

A Bottom-Up Tax Cut to Build Georgia's Middle Class

The Case for a State Earned Income Tax Credit

By Wesley Tharpe, Senior Policy Analyst

Building a better Georgia, with a strong economy and vibrant businesses, requires a more resilient middle class and more opportunities for working families to climb the economic ladder. One of the best tools to help ensure that Georgians broadly share in that prosperity is a state-level Earned Income Tax Credit (EITC).

The EITC is a federal tax credit that serves as one of the nation's most effective anti-poverty policies. It cuts federal taxes for low-wage workers like cashiers, teaching assistants and home health aides – providing a modest wage enhancement for families striving toward the middle class. The credit is available only to people who work and it grows in size, up to a point, as wages rise. That encourages people to stay employed and work more hours, rather than rely on public assistance.

Twenty six states and the District of Columbia build on the EITC's success with their own state-level versions of the tax credit. State EITCs piggyback on the federal version by providing a limited credit against state and local taxes, up to a certain value determined by each state. Here are the benefits such a policy would bring to Georgia.

- **Provide a bottom-up tax cut to working Georgia families.** State EITCs are designed to reduce state taxes from the bottom up, rather than the top down. The largest value goes to families making from about \$10,000 to \$23,000 a year, though families making up to about \$38,500 to \$52,500 (depending on number of children) still benefit. Working Georgians in fields as diverse as health care, retail and construction stand to gain.
- **Help Georgians with jobs afford the basics and work their way into the middle class.** Nearly 1.1 million Georgia households, or 28 percent of all Georgia income tax filers, received the federal EITC in 2013.¹ The EITC helps these families afford basic necessities like food and child care, as well as larger investments that smooth the path to the middle class like a reliable car to get to work or a down-payment on a new home.
- **Boost small businesses, local economies and Georgia's future workforce.** A state EITC would pump millions of dollars into Georgia communities by giving customers more disposable income and helping local shops and entrepreneurs succeed. It would also strengthen the foundation for young people who comprise Georgia's future workforce, since research finds that children whose families receive more income from the EITC are likelier to excel in school, graduate high school, attend college and earn more as adults.²

A state EITC is an affordable, targeted reform that encourages work, expands the middle class and strengthens businesses and local economies. When the General Assembly reconvenes in January 2016, it will be in Georgia's best interest if lawmakers make it the next state to adopt the policy.

The EITC Supports Hardworking Georgians from All Walks of Life

The federal EITC is a credit against income taxes designed to supplement the wages of low- and moderate-income people, helping keep them on the job, off welfare and moving toward the middle class. Established in 1975, the program's effectiveness led to subsequent enhancements in 1986, 1993, 2001 and 2009. Roughly half of all taxpayers with children make use of the EITC at some point in their lives, usually for only a year or two at a time.³

The size of the credit depends on a family's income, marriage status and number of dependent children. The largest value goes to families making from about \$10,000 to \$23,000 a year, though families making up to about \$38,500 to \$52,500 (depending on number of children) still benefit. The federal credit is refundable, which means that if a family's credit exceeds their income tax liability, they receive the spillover as a refund. A detailed explanation of how the credit works is provided in the Appendix. Below are some key facts about who benefits from the federal EITC and, by extension, who would benefit from a state-level add-on.

- **Nearly 1.1 million** Georgia households claimed the EITC in 2013, the equivalent of 28 percent of all Georgians filing federal income tax returns. Those households consist of an estimated 2.6 million Georgians in total, including nearly 1.2 million children.⁴
- An estimated **770,000 working mothers** and **410,000 working fathers** were in Georgia households that received the credit in 2012.⁵
- More than **80,000 veterans and military families** in Georgia got the federal EITC in 2012. Some of these households include an active service member, and the others include a veteran.⁶
- The EITC lifted an average of **248,000 Georgians**, including **131,000 children**, out of poverty each year, from 2011 to 2013.⁷

