

Testimony in Support of HB08-1362 to Reinstate Colorado's Earned Income Tax Credit

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We support HB08-1362 to reinstate Colorado's Earned Income Tax Credit for income tax years 2008 and 2009. This legislation represents an opportunity gain for Colorado by providing a tax cut for low-income workers, reducing poverty, encouraging work and supporting people as they move off of public assistance. We urge you to vote yes on HB08-1362.

Summary of the Legislation

This bill will restore Colorado's Earned Income Tax Credit (EITC) for income tax years 2008 and 2009. All Colorado taxpayers who qualify for the federal EITC would qualify for a tax credit on their Colorado taxes equal to 10 percent of the federal EITC.

Funds from the federal Temporary Assistance for Needy Families (TANF) block grant would be used to pay for 90 percent of the EITC. The Executive Director of the Department of Revenue is directed to submit an estimate of the amount of EITC likely to be claimed for tax year 2009 and the General Assembly is directed to appropriate 90 percent of the amount due from the TANF block grant. Current federal regulations allow states to use a portion of their Temporary Assistance to Needy Families block grant to fund a portion of an EITC.

Unemployment Insurance Tax Surcharge revenues would be used to fund the remaining 10 percent of the EITC, unless the average weekly wages reported by employers decline by 3 percent or more over the previous year or if average unemployment benefits paid increase by 10 percent or more over the previous year. These "triggers" would prevent Unemployment Insurance funds from being diverted from the trust fund if the economy is weakening and the need for unemployment benefits is rising.

There is precedent for the General Assembly to use funds from the unemployment tax surcharge for other purposes. In 2003, SB03-296 diverted half of the unemployment tax surcharge from the Unemployment Compensation Fund into the General Fund to be used to promote economic development. The fiscal note on SB08-236 estimated this amount to total \$20 million. The funds were redirected to the Unemployment Compensation Fund beginning in July 1, 2004.

Background on the EITC

The federal EITC, first enacted under President Ford in 1976 and expanded under presidents Reagan and Clinton, has broad bipartisan support. Colorado enacted a state Earned Income Tax Credit in 1999 set at 8.5 percent of the federal credit. Governor Bill Owens called for the EITC in his State of the State Address as part of a proposal to lower the income tax rate from 5 percent to 4.75 percent.¹ In 2000 the General Assembly raised the rate to 10 percent of the federal credit.

However, the EITC was not created as a tax credit but as a TABOR refund mechanism. Therefore, it is available only in those years when there is a TABOR surplus. Colorado's EITC was paid for tax years 1999, 2000 and 2001. Because there were no TABOR surpluses in 2002 through 2005, 2001 was the last year the state EITC was available. Referendum C, passed in 2005, suspended the TABOR revenue limit for fiscal years 2005-06 through 2009-10, thus eliminating the funding source for the EITC until at least 2011.

The federal EITC and Colorado's EITC are refundable. This means families receive the tax credit whether or not they owe income taxes. The EITC is first used to reduce a family's tax liability and whatever remains is returned in the form of a refund. Although low-income families may owe little or no state income taxes, they still pay state and local sales and local property taxes. The EITC is a method for using the income tax system to reduce overall taxes for low-income working families.

The EITC is also simple to implement, administer and claim. By piggybacking on the federal credit, states can take advantage of the federal statutory structure and the existing tax system to file claims. The cost of administering the federal EITC is estimated at about 1 percent of the program's cost, extremely low compared to other income support programs.²

The number of Coloradans who receive the federal EITC

In tax year 2004, about 260,000 Colorado taxpayers claimed over \$427 million in the federal EITC. The average federal EITC totaled about \$1,625. At 10 percent of the federal EITC, the state EITC would have averaged about \$162.³

In tax year 2005, about 264,000 Colorado taxpayers claimed over \$448 million in the federal EITC. The average federal EITC totaled about \$1,642. At 10 percent of the federal EITC, the state EITC would have averaged about \$164.⁴

