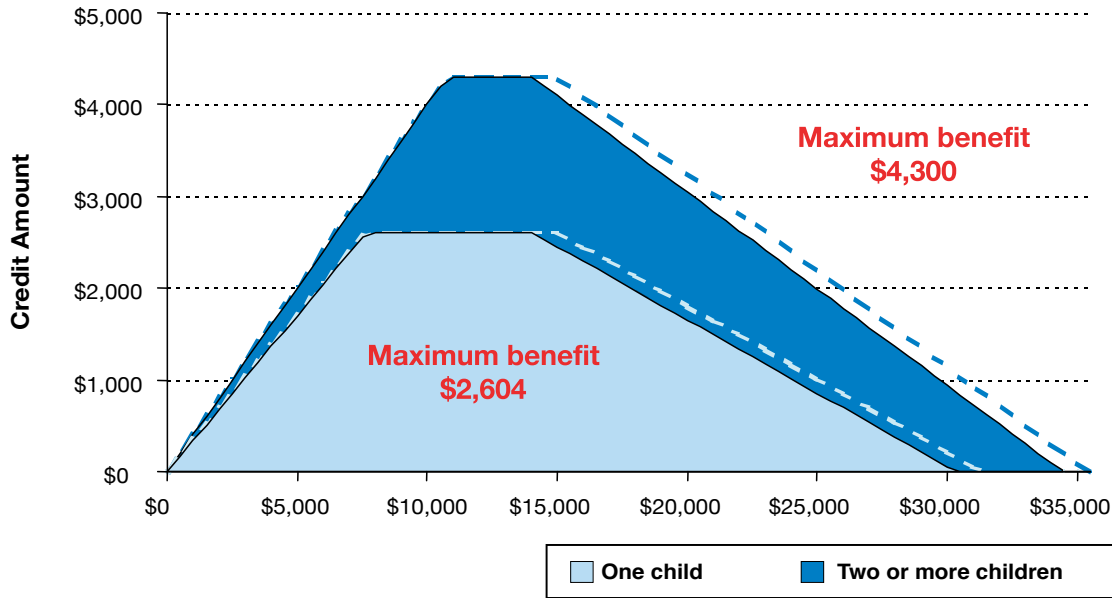
How the Federal EITC Works

The federal EITC provides a credit and refund based on income and family size. Figure 1 illustrates the credit structure for different income levels and family compositions. Initially, the credit increases as income increases. After families reach a certain level of income however, the credit begins to decrease as income rises and phases out completely between \$30,000 and \$35,500. As shown in Figure 1, for tax year 2004:

- Workers with one child and income less than \$30,338 (or \$31,338 for married workers) could receive an EITC of up to \$2,604.
- Workers with two or more children and income less than \$34,458 (or \$35,458 for married workers) could receive an EITC of up to \$4,300.

While the graph does not show credits for childless workers, there are smaller credits available for those workers. For tax year 2004, childless workers ages 25 to 64 with income below \$11,490 (or \$12,490 for married workers) could receive an EITC of up to \$390.

Figure 1: Federal EITC, Tax Year 2004



Note: Married couples with income in the phaseout range qualify for higher credit than single parents - shown by dashed lines.
Source: Center on Budget and Policy Priorities

As shown in Figure 2, the federal EITC helps Georgia families in every part of the state. In tax year 2002, over 770,000 taxpayers claimed the federal EITC for a total of over \$1.4 billion. By tax year 2003, the number of federal EITC claims in Georgia rose to approximately 845,000.⁵