The EITC Helps Keep Low-Income Georgians on the Job

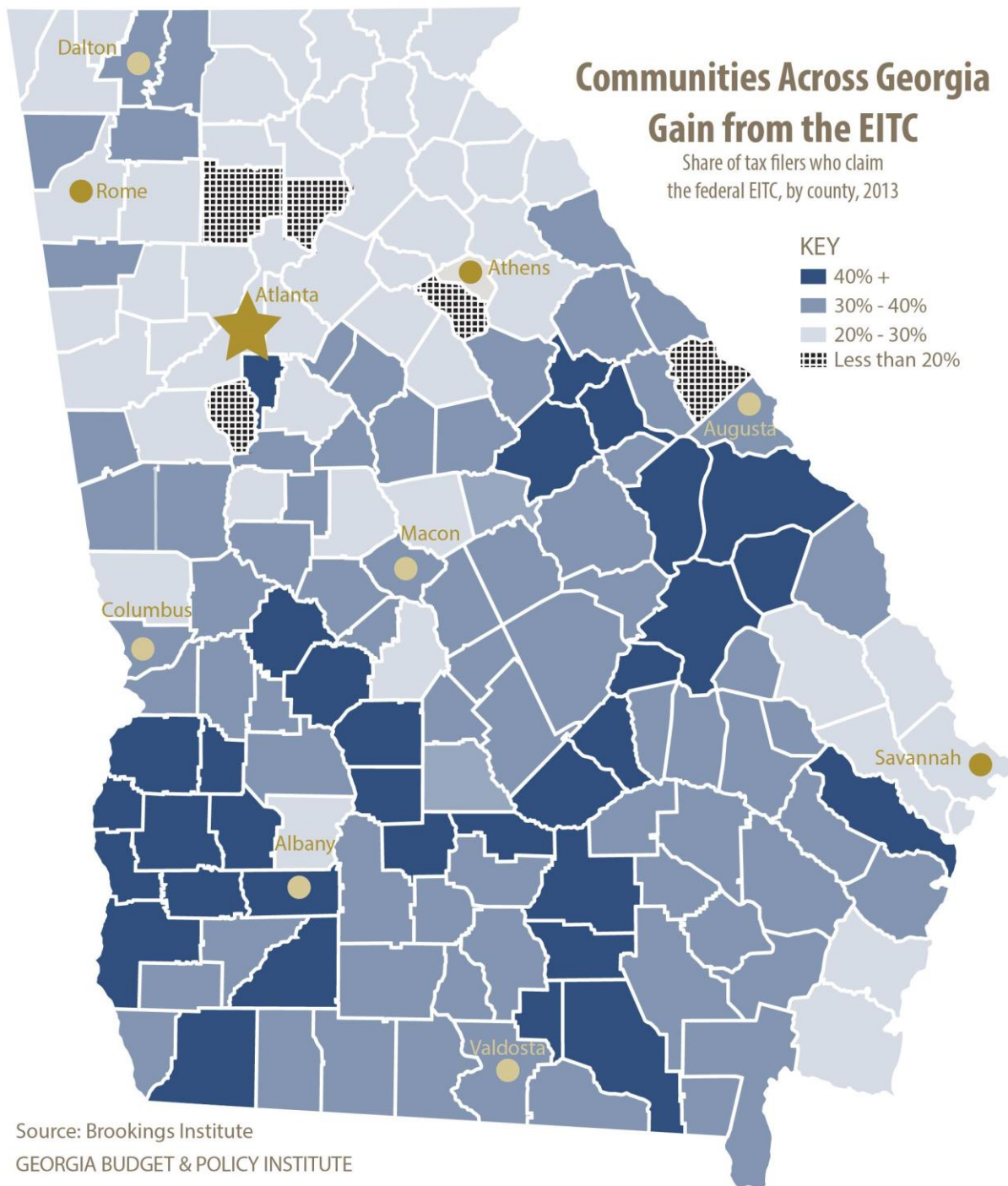
The EITC is available only to low- and moderate-income people who work, providing a strong incentive for people to get jobs and keep them. It is a proven way to move families toward self-sufficiency and off of other forms of public assistance such as Temporary Aid for Needy Families (commonly known as welfare). Expansions of the EITC in the mid-1990s helped move half a million families from cash welfare to work, according to one landmark study.⁸ Georgians who receive the EITC work in a range of professions throughout the state, as shown below.

Top Five Industries		Top Five Occupations	
Retail	14.6%	Office and Administrative	13.5%
Food Service and Hospitality	12.5%	Retail Salesperson	11.6%
Health Care	10.1%	Food Preparation and Related Services	10.2%
Construction	9.9%	Transportation and Material Moving	9.6%
Manufacturing	9.3%	Construction, Resource Extraction	8.7%

Share of Georgia EITC population, by industry and occupation, 2013
Source: "Characteristics of the EITC-Eligible Population," Brookings Institution

Communities Across Georgia Gain from the EITC

In 2013, the credit delivered \$2.93 billion to a broad swath of working Georgians at an average value of \$2,700 per recipient. These households are found in virtually every community in the state, as the map shows. In 97 percent of Georgia counties, or 154 out of 159, at least 20 percent of households filing a federal income tax return claimed the credit in 2013.



