Informational Paper 3

Earned Income Tax Credit

Wisconsin Legislative Fiscal Bureau
January, 2011

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Introduction

The earned income tax credit (EITC) is offered at both the federal and state levels as a means of providing assistance to lower-income workers. The credit provides a supplement to the wages and self-employment income of such families and is intended to offset the impact of the social security tax and increase the incentive to work.

The federal earned income tax credit has been provided since 1975. In tax years 1991 through 1993, supplemental credits were also provided for health insurance and children under the age of one. The supplemental credits were eliminated beginning in 1994 and the credit was extended to lower-income families without children as part of the federal Revenue Reconciliation Act of 1993. The credit was simplified under the federal Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), and the income phase-out ranges for married couples applying for the EITC were raised in comparison to the levels for other claimants. The American Recovery and Reinvestment Act of 2009 (ARRA) further increased the income phase-out ranges for married couples. Also, ARRA increased the maximum amount of the credit by adding an additional reimbursement level for taxpayers with three or more children. While ARRA limited both of these changes to tax years 2009 and 2010, the Tax Relief, Unemployment Compensation Reauthorization and Job Creation Act of 2010 extends these changes to 2011 and 2012.

A nonrefundable Wisconsin credit was first enacted in 1983 Wisconsin Act 27. The initial state credit was set at 30% of the federal credit and was available only in 1984 and 1985; the credit was repealed, beginning with the 1986 tax year, in 1985 Wisconsin Act 29. A refundable state earned income credit was reinstated in 1989 Wisconsin Act 31, beginning in tax year 1989. In tax years 1989 through 1993, the state credit was calculated as a percentage of the federal credit. Under 1993 Wisconsin Act 16, a separate, stand-alone state credit was established, effective for tax year 1994. In 1995 Wisconsin Act 27, the state credit was modified to again be calculated as a percentage of the federal credit.

Both the federal and Wisconsin credits are refundable so individuals with little or no income tax liability may still receive the credit. In 2009, 22 other states and the District of Columbia offered an earned income credit that was calculated as a percentage of the federal credit. In addition to Wisconsin, 19 states and the District of Columbia offered a