Figure 2: Federal EITC Claims by Congressional District, Tax Year 2002

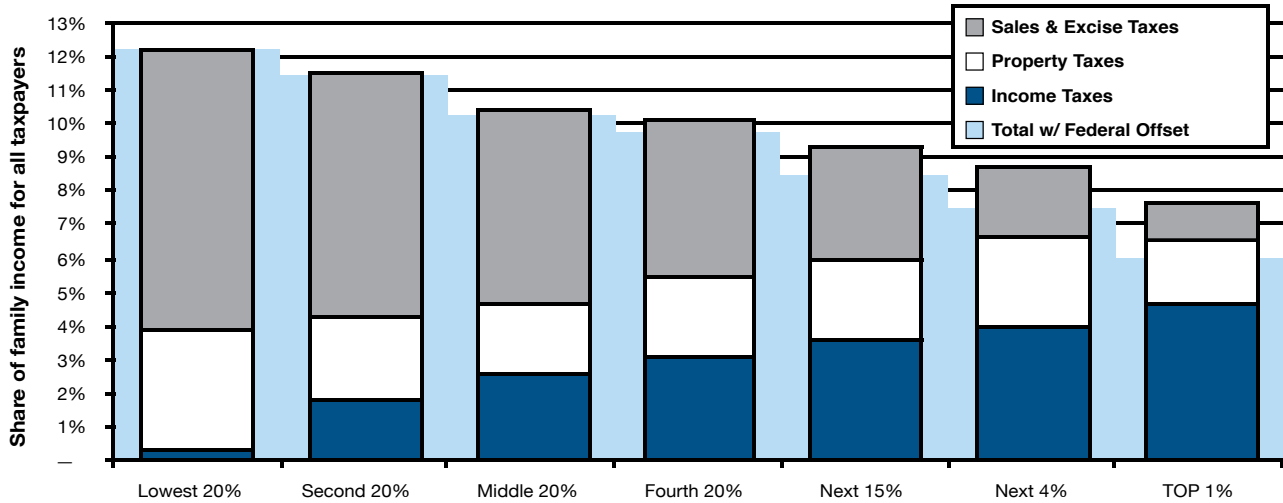
District	Representative	Total Tax Returns	EITC Claims	Share of Returns Claiming EITC	EITC Amount
01	Jack Kingston	285,071	74,215	26.0%	\$144,799,418
02	Sanford D. Bishop Jr.	173,607	63,892	36.8%	\$134,774,702
03	Jim Marshall	251,622	80,562	32.0%	\$166,854,817
04	Cynthia McKinney	270,020	61,396	22.7%	\$114,382,497
05	John Lewis	318,809	65,634	20.6%	\$127,900,231
06	Tom Price	299,279	23,560	7.9%	\$38,226,446
07	John Linder	260,335	34,108	13.1%	\$59,447,714
08	Lynn Westmoreland	321,082	51,647	16.1%	\$94,462,438
09	Charlie Norwood	283,139	59,471	21.0%	\$108,652,297
10	Nathan Deal	293,658	55,654	19.0%	\$99,319,427
11	Phil Gingrey	283,871	69,471	24.5%	\$130,624,089
12	John Barrow	217,902	67,802	31.1%	\$137,187,932
13	David Scott	245,282	64,112	26.1%	\$122,150,320
TOTAL		3,503,677	771,524	22.0%	\$1,478,782,328

Source: Brookings Institution, Metropolitan Policy Program⁶

Georgia's Families in Need

With a generous federal EITC program, is there a need for a similar state-level program? As Figure 3 demonstrates, the need in Georgia for a state EITC is quite clear. Georgia's state and local taxes are regressive – meaning, residents with the lowest incomes pay the highest share of income in taxes. Although low-income Georgians pay a smaller share in income taxes, those families pay an excessively high share of income in sales and property taxes as compared to wealthier households. Georgians in the lowest quintile (average income of \$9,600) pay an estimated 12.2% of income in state and local sales, income, and property taxes. That compares to a range of 6.0% to 8.5% tax obligation for Georgia's highest earners after federal offsets.⁷

Figure 3: Georgia State and Local Tax Burden by Income Group, 2004



Source: Institute on Taxation and Economic Policy

To illustrate further, consider a family of three living in Georgia with a single working parent, Jill. At a full-time, year-round job, Jill earns \$7.50 an hour for an annual salary of \$15,600, or just below the poverty guideline for a family of three. On her federal income tax form, Jill (like 845,000 other Georgians) applies for the federal EITC. Jill receives a refundable earned income credit of over \$4,000, which brings Jill's family out of poverty and offsets other federal withholding taxes. In contrast to the federal refund, Jill owes Georgia income taxes.⁸ Jill's \$84 state income tax bill is in addition to the sales and property tax burden illustrated in Figure 3.