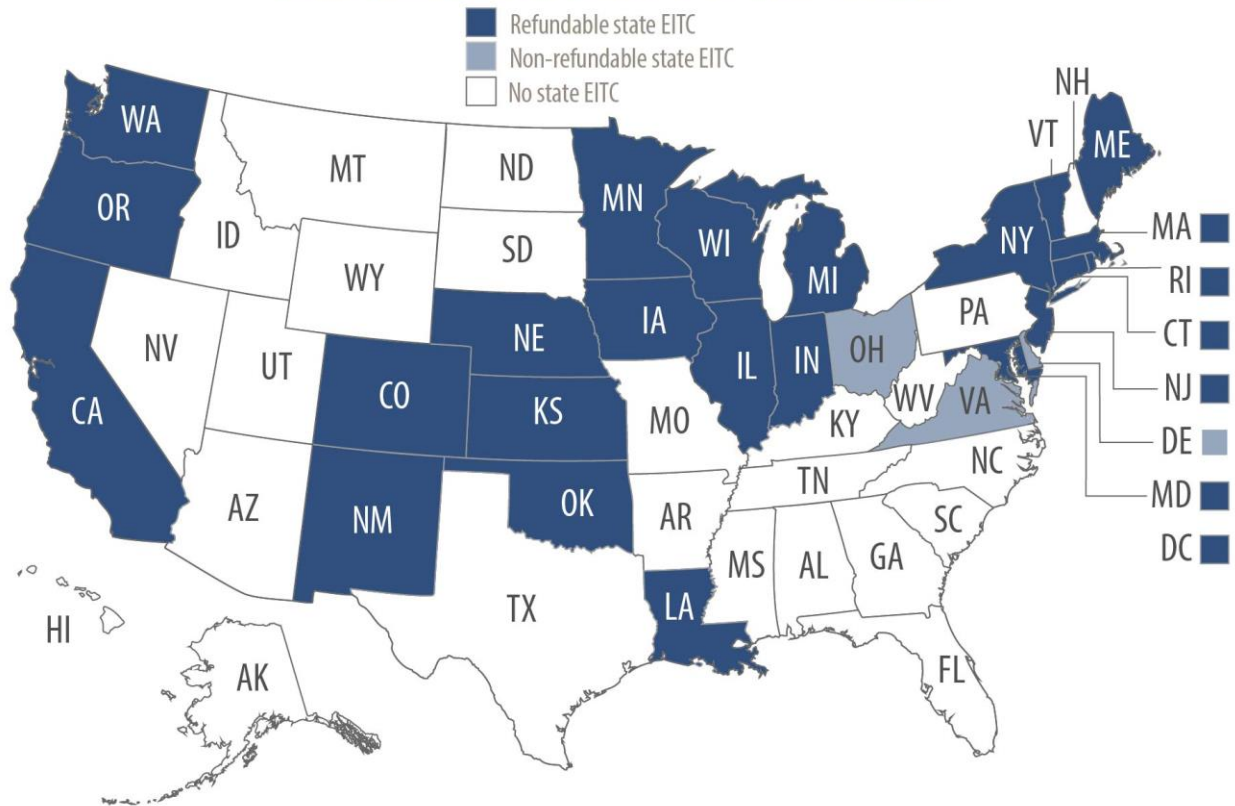
A Georgia EITC Can Build on the Federal Credit's Success

Twenty-six states and the District of Columbia enhance the considerable value of the federal credit with their own EITCs. These state credits provide a modest yet critical boost for taxpayers who already receive the federal EITC. State EITCs are typically claimed as a percentage of the federal credit's value, ranging from a low of 3.5 percent in Louisiana to a high of 40 percent in Washington, D.C.⁹ Here is one example of what this means in practice. In a state with a 10 percent EITC, a family with a \$3,000 federal credit also receives a \$300 state credit.

In all but three states with an EITC, that extra \$300 would help to reduce the full range of state and local taxes that low-income families pay. That's because most states allow working individuals and families to keep the full value of the credit, even if it exceeds their state income taxes. This is important because lower earning households spend a greater share of their income paying other taxes, like sales taxes and fees, than do affluent households.¹⁰ A refundable state EITC helps correct that imbalance and lets working people keep more of what they earn.

