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

May 18, 2017

Kim Rueben, Frank Sammartino, and Kirk Stark

National Tax Association Spring Symposium

TPC TAX POLICY CENTER
URBAN INSTITUTE & BROOKINGS INSTITUTION

UCLA | SCHOOL OF LAW

From “Negative Income Tax” to “Work Bonus”

← Milton Friedman
Author of *Capitalism and Freedom,*
which advocated a negative income tax.

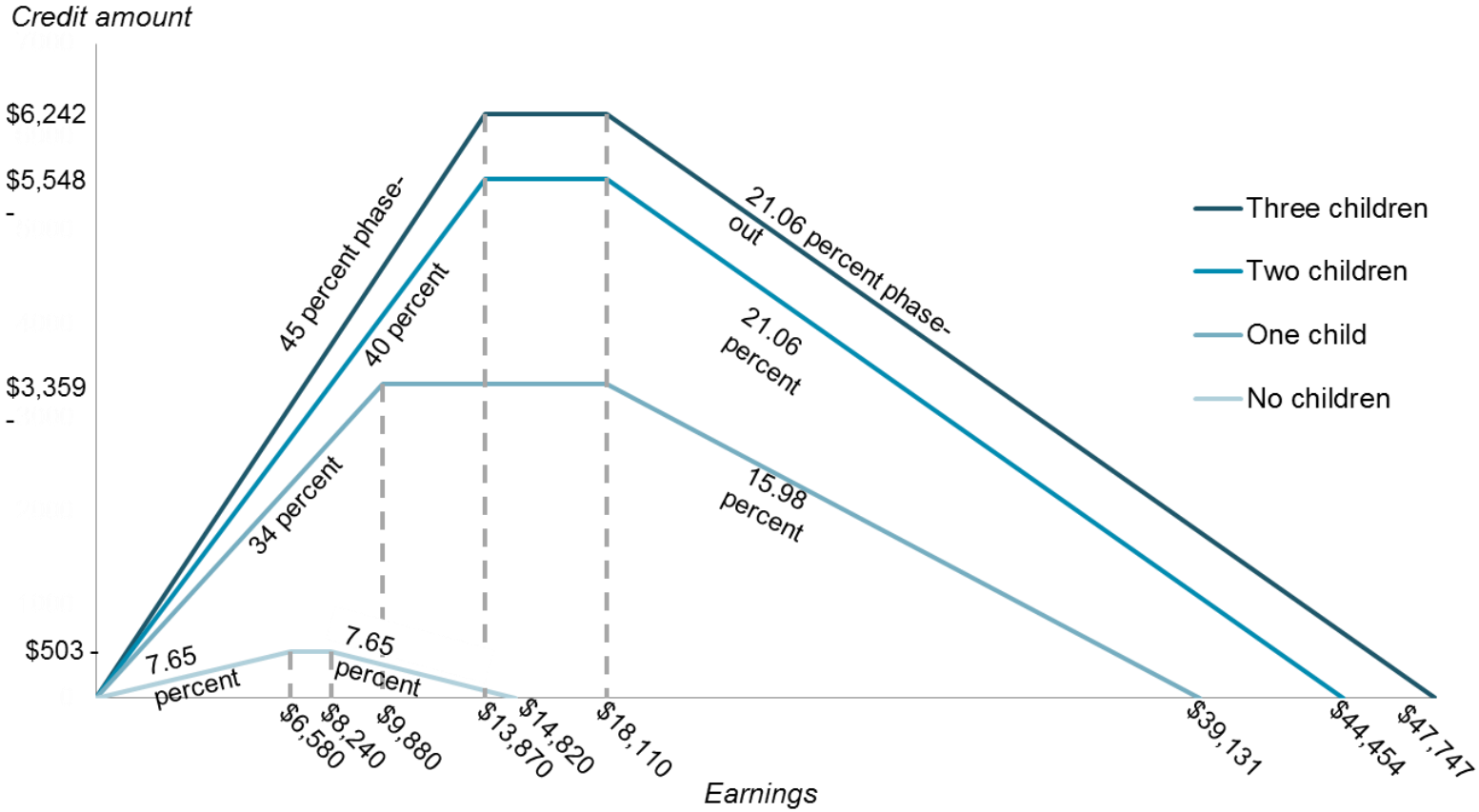
Senator Russell Long →
Originated “work bonus”
proposals that formed the basis of
EITC in Tax Reduction Act of 1975

