Upward Mobility and State-Level EITCs: Evaluating California’s Earned Income Tax Credit

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National Tax Association Spring Symposium
From “Negative Income Tax” to “Work Bonus”

Senator Russell Long →
Originated “work bonus” proposals that formed the basis of EITC in Tax Reduction Act of 1975

← Milton Friedman
Author of Capitalism and Freedom, which advocated a negative income tax.
**Key Design Features of Federal EITC**

**FIGURE 1**

Federal Earned Income Tax Credit  
Single or Head-of-household Filers, Tax Year 2015

Credit amount

- $6,242
- $5,548
- $3,359
- $503

Earnings

- $6,980
- $9,880
- $13,870
- $18,110
- $39,131
- $44,454
- $57,747

### Source:
Tax Policy Center, 2015.

### Note:
Assumes all income comes from earnings. Amounts are for taxpayers filing a single or head-of-household tax return. For married couples filing a joint tax return, the credit begins to phase out at income $5,520 higher than shown.
# The EITC Wheelhouse: $10,000-$30,000

## TABLE 1

**Federal Returns with Earned Income Tax Credits**

**Tax Year 2014**

<table>
<thead>
<tr>
<th>Adjusted Gross Income</th>
<th>Tax Returns Claiming the Credit</th>
<th>Amount of Credit Claimed</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number (thousands)</td>
<td>Percent of all returns claiming the credit</td>
</tr>
<tr>
<td>$1 under $5,000</td>
<td>2,467</td>
<td>8.6</td>
</tr>
<tr>
<td>$5,000 under $10,000</td>
<td>4,981</td>
<td>17.5</td>
</tr>
<tr>
<td>$10,000 under $15,000</td>
<td>6,293</td>
<td>22.1</td>
</tr>
<tr>
<td>$15,000 under $20,000</td>
<td>3,872</td>
<td>13.6</td>
</tr>
<tr>
<td>$20,000 under $30,000</td>
<td>5,463</td>
<td>19.1</td>
</tr>
<tr>
<td>$30,000 under $40,000</td>
<td>3,812</td>
<td>13.4</td>
</tr>
<tr>
<td>$40,000 under $50,000</td>
<td>1,369</td>
<td>4.8</td>
</tr>
<tr>
<td>$50,000 or more</td>
<td>69</td>
<td>0.2</td>
</tr>
<tr>
<td>All</td>
<td>28,538</td>
<td>100.0</td>
</tr>
</tbody>
</table>

**Source:** Internal Revenue Service, Statistics of Income, Individual Income Tax Returns 2014: Publication 1304, Table 1.1 "Selected Income and Tax Items" and Table 2.5 "Returns with Earned Income Credit."

**Note:** Returns with adjusted gross income under $1 are included in the all returns.
### The EITC is largely a “Child Tax Credit”