A new state EITC in Georgia carries a relatively modest cost and a good return on investment. States often start small, then build on the program over time. For example, a Georgia EITC set at 10 percent of the federal credit would put an estimated \$270 million annually into the pockets of people in about 1 million working households.¹¹ Numerous options exist for offsetting this modest investment, such as raising Georgia's bargain-basement tobacco tax or scaling back the most generous itemized deductions.¹²

More Than Half of States Offer Add-on EITCs



Source: Center on Budget & Policy Priorities

GEORGIA BUDGET & POLICY INSTITUTE

A State EITC Would Cut Georgians' Taxes from the Bottom Up

A Georgia EITC would amount to a tax cut for people who need it the most – workers in low-wage jobs and their families striving toward the middle class. Through its unique design, the EITC reduces income taxes from the bottom up, rather than the top down. That stands in stark contrast to the more common tax-cutting approach of reducing income tax *rates*, a tactic that disproportionately benefits the wealthy.¹³

Consider three hypothetical cases of Georgia families that would benefit from a state EITC. These examples assume that lawmakers set Georgia's new EITC at 10 percent of the federal credit, a modest and affordable goal.¹⁴



Single Mom, One Child

Jane is a single mother of one in Macon who works full-time as a cashier, making minimum wage. She earns \$14,500 annually before taxes, so she would owe about \$189 in Georgia state income taxes in 2015.

A refundable state EITC at 10 percent of the federal credit comes out to \$331 for Jane, delivering her an estimated state refund of \$142. That offsets both her state income taxes and some of the other state and local taxes she contributes, such as sales taxes on everyday purchases.



Married Couple, Two Children

Jack and Sarah are a young Atlanta couple with two children. She works part-time as a home health aide; he tends bar at a local restaurant. Their combined income is \$29,000. In 2015, they would owe an estimated \$496 in Georgia state income taxes.

A 10 percent EITC comes out to an estimated \$425 for them, dropping their Georgia income tax bill down to \$71. They use the savings for child care, transportation and other investments critical to staying employed and moving to the middle class.¹⁵



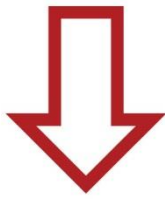
Married Couple, Three Children

Brooke and Jamal live in Athens with three kids. He works construction almost full time, while she puts in a few hours a week as a substitute teacher. With an income of \$40,000, they would owe Georgia an estimated \$976 in 2015.

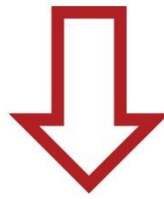
Because they're nearing the middle class, this family's EITC is in the process of gradually phasing out. But a 10 percent Georgia EITC would still cut their state income tax bill by \$261, reducing their total Georgia liability to \$715.

The EITC is Good for Small Businesses and Local Economies

A state EITC set at 10 percent of the federal credit would pump an estimated \$270 million into Georgia communities, targeted directly at the people most likely to spend additional money in local businesses.¹⁶ That can help counteract the sluggish consumer demand that continues to hold back Georgia businesses and local communities. Small businesses today consistently cite things like “poor sales” and “not enough customers” as among the key reasons why they struggle.¹⁷ When the finances of working-class families are squeezed, small businesses lack the customers with disposable income they need to thrive. Georgians continue to face falling incomes, smaller paychecks and rising costs in the wake of the recent recession, as shown below.



Income for a typical Georgia family fell 13.4 percent from 2007 to 2013. That equals an inflation-adjusted drop of nearly \$7,400.



Wages in Georgia fell by 10 percent from 2009 to 2014 for a typical low-wage worker and 12 percent for a typical mid-wage worker.



Expenses are rising. From 2007 to 2014, prices rose 19 percent for groceries, 23 percent for child care, and 41 percent for attending college.

The EITC is a Proven Tool to Strengthen Tomorrow's Workforce

Young people would receive outsized benefit from a state EITC, meaning the credit would strengthen Georgia's future workforce and provide another long-term benefit to the state's economy. Research finds that children and young adults in families receiving federal and state EITC experience several key benefits that strengthen their foundation for future success as students, workers and eventually parents.