Key Design Features of Federal EITC

FIGURE 1

Federal Earned Income Tax Credit

Single or Head-of-household Filers, Tax Year 2015



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

Adjusted Gross Income	Tax Returns Claiming the Credit			Amount of Credit Claimed		
	Number (thousands)	Percent of all returns claiming the credit	Percent of returns in the income group	Total (millions of $)	Percent of credit claimed	Average credit claimed ($)
$1 under $5,000	2,467	8.6	24.0	1,228	1.8	498
$5,000 under $10,000	4,981	17.5	42.2	7,760	11.4	1,558
$10,000 under $15,000	6,293	22.1	51.2	16,737	24.5	2,660
$15,000 under $20,000	3,872	13.6	34.2	15,673	22.9	4,048
$20,000 under $30,000	5,463	19.1	28.9	18,515	27.1	3,389
$30,000 under $40,000	3,812	13.4	26.1	6,929	10.1	1,817
$40,000 under $50,000	1,369	4.8	11.9	1,259	1.8	920
$50,000 or more	69	0.2	0.1	18	0.03	264
All	28,538	100.0	19.2	68,339	100.0	2,395

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

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

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.

[a] Estimates are based on a small number of sample returns and should be used with caution.

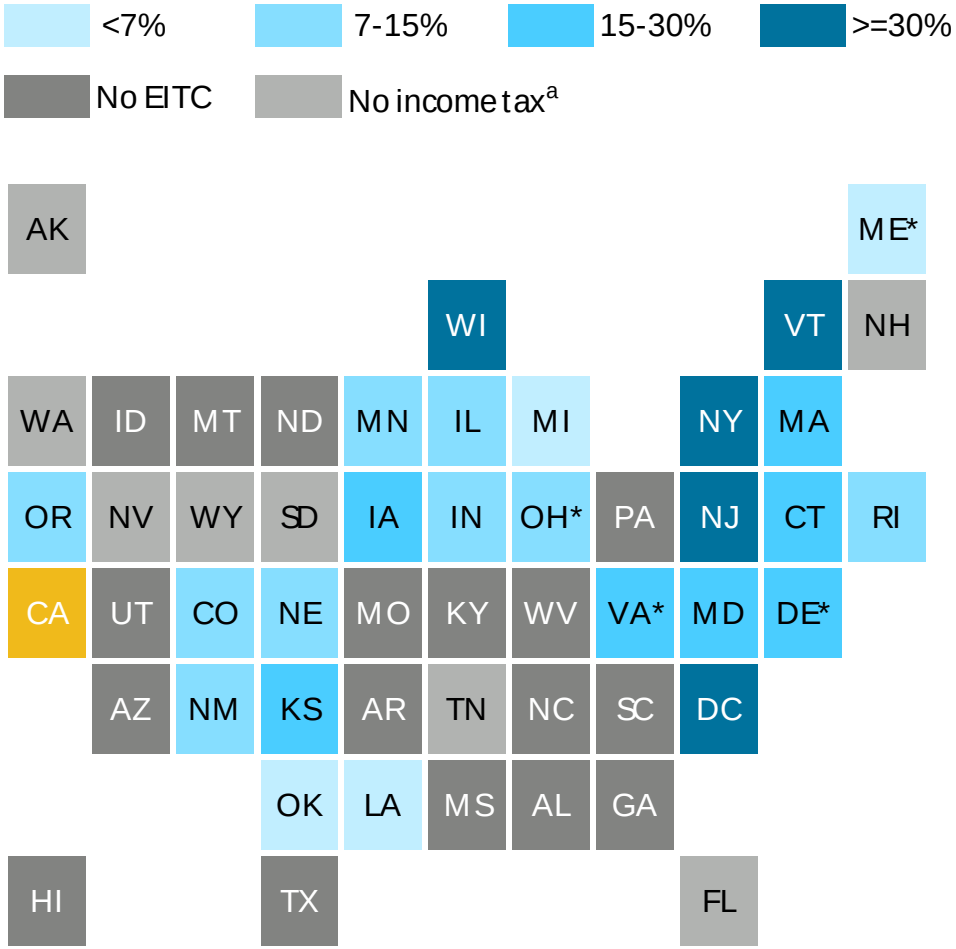
State EITCs "amplify" Federal EITC

- 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 (≈ $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 ≈ $380 million