In tax year 2004, one in eight Colorado taxpayers (almost 13 percent) received the federal EITC.⁵ A review of data from tax year 2001 found that EITC claims came from 14 percent of taxpayers in Colorado's large cities, 13 percent of taxpayers in rural areas, 11 percent of taxpayers in small cities and 8 percent of taxpayers in suburbs.⁶

Military families are also eligible for the EITC. The Bell Policy Center estimated that 150,000 military families nationwide, including 3,000 stationed in Colorado, were eligible for the EITC in tax year 2004.⁷

Qualifications for the EITC

For tax year 2007, the maximum amount of adjusted gross income taxpayers can earn and still qualify for the federal EITC depends on family size and tax filing status. To qualify, a taxpayer (or spouse) must be 25 to 64 years old, have a valid social security number and receive less than \$2,900 a year in investment income. The age requirement does not apply if the taxpayer has a qualifying child.

The EITC is structured so single parents with two or more children and who earn \$11,750 to \$15,400 per year, or married couples with two or more children who earn \$11,750 to \$17,400 per year, receive the maximum credit. The credit increases with family earned income up to \$11,750 a year. Then, as family earned income increases above \$15,400 for single parents and \$17,400 for married parents, the credit decreases. It falls to zero when family earned income hits \$37,750 for single parents and \$39,784 for married parents. The credit is structured the same way for parents with one child and for single and married taxpayers without children.⁸

Table 1 - Federal EITC earned income limits, 2007

Number of children	Married filing jointly	Other filing status
None	\$14,590	\$12,590
One	\$35,241	\$33,241
Two or more	\$39,783	\$37,783

Table 2 - Maximum federal EITC different types of families can receive, 2007

Number of Children	Maximum EITC
Two or more qualifying children	\$4,716
One qualifying child	\$2,853
No children	\$428

Other states with EITCs

Currently, 23 states, and the District of Columbia, have enacted Earned Income Tax Credits. Four states enacted their EITCs in 2007. In 2008 Washington became the 23rd state, and the only one without a state income tax, to enact an EITC. The credits range from 5 percent of the federal EITC in Maine to 43 percent of the federal EITC in Wisconsin for a family with three children. Twenty one states have made their EITC refundable.⁹

Research and Evidence of Effectiveness

A broad range of studies have concluded that the federal EITC lifts people out of poverty, encourages low-income workers to participate in the labor force, reduces welfare and increases the economic well being of low-income working families.

Reduces Poverty

The federal EITC lifts about 4.5 million people out of poverty, about half of them children, and is considered the nation's most effective antipoverty program for working families.¹⁰ This is important given that the number of Colorado children living in poverty has increased since 2001 and has ranged between about 12 and 14 percent since 2002¹¹.

Encourages Work

Because people must have earned income to claim it, the EITC has been found to encourage low income workers to enter and stay in the labor force. A number of researchers have found that expansions of the federal EITC have resulted in greater workforce participation, particularly among single women with children. Two Northwestern University economists found that expansions in the federal EITC explained more than 60 percent of the increase in employment among single mothers from 1984 to 1996. They also found that state EITCs, where available, encouraged more people to join the workforce.¹²

Jeffery Grogger, a UCLA economist, determined that the federal EITC explained about one-third of the decline in welfare use from 1993 to 1999 and almost half of the increase in employment. He found that a large part of the decline in welfare occurred because people did not go on it in the first place, and that the EITC heavily influenced the decision not to seek welfare.¹³

By inducing nonworkers to join the labor force, the EITC also limits long-term unemployment and improves the job skills of workers, which increases their earnings. David Neumark, an economist at the University of California at Irving, concluded that "a more generous EITC boosts employment of single mothers and in so doing raises incomes and earnings of low-income families"¹⁴ Rebecca Blank, a University of Michigan economist, determined that steady work, even at a relatively low-wage, when combined with the EITC and other work supports such as child care assistance, resulted in women being substantially better off.¹⁵