- **Do better in school.** The EITC is linked to higher test scores, especially in math, for low-income students in elementary and middle-school. A credit that's worth around \$3,000 during a child's early years may boost performance by about the equivalent of two extra months of school.¹⁸
- **Graduate high school and attend college.** Rates of high school graduation and college attendance are also higher for students in EITC families, compared to young people in poor families not getting the credit. One study estimated a \$1,000 boost for an EITC-eligible family with a high school senior raised the likelihood of college attendance the next fall by 10 percent.¹⁹
- **Succeed in the workforce.** Children in EITC families are likelier to work more hours and earn more when they enter the workforce as adults. One study says for each \$3,000 a year in added income a child in a poor family receives from the EITC before age six, earnings as an adult rise by 17 percent.²⁰

Conclusion

State legislators can seize the opportunity to invest in Georgia's future prosperity when they return to work in January 2016. Observers expect tax reform to be one of next year's main legislative debates, and passing a state EITC should be central to that discussion. It is a targeted and affordable way to cut taxes from the bottom-up, keep people working toward self-sufficiency and give local businesses a boost. The experience from other states is clear that EITCs can help build the middle class, strengthen communities and keep young people on the path to the workforce. It is a smart way for Georgia to chart a better course forward.

Appendix: How the EITC Keeps People Working and Helps Families with Kids

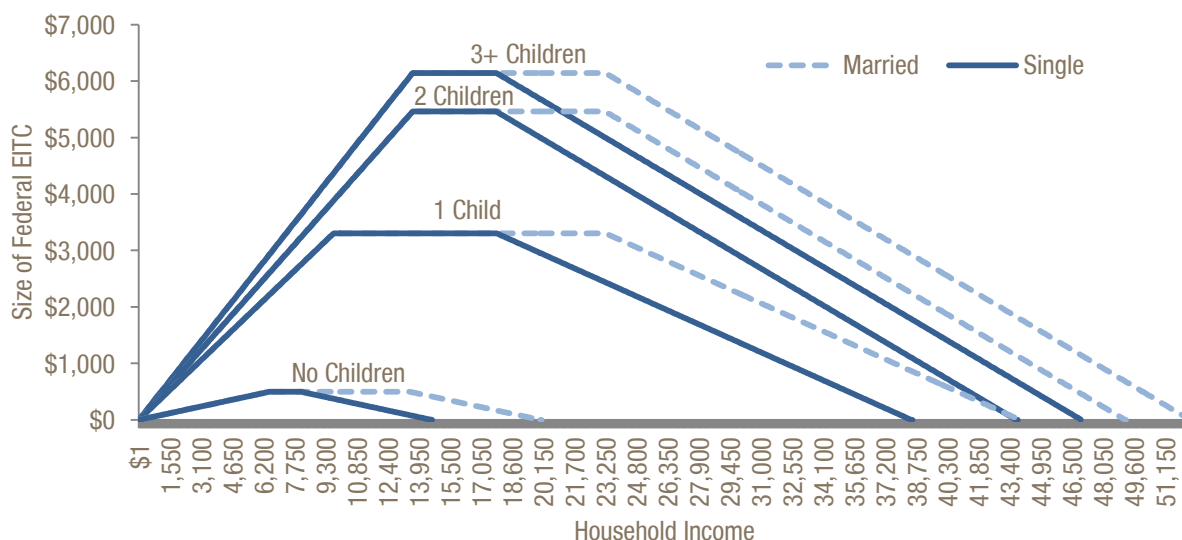
The federal EITC boosts the wages of low- and moderate-income workers and their families. It helps keep them on the job, off welfare and moving toward the middle class. The size of each taxpayer's credit varies based on their annual income, marriage status and number of dependent children.

The EITC's value grows up to a certain threshold based on income and family size, at which point it plateaus and then begins to phase down. The largest credit goes to families with children making about \$10,000 to \$23,000 a year. It gradually phases out as workers begin to earn more, returning to zero at about double poverty level of income. The credit fully phases out between \$38,500 and \$52,500, depending on marriage status and number of children. This unique structure is designed to help families the most as they escape poverty but still provide some value as they gain a firmer economic footing.

The credit is refundable, which means a family gets the full value of the credit even if it exceeds their income tax liability. Technically referred to as refundability, this is arguably the most critical component of the policy because it allows the credit to still reward work even if workers have small state income tax bills. Without this component, the EITC does far less to reduce poverty and encourage work, particularly among workers earning the least.