Rise of involuntary part-time work in California

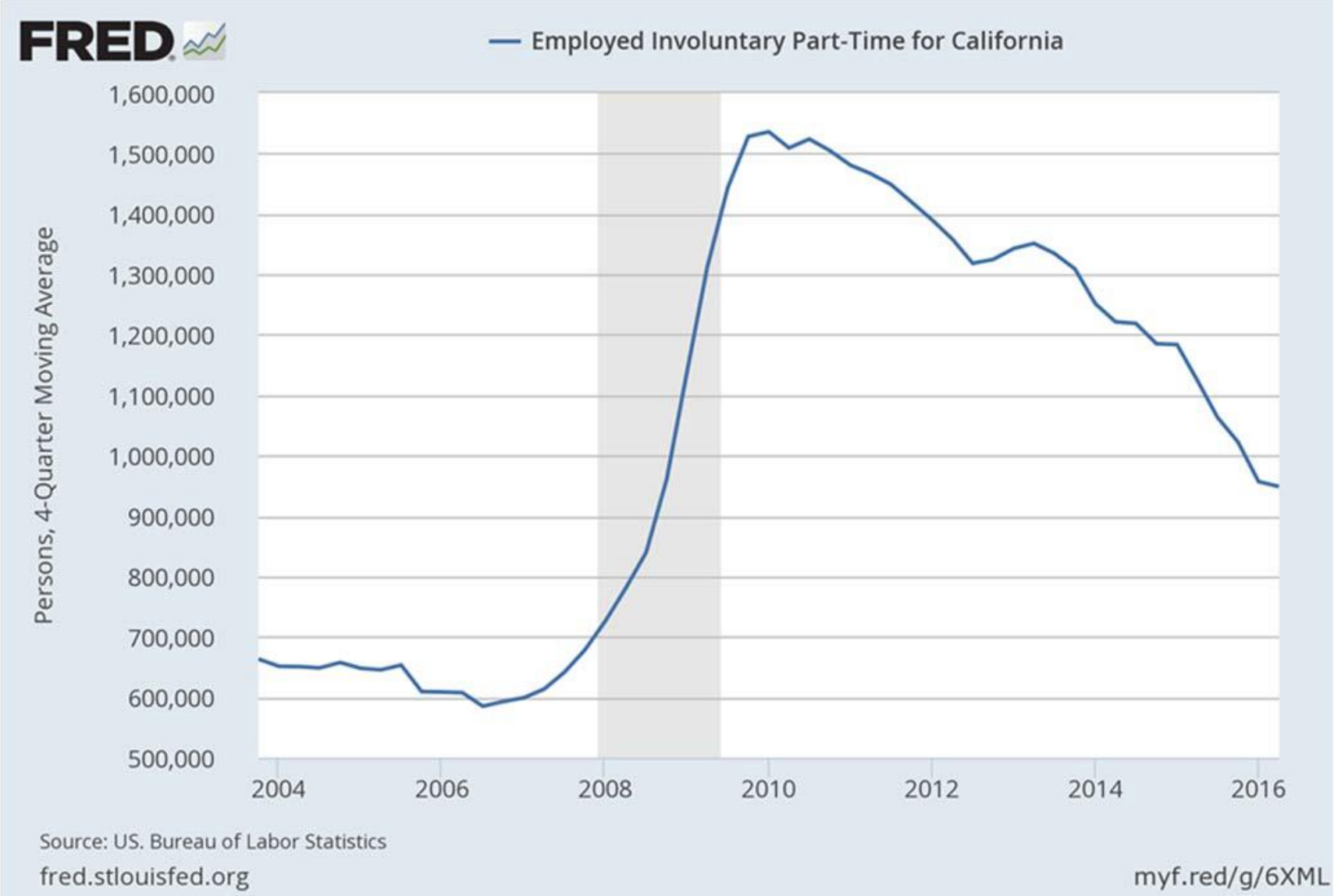
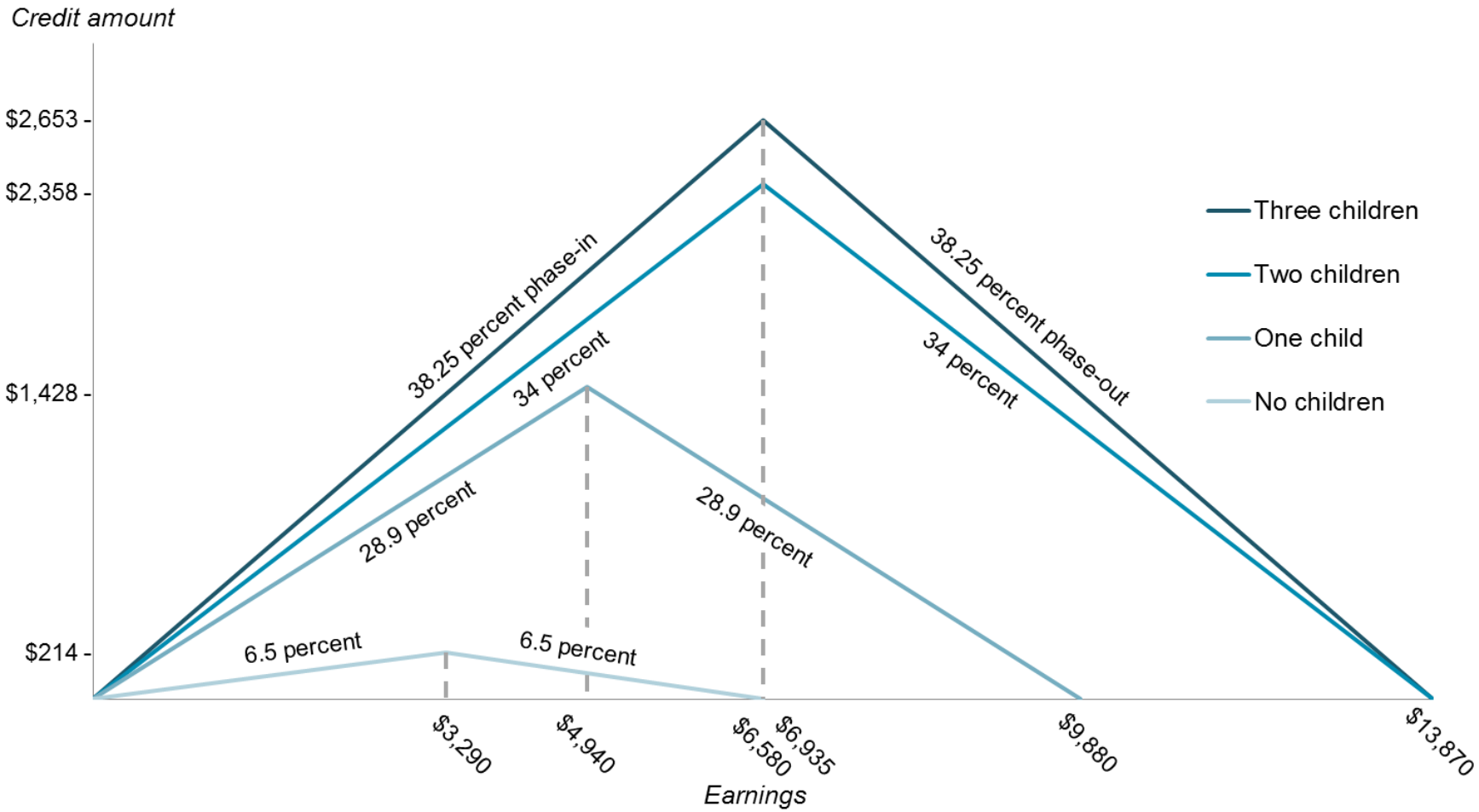