Stimulates Local Economies

Most families that receive an EITC spend the money locally on day-to-day living expenses. A 2003 survey of EITC recipients in Denver found their top priorities for the tax credit were paying for current bills, car repairs and school clothes for their kids. This spending ripples through the local economies as dollars move among consumers, businesses and their employees. A 2003 study in San Antonio, Texas estimated that

every \$1.00 in EITC refunds generates another \$1.58 in local economic activity.¹⁶ Other economists estimate that the EITC refunds could be re-spent three to five or more times in the local economy.¹⁷

Public Support for the EITC

In January 2008, the Center for Policy Entrepreneurship commissioned a poll to assess public opinion on restoring Colorado's EITC. The poll was conducted by Talmey-Drake Research and Strategy, Inc. based on 500 random calls with active voters throughout Colorado. According to the poll, 70 percent of respondents support legislation to make the Colorado EITC permanent. The poll found overwhelming support, regardless of political affiliation, region, gender, income, education level, ethnicity and age.¹⁸

Restoring Colorado's Earned Income Tax Credit is a cost effective way to give an economic boost to Colorado's low-income working families while at the same time providing economic stimulus to local economies.

End Notes

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² How Can A State Earned Income Tax Credit Help California's Working Poor Make Ends Meet?, California Budget Project, Budget Brief, March 2001. <http://www.cbp.org/pdfs/2001/bb010302.pdf>

³ "Tax Credits – A Crucial Support of Working Families", Piton Foundation, 2007.

<http://www.piton.org/content/TheEarnedIncomeTaxCreditinColorado.html>

⁴ "Tax Credits Help Striving Families Become Thriving Families", EITC Fact sheet by Legislative District that uses the Brookings Institutions EITC data for tax year 2005, Piton Foundation, 2008,

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⁵ Piton Foundation, endnote 2.

⁶ The Earned Income Tax Credit in Colorado: An Overview, The Bell Policy Center, February 2005.

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⁸ Publican 596, Earned Income Credit, Tax Year 2007, Internal Revenue Service.

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⁹ Jason Levitis and Jeremy Koulisch, "A Majority of States With Income Taxes Have Enacted State Earned Income Tax Credits", Center on Budget and Policy Priorities, October 5, 2007. <http://www.cbpp.org/10-5-07sfp.htm>

¹⁰ Jason Levitis, "Testimony Before the Maryland Senate Budget and Taxation Committee", Center on Budget and Policy Priorities, February 28, 2007. <http://www.cbpp.org/mdtestimony.pdf>

¹¹ State of Working Colorado 2007, Colorado Fiscal Policy Institute, February 2008.

<http://www.cclponline.org/pubfiles/State%20of%20Working%20Colorado%202007%20summary.pdf>

¹² Ami Nagle and Nicholas Johnson, "A Hand Up: How State Earned Income Tax Credits Help Working Families Escape Poverty in 2006", Center on Budget and Policy Priorities, March 8, 2006.

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¹³ Robert Wirtz, Anti-Poverty Design: The Cash Out Option, Federal Reserve Bank of Minnesota, June 2003, <http://www.minneapolisfed.org/pubs/region/03-06/wirtz.cfm>

¹⁴ David Neumark, “Alternative Labor Market Policies to Increase Economic Self-Sufficiency, The Institute for the Study of Labor, Bonn, Germany, February 2008. <http://ftp.iza.org/dp3355.pdf>

¹⁵ Robert Wirtz, endnote 3.

¹⁶ Alan Berube, “Using the Earned Income Tax credit to Stimulate Local Economies”, The Brookings Institution, November 2006. http://www.brookings.edu/~media/Files/rc/reports/2006/11childrenfamilies_berube/Berube20061101eitc.pdf

¹⁷ The Earned Income Tax Credit in Colorado, Fact Sheet, Colorado Fiscal Policy Institute, February 2006.

¹⁸ Spiros Protopsaltis, “Poll on making the Colorado EITC permanent”, Center for Policy Entrepreneurship, February 13, 2008.