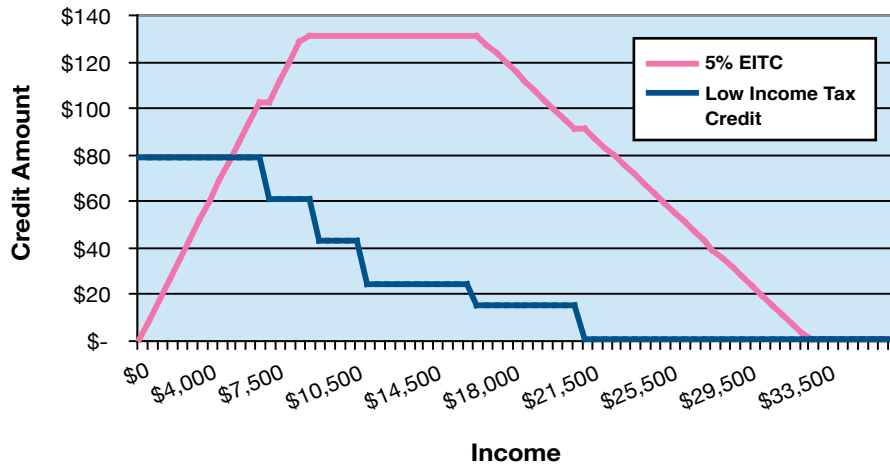
There is a need in Georgia for low-income tax relief, and there is also a precedent. Since 1991, Georgia has had a low income tax credit for households making less than \$20,000. The base credit ranges from \$5 to \$26 and is multiplied by the number of family members to calculate the full credit. Thus, for Jill's family of three, her income qualified for a \$5 base credit, which was then multiplied by three (for her family size) to provide a total credit of \$15.

While the current low income tax credit offers some relief, it suffers from two major drawbacks: it is not indexed to inflation and it does not reward work. The credit has diminished in value over the last decade since it has not grown with inflation. The federal EITC, in contrast, is adjusted for inflation; and thus, states that link their EITC to the federal EITC automatically index for inflation annually. The value of the low income tax credit will continue to shrink over time unlike a state level EITC that is indexed automatically for inflation.

In addition, the existing low income tax credit does not reward work as the EITC does. As shown in Figure 4, the low income tax credit decreases in a stair-step manner as income rises. In contrast, until a certain level of income is reached, the EITC increases as income rises. (While Figure 4 shows an example of a married couple with one child, the same

illustration holds true for most families with children, single or married.) The EITC has long been a part of the “make work pay” strategy that encourages the transition from welfare to work. As income rises, the credit rises in recognition of the costs associated with transitioning to work such as transportation and childcare.

Figure 4: Georgia EITC vs. Low Income Tax Credit for Married Couple with One Child



Designing a State EITC for Georgia

Designing a state EITC is relatively straightforward as examples exist in 18 other states and the program follows the structure of the federal EITC. For the most part, variations in design center around how generous the program will be. Two components determine the generosity of the state EITC: the level of the credit and the refundable option.

- Level of Credit.** States base their credit levels and eligibility rules on the federal EITC. The level of credit is a percentage of the federal credit and ranges from 5% to 50% among states. For example, Oklahoma’s EITC is 5% of the federal EITC. Vermont’s EITC is 32%. Thus, a family qualifying for a federal EITC of \$4,000 would receive a \$200 state credit if they lived in Oklahoma or a \$1,280 state credit if they lived in Vermont. Figure 5 shows the state EITC benefits at the 5%, 10%, and 20% level of the federal credit for different family incomes and sizes.

Figure 5: EITC by Family Type and Income Level, 2004

	Gross Earnings	Federal EITC	20% State EITC	10% State EITC	5% State EITC
Family of four with two children					
Full-time minimum wage	\$10,700	\$4,280	\$856	\$428	\$214
Wages equal to poverty line	\$19,000	\$3,466	\$693	\$347	\$173
Wages equal to 150% of poverty line	\$28,500	\$1,465	\$293	\$147	\$73
Family of three with one child					
Full-time minimum wage	\$10,700	\$2,604	\$521	\$260	\$130
Wages equal to poverty line	\$15,100	\$2,594	\$519	\$259	\$130
Wages equal to 150% of poverty line	\$22,650	\$1,388	\$278	\$139	\$69

Source: Center on Budget and Policy Priorities and GBPI calculations

- Refundable versus Non-refundable.** As noted previously, the federal EITC is a refundable credit. This means that families receive a refund for the amount of the credit that is in excess of the income taxes they owe. If a

family owes \$300 in federal income taxes and qualifies for a \$2000 EITC, they will receive a refund of \$1700. The majority of states with an EITC also make the credit refundable. This provides income tax relief as well as relief from other taxes such as sales and property. Delaware, Iowa, Maine, Rhode Island, and Virginia have non-refundable credits, which lowers the income tax liability but does not offer further relief. Since 2000, the majority of states that have created or expanded their EITC have chosen to make the credit refundable.⁹

A final design concern is the interaction of a Georgia EITC with the existing Georgia low income tax credit. The low income tax credit reached almost 960,000 households in 2002 for a total cost of over \$24 million. In contrast, the federal EITC (which would be the model for the Georgia EITC) reached approximately 770,000 Georgia households in that same year. Thus, there is a gap between the number of households applying for the federal EITC and those applying for the state low income tax credit. If Georgia enacted a state EITC, many families would claim the state EITC rather than the low income tax credit because of the EITC's generosity. However, there would remain certain households that would benefit more from the existing low income tax credit, such as those with no earnings or childless households. Thus, a state EITC should not replace the low income tax credit, but instead, work as a complement. While the low income tax credit is more generous for those in extreme poverty, the state EITC functions better as a wage supplement and targets households with children.