FIGURE 2

California Earned Income Tax Credit

Tax Year 2015

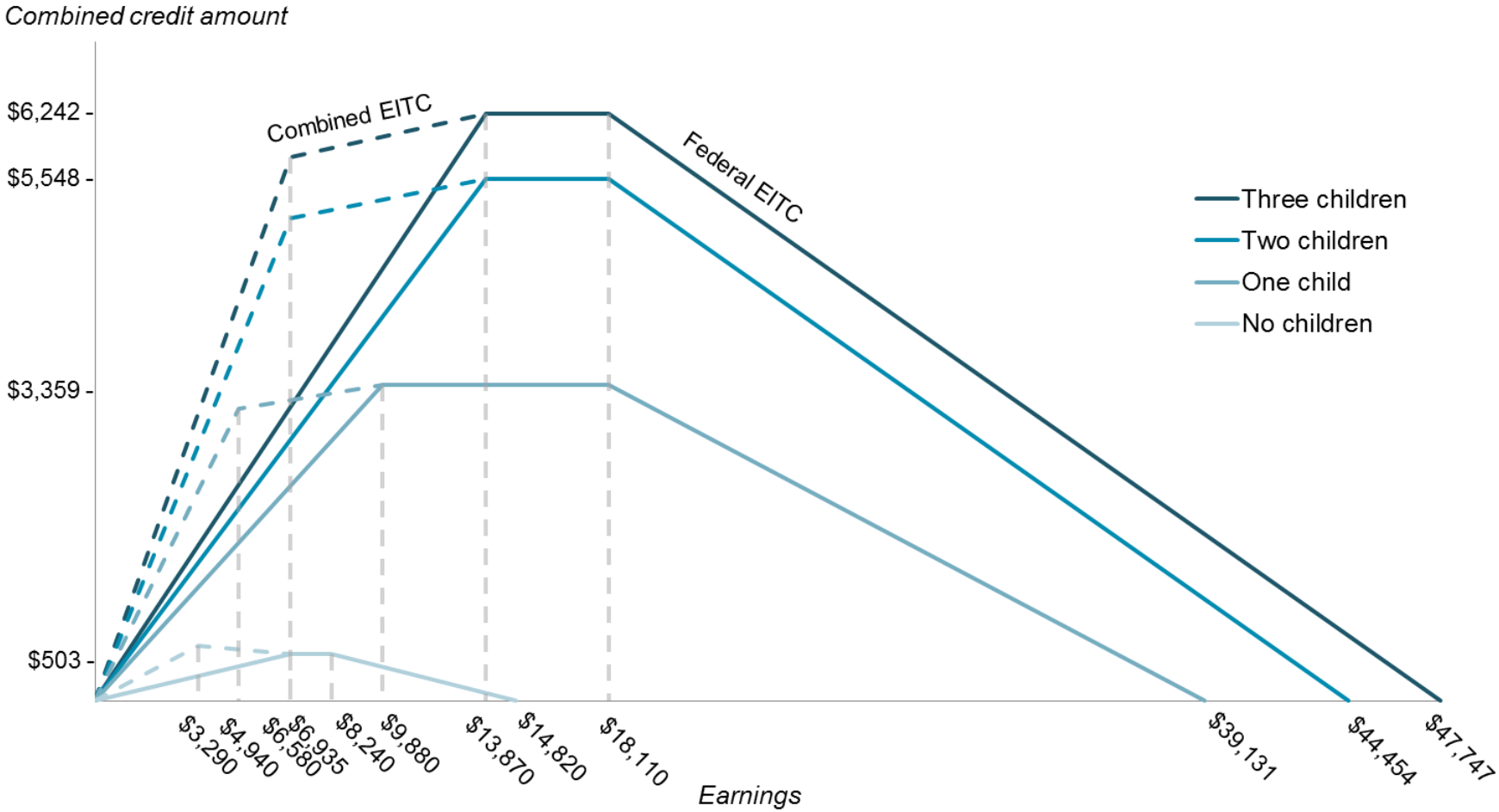


Source: California Senate Bill No. 80, 2015; Claire Montialoux and Jesse Rothstein, "The New California Earned Income Tax Credit," Institute for Research on Labor and Employment, 2015.
Note: Assumes all income comes from earnings. Amounts are for taxpayers filing a single, head-of-household, or married couples filing jointly tax return.

FIGURE 3

Combined Federal and California Earned Income Tax Credit

Single Filers, Tax Year 2015



Source: Tax Policy Center, 2016; California Senate Bill No. 80, 2015; Claire Montialoux and Jesse Rothstein, "The New California Earned Income Tax Credit," Institute for Research on Labor and Employment, 2015.
Note: Assumes all income comes from earnings. Amounts are for taxpayers filing a single tax return.