#### Table 2
Federal Returns with Earned Income Tax Credits
By Number of Qualifying Children, Tax Year 2014

<table>
<thead>
<tr>
<th>Adjusted Gross Income</th>
<th>No children</th>
<th></th>
<th></th>
<th>One child</th>
<th></th>
<th></th>
<th>Two children</th>
<th></th>
<th></th>
<th>Three or more children</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number (thousands)</td>
<td>Total credit claimed (millions of $)</td>
<td>Number (thousands)</td>
<td>Total credit claimed (millions of $)</td>
<td>Number (thousands)</td>
<td>Total credit claimed (millions of $)</td>
<td>Number (thousands)</td>
<td>Total credit claimed (millions of $)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$1 under $5,000</td>
<td>1,752</td>
<td>375</td>
<td>461</td>
<td>508</td>
<td>180</td>
<td>233</td>
<td>74</td>
<td>111</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$5,000 under $10,000</td>
<td>2,708</td>
<td>1,157</td>
<td>1,601</td>
<td>4,461</td>
<td>488</td>
<td>1,499</td>
<td>184</td>
<td>644</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$10,000 under $15,000</td>
<td>2,453</td>
<td>497</td>
<td>1,916</td>
<td>6,234</td>
<td>1,392</td>
<td>6,998</td>
<td>533</td>
<td>3,009</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$15,000 under $20,000</td>
<td>321</td>
<td>59</td>
<td>1,712</td>
<td>5,477</td>
<td>1,292</td>
<td>6,866</td>
<td>546</td>
<td>3,270</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>$20,000 under $30,000</td>
<td>a</td>
<td>a</td>
<td>2,807</td>
<td>6,531</td>
<td>1,811</td>
<td>7,714</td>
<td>843</td>
<td>4,270</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$30,000 under $40,000</td>
<td>0</td>
<td>0</td>
<td>1,772</td>
<td>1,640</td>
<td>1,354</td>
<td>3,171</td>
<td>686</td>
<td>2,118</td>
<td></td>
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</tr>
<tr>
<td>$40,000 under $50,000</td>
<td>0</td>
<td>0</td>
<td>191</td>
<td>62</td>
<td>674</td>
<td>512</td>
<td>504</td>
<td>685</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$50,000 or more</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>69</td>
<td>18</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All</td>
<td>7,384</td>
<td>2,121</td>
<td>10,491</td>
<td>24,976</td>
<td>7,213</td>
<td>27,075</td>
<td>3,449</td>
<td>14,167</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Source:** Internal Revenue Service, Statistics of Income, Individual Income Tax Returns 2014: Publication 1304, Table 2.5 “Returns with Earned Income Credit.”

**Note:** Returns with adjusted gross income under $1 are included in the all returns.

* Estimates are based on a small number of sample returns and should be used with caution.
State EITCs “amplify” Federal EITC

- Maryland leads the way in 1987 with first state EITC
- 2016: 26 states & DC have credits
- Standard “Piggyback” Design – i.e., % of federal credit
  - Match rates vary (e.g., 3.5% in Louisiana; 40% in D.C.)
  - Most are refundable, five are not (DE, ME, OH, OK, VA)
- Piggyback model replicates & amplifies the work incentives/disincentives implicit in federal phase-in/out
- Example: For a single parent with 2 children, a 30% state match results in combined:
  - Phase-in rate goes from 40% → 52% (i.e., 40% x 1.30)
  - Phaseout rate goes from 21% → 27% (i.e., 21% x 1.30)
FIGURE 7
State EITCs as a Percentage of the Federal EITC
Tax Year 2015

Source: Internal Revenue Service, "State and Local Governments with Earned Income Tax Credit" (December 2015).

Notes: Minnesota’s EITC varies by income and may range from 25 to 45% of the federal credit. Wisconsin’s EITC varies by number of children (4% for one child, 11% for two children, and 34% for three children).
a No income tax states reflects states without a broad-based individual income tax.
* Indicates states with a nonrefundable credit.
SB 80 (2015): New California Refundable EITC

- Creates Refundable EITC “*with certain modifications*”

**Key Modifications of California Approach:**
- Dollar-for-dollar match over the first half of the phase-in range of the federal EITC.
  - Maximum credit ($\approx 2,500$) at $6,975$ of earned income
  - Phaseout at the same rate over the second half of the phase-in range of the federal EITC.
    - Fully phased out at $13,870$ of earned income
    - Only employee compensation (not self-employment income)

- Currently funded at 85 percent, so phase-in and phaseout percentages equal the federal rate, multiplied by 85 percent.

- Estimated Cost $\approx 380$ million
Rise of involuntary part-time work in California

Source: US. Bureau of Labor Statistics
fred.stlouisfed.org
FIGURE 2
California Earned Income Tax Credit
Tax Year 2015

Credit amount

$2,653 -
$2,358 -
$1,428 -
$214 -

Earnings

$3,290 $4,940 $6,580 $9,880 $13,870

6.5 percent
28.9 percent
34 percent
38.25 percent phase-in
38.25 percent phase-out

Three children
Two children
One child
No children

Note: Assumes all income comes from earnings. Amounts are for taxpayers filing a single, head-of-household, or married couples filing jointly tax return.
FIGURE 3
Combined Federal and California Earned Income Tax Credit
Single Filers, Tax Year 2015

