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A lifeline for low-income families

Colorado should beef up the Earned Income Tax Credit

By Spiros Protopsaltis

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The state Legislature is debating a bill that would expand Colorado's Earned Income Tax Credit and make it permanent. Passing this bill would be a significant step in helping low-income working families in our state.

Historically, the Earned Income Tax Credit has been the most effective way to help these families become self-sufficient. It has enjoyed bipartisan support on the national level and in several other states, including Colorado, because it primarily benefits families with children below the poverty line by rewarding hard work. In combination with child tax credits, it effectively brings their combined federal income and payroll taxes down to almost $0. Income and family size determine the amount of the tax credit, and the maximum federal credit is $4,300 for a family with two or more qualifying children.

But in Colorado, where the Earned Income Tax Credit is set at 10 percent of the federal credit, it is only available when there is a TABOR surplus. This means that working families are losing this critical assistance during the times they need it most-during an economic downturn such as the one we've experienced over the last three years. In years that it's available, Colorado's Earned Income Tax Credit will provide these families with a tax refund to help take care of basic needs.

The federal EITC was designed to offset the burden of Social Security and Medicare payroll taxes for low-income working people with children and to provide incentives for low-skilled workers. Few government programs have enjoyed such broad, bipartisan support. It was launched under the Ford administration, and expanded by President Reagan, the first President Bush, and President Clinton. In 2001, President Bush expanded eligibility for low-income working taxpayers, and especially for military personnel, and increased benefits for married families with children.

The EITC has effectively become the largest federal anti-poverty program, and last year over 21 million families, almost all of them with children, received $37.5 billion. Some 250,000 Coloradoans, which represents more than 12 percent of all taxpayers, benefited to the tune of about $400 million, with an average federal EITC of about $1600.

The bipartisan support is explained by the fact that few other government programs can measure up to the effectiveness of the Earned Income Tax Credit. Here's why.

First, it is themost effective anti-poverty tool, lifting more families with children out of poverty than any other program. At least 2.4 million children are above the poverty level because of EITC benefits, and 60 percent of payments go to taxpayers who would be poor without it.

Second, the Earned Income Tax Credit increases employment, labor supply, and earnings of low-skilled workers and single-parent families. Low-income families get the credit even if it exceeds the amount of income taxes they owe. As a result, it effectively adds about $2 per hour to the net income

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of 10 million low-income families with children, and about a $1.50 per hour to the net income of 6 million slightly better-off families. It also creates a marriage reward for the poorest single parents.

Third, by fueling consumption, the EITC stimulates the economy more efficiently than broad-based tax refunds. It is estimated that around 70 percent of EITC checks are spent in the month they are received. The program is used by families to pay for basic needs, such as to buy items for their kids and to pay off debt. A 2003 survey of over 300 recipients in Denver revealed that the top priorities for these families were to pay immediate bills-such as rent and utility bills-repair their cars, and buy school clothes for their children. Other studies indicate that many families use the EITC to pay for educational expenses, pay off debt, purchase food, or set aside savings.

Finally, the Earned Income Tax Credit has contributed to the decrease in welfare use and is particularly effective in moving non-working welfare recipients into the workforce.

The success of the federal Earned Income Tax Credit in reducing poverty and rewarding work has led to 17 states enacting complementary programs. All but one of the state programs piggy-back on the federal EITC, using federal eligibility rules and paying a flat percentage (usually between 15-20 percent) of the federal credit, depending on family status and composition.

The Colorado EITC was enacted in 1999 as a refundable credit set at 8.5 percent of the federal credit, and in 2000 it was expanded to 10 percent of the federal credit. But because the state did not have a TABOR surplus, it was suspended for tax years 2002, 2003, and 2004. The suspension of the Colorado EITC means that the income level at which a family of four begins to pay state income taxes declines. For example, for tax year 2002, when the state EITC was suspended, the state's income tax threshold for a family of four decreased from $28,700 to $21,400. This was the steepest decline in any state's income tax threshold at any time in at least ten years. In 1991, a family of four owed income tax when its income reached 3 percent above the poverty line. By 2001, Colorado's tax threshold was 59 percent above the poverty line. In 2002, the threshold dropped to 16 percent above the poverty line.

The bill now before the legislature (HB1232) would incrementally increase the amount of Colorado's Earned Income Tax Credit from 10 percent of the federal EITC to 20 percent and make it permanent. This would effectively double the amount of the average state EITC payments from $160 to $320. More important, it would cut the ties between the Earned Income Tax Credit and TABOR, ensuring that working families receive the credit every year. By making the EITC permanent and increasing it to the level used by several other states, Colorado can provide meaningful support to hundreds of thousands of working families with children and also stimulate its economy.

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