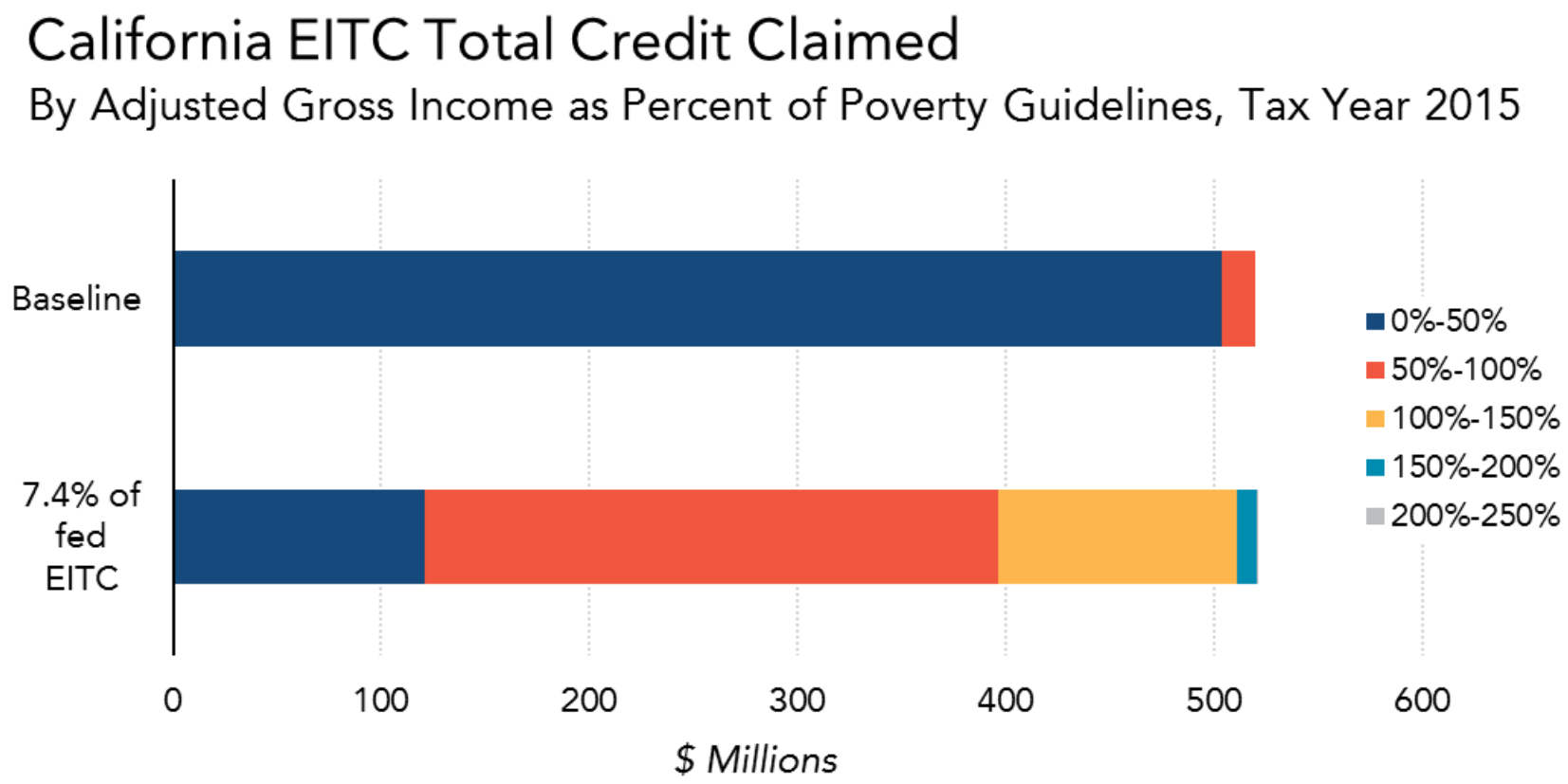
Pros and Cons of the California Model

- 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

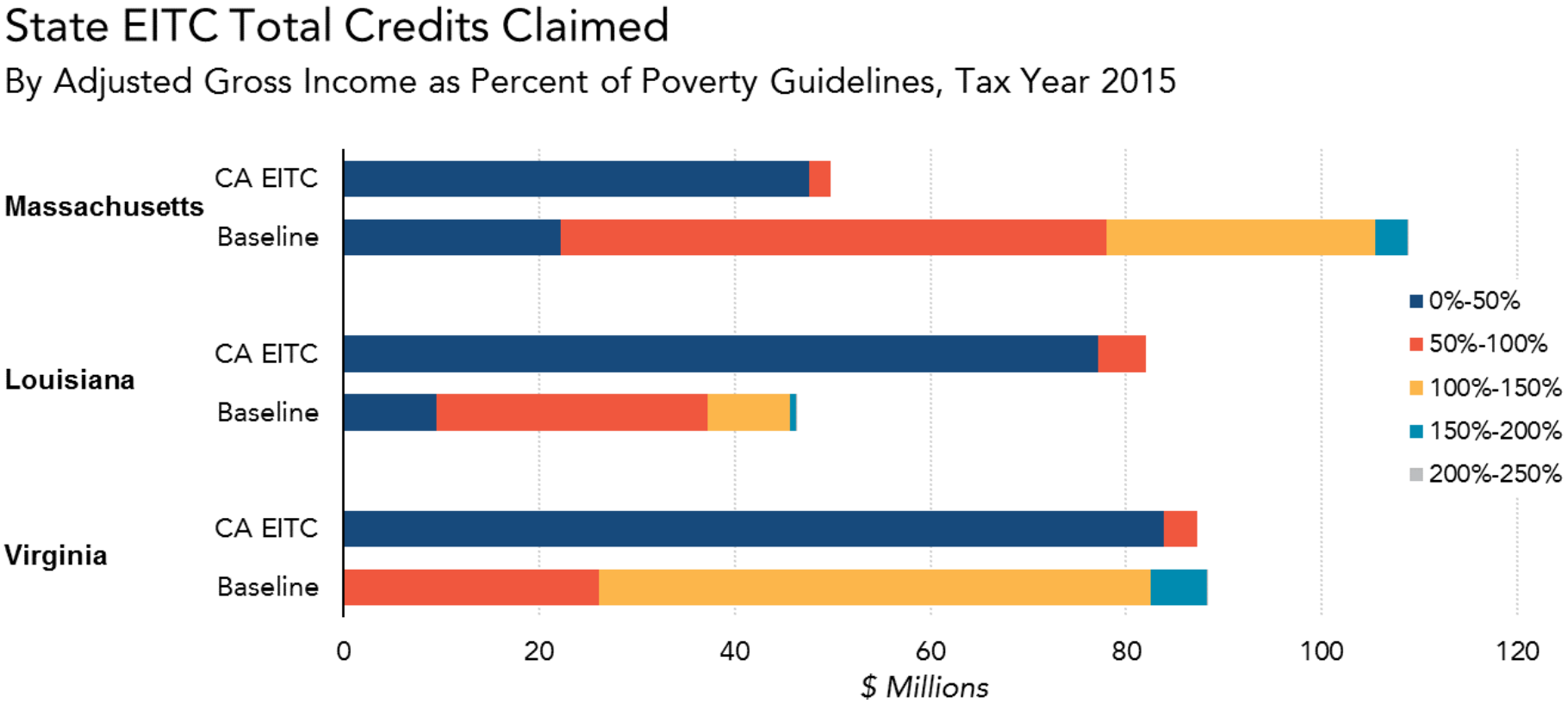
- TPC tax model state tax calculators
- Microsimulation model based on representative sample of 2011 taxpayers
- We examine 2015 tax rules deflated to 2011
- First comparison for California:
  - SB 80 Approach assumed 100%, versus
  - Standard piggyback credit at same cost
  - (assuming take-up rate 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