Combined credit amount

$6,242 -
$5,548 -
$3,359 -
$503 -

Earnings

$3,290 -
$4,464 -
$5,630 -
$6,790 -
$7,950 -
$9,110 -
$10,270 -
$11,430 -
$12,590 -
$13,770 -
$14,930 -
$16,100 -
$17,270 -
$18,430 -
$19,630 -
$20,800 -
$21,970 -
$23,140 -
$24,310 -
$25,480 -
$26,650 -
$27,820 -
$28,990 -
$30,160 -
$31,330 -
$32,500 -
$33,670 -
$34,840 -
$36,010 -
$37,180 -
$38,350 -
$39,520 -
$40,690 -
$41,860 -
$43,030 -
$44,200 -
$45,370 -
$46,540 -

Three children
Two children
One child
No children


Note: Assumes all income comes from earnings. Amounts are for taxpayers filing a single tax return.
Pros and Cons of the California Model

- Financial support for the state’s poorest working families, but not enough to lower poverty rate.

- A cushion against employment gaps or reduction of hours

- Augments federal incentive for non-workers to enter the labor force, but only for those working part-time
  - Max CA credit for those working 600-800 hour at $10 per hour.
  - Zero credit for anyone making > $13,870 (e.g., any full time worker)

- Alters the work incentive over the federal phase-in range by:
  - Increasing phase-in rate (over the first half) – e.g., rate for parent with 2 kids goes from 40% to 80% (NOTE: this also increases the incentive for California workers to draw down federal credit)
  - Neutralizing the phase-in rate (over the second half) – e.g., rate for parent with 2 kids goes from 40% to zero (i.e., flat range starts at lower income)

- Unlike standard piggyback model, CA approach does not exacerbate work disincentive over phaseout range.
Revenue and Distributional Comparisons

- TPC tax model state tax calculators
- Microsimulation model based on representative sample of 2011 taxpayers
- We examine 2015 tax rules deflated to 2011
- First comparison for California:
  - SB 80 Approach assumed 100%, versus
  - Standard piggyback credit at same cost
  - (assuming take-up rate equal to those who claim federal EITC)
- How “generous” would such a credit be? (i.e., what %?)
- How does distribution of SB 80 approach compare with standard piggyback approach?
Fully-Funded California EITC costs same as 7.4% match

California EITC Total Credit Claimed
By Adjusted Gross Income as Percent of Poverty Guidelines, Tax Year 2015


Note: Federal EITC figures come from the TPC model; state EITC figures come from the State Income Tax Model and apply 2015 tax law to 2011 data.
What if other states followed the California model?

State EITC Total Credits Claimed
By Adjusted Gross Income as Percent of Poverty Guidelines, Tax Year 2015

- **Massachusetts**
  - CA EITC
  - Baseline

- **Louisiana**
  - CA EITC
  - Baseline

- **Virginia**
  - CA EITC
  - Baseline

$ Millions


**Note:** Federal EITC figures come from the TPC model; state EITC figures come from the State Income Tax Model and apply 2015 tax law to 2011 data.
Any state could target part of credit and still provide more general support – e.g., NJ

New Jersey EITC Total Credit Claimed
By Adjusted Gross Income as Percent of Poverty Guidelines, Tax Year 2015


Note: Federal EITC figures come from the TPC model; state EITC figures come from the State Income Tax Model and apply 2015 tax law to 2011 data.
Lessons for other states

- Cautious in recommendations for other states/Federal government to adopt as population helped is very limited
- However, might be option for states with limited funds (shifting from non-refundable credit)
- Also could be used as an additional credit to help target some of funds
- Information on effectiveness can also inform states about ability to deviate from Federal rules
Conclusions

- California’s EITC is very generous to targeted population
- Targeting can substantially reduce program cost
- However, beneficiaries cannot work full-time
- California credit significantly alters the work incentives that, but only over the phase-in range of the federal EITC
- By substantially increasing the phase-in range, it may induce further uptake of the federal credit for some.
- Uncertainty in size of credit could limit effectiveness
- While helpful to alleviate extreme poverty limited success in reducing poverty level
THANK YOU

For more information please contact:

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