Virginia and the District of Columbia offer examples of governments that have created a state EITC in addition to their existing low income tax credit. Georgia could follow their example in terms of administration and outreach to allow families to apply for either the state EITC or the existing low income tax credit depending on which provides the greatest benefit.

Estimating the Cost

The cost to Georgia of an EITC would depend on the level of credit and refundable component discussed above as well as the number of residents claiming the EITC. Since most other states have refundable credits and Georgia's existing low income tax credit is refundable, we assume that Georgia's EITC would also be refundable. Using 2004 data on the number of federal EITC claims in Georgia, we can estimate the cost of a refundable EITC for Georgia. Based on the minimum credit level used by other states (5%), a refundable EITC in Georgia would have cost approximately \$60 to \$70 million. An EITC at 10% of the federal credit would have cost an estimated \$120 to \$130 million.¹⁰ Presumably, the cost of a Georgia EITC would be slightly lowered since some families will switch from the existing low income tax credit to the EITC. Thus, the cost of a state EITC would be partially, albeit minimally, offset by declines in the cost of the existing low income tax credit.

An additional cost consideration is the availability of Temporary Assistance for Needy Families (TANF) funds. The federal government recognizes that the EITC is a work incentive since it provides assistance for families transitioning to work. States are allowed to use federal TANF funds or state Maintenance of Effort (MOE) funds to pay for the refundable portion of the EITC. The use of TANF or MOE funds for a Georgia EITC would reduce the amount of money going to other assistance programs such as cash assistance, child care, and other programs. Thus, there would need to be a thoughtful policy discussion on whether to include the EITC in this stream of funding, as it might affect funds available to other programs.

Conclusion

The federal earned income tax credit has long been associated with making work pay. Through tax relief and work supplements, the EITC allows low-income working families to rise out of poverty and make ends meet. Eighteen states have also recognized that low-income citizens need tax relief at the state-level to balance the regressive nature of state and local taxes. As home heating bills soar in the coming months and low-wage jobs continue to multiply, Georgia lawmakers should take action to correct the imbalance within the Georgia tax system. Creating a state EITC would be one step towards that goal by making the tax structure more equitable and assisting working families.

The Georgia Budget and Policy Institute (GBPI) is an independent, nonprofit, non-partisan organization engaged in research and education on the fiscal and economic health of the state of Georgia. The GBPI provides reliable, accessible and timely analyses to promote greater state government fiscal accountability as a way to improve services to Georgians in need and to promote quality of life for all Georgians.

¹ *Federal Earned Income Tax Credit: What Legislators Need to Know*. National Conference of State Legislatures. www.ncsl.org/programs/wln/EITCproject.htm.

² Katz, Bruce. *The State Role in Rewarding Work through the EITC*. Brookings Institution. Remarks to the National Governors Association Committee on Human Resources, February 23, 2003.

³ Greenstein, Robert. *The Earned Income Tax Credit: Boosting Employment, Aiding the Working Poor*. Center on Budget and Policy Priorities. August 17, 2005. www.cbpp.org.

⁴ Greenstein (2005)

⁵ Greenstein (2005)

⁶ Brookings Institution, Metropolitan Policy Program. www.brookings.edu/es/urban/eitc.htm.

⁷ Calculations by the Institute on Taxation and Economic Policy for GBPI. August 2005.

⁸ GBPI estimates based on H&R Block Tax Estimator and Georgia Department of Revenue tax publications.

⁹ Llobrera, Joseph and Zahradnik, Bob. *A Hand Up: How Earned Income Tax Credits Help Working Families Escape Poverty in 2004*. Center on Budget and Policy Priorities. May 14, 2004. www.cbpp.org. (Note: Rhode Island and Maryland have both refundable and nonrefundable credits.)

¹⁰ Based on calculation by the Institute on Taxation and Economic Policy for GBPI. August 2005.