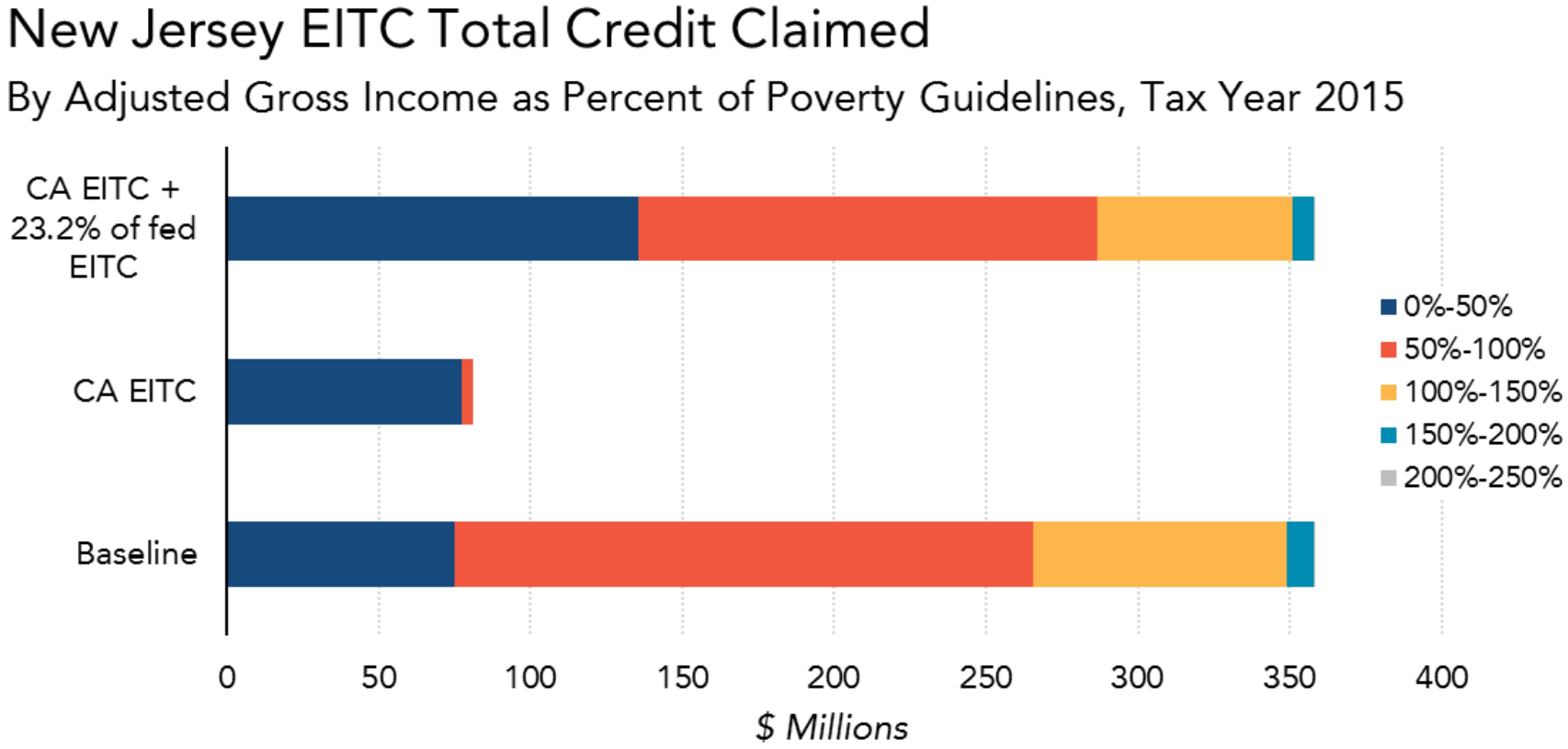
Source: State and Local Finance Initiative, State Income Tax Model and Urban-Brookings Tax Policy Center Microsimulation Model (version 0516-1). 2015 Poverty guidline figures from the U.S. Department of Health and Human Services. https://aspe.hhs.gov/2011-hhs-poverty-guidelines.
Note: Federal EITC figures 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?



Source: State and Local Finance Initiative, State Income Tax Model and Urban-Brookings Tax Policy Center Microsimulation Model (version 0516-1). 2015 Poverty guidline figures from the U.S. Department of Health and Human Services. https://aspe.hhs.gov/2011-hhs-poverty-guidelines.
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



Source: State and Local Finance Initiative, State Income Tax Model and Urban-Brookings Tax Policy Center Microsimulation Model (version 0516-1). 2015 Poverty guidline figures from the U.S. Department of Health and Human Services. https://aspe.hhs.gov/2011-hhs-poverty-guidelines.
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:

Kim Rueben
krueben@urban.org

Frank Sammartino
fsammartino@urban.org

Kirk Stark
stark@law.ucla.edu