EITC's Unique Structure Rewards, Encourages Work

Federal EITC value by income, marriage status and number of children, 2014



Source: 2014 Earned Income Credit (EIC) Table. Internal Revenue Service, Publication 596-Additional Material

ENDNOTES

¹ IRS data compiled and analyzed by the Urban-Brookings Joint Tax Policy Center. Publically available at: <http://www.brookings.edu/research/interactives/eitc>.

² "EITC and Child Tax Credit Promote Work, Reduce Poverty, and Support Children's Development, Research Finds," Center on Budget & Policy Priorities. April 3, 2015.

³ 61 percent of EITC recipients from 1989 to 2006 got the credit for only one or two years at a time. *Ibid*.

⁴ "Characteristics of the EITC-Eligible Population," Brookings Institution. 2013. Precise estimates are 2,591,525 million people living in EITC-eligible homes, 1,183,013 of whom are children.

⁵ Data provided upon request from the Washington, D.C.-based Center on Budget and Policy Priorities. More details available in the following two reports, which combine EITC recipients with parents receiving a separate federal tax benefit – the Additional Child Tax Credit – resulting in a higher overall number. "21 Million Mothers Benefit from Tax Credits for Working Families," CBPP. May 2015. And "13 Million Fathers Benefit from Tax Credits for Working Families," CBPP. May 2015.

⁶ Data provided upon request from the Washington, D.C.-based Center on Budget and Policy Priorities. More details available in the following report, which combines EITC recipients with parents receiving the Additional Child Tax Credit, resulting in a higher number overall. "Pro-Work Tax Credits Help 2 Million Veterans and Military Families," CBPP. June 2015.

⁷ "State Estimates of People and Children Lifted out of Poverty by the EITC and CTC Each Year, 2011-2013," Brookings Institution analysis of Supplemental Poverty Measure Public Use Data.

⁸ "The Earned Income Tax Credit and Transfer Programs: A Study of Labor Market and Program participation," Tax Policy and the Economy, Vol. 9, MIT Press, 1995.

⁹ "States With EITCs," Tax Credits for Working Families. Accessed 7/15/2015.

¹⁰ A Georgia household with earnings under \$16,000 in 2015 paid an average of 9.7 percent of their income in sales and property taxes, compared with 2.4 percent paid by Georgians making more than \$432,000 a year. For more details, see "Who Pays?" Institute on Taxation and Economic Policy (ITEP). January 2015.

¹¹ Estimate provided upon request by the Institute on Taxation and Economic Policy (ITEP).

¹² For more details, see "Menu of Revenue Options to Pave Way for Georgia's Rebound: 2014 Update," Georgia Budget & Policy Institute. June 2014.

¹³ For more details, see "Shifting from Income to Sales Taxes Would Raise Taxes for Many," Georgia Budget & Policy Institute. December 2014.

¹⁴ GBPI calculated these estimates based on the federal EITC available to Georgia households depending on filing status, income and family size. The federal EITC credit values are publically available in IRS Publication 596, Federal EIC Table 2014. Georgia income tax liabilities assume no above-the-line deductions to federal adjusted gross income and no specific state tax credits other than the Low-Income Credit available to the single mother making \$14,500 a year. Specific liabilities would vary slightly between taxpayers based on each's unique circumstances. More details on GBPI's calculations of a 10 percent state EITC are available upon request.

¹⁵ For more examples of the types of ways families spend their EITC, see "When Tax Credits are About More than Money," The Atlantic. April 2015.

¹⁶ Low- and moderate-income families tend to spend most of their income on basic needs, whereas affluent families are more likely to save or invest. "Using the EITC to Stimulate Local Economies," Brookings Institution. 2006.

¹⁷ For one example, see "[Georgia Small Business Sentiment](#)," Thumbtack.com. July 2015. In that survey, 19.2 percent of companies reported "poor sales" as their top problem, more than any other option. Economic uncertainty and access to capital followed as the next two highest concerns at 18.4 percent and 13.2 percent, respectively. Taxes were cited as the top concern by only 6.4 percent of small businesses.

¹⁸ "EITC and Child Tax Credit Promote Work, Reduce Poverty, and Support Children's Development, Research Finds," Center on Budget & Policy Priorities. April 3, 2015.

¹⁹ *Ibid*.

²⁰ "Early-Childhood Poverty and Adult Attainment, Behavior, and Health," Child Development. January/February 2010, pp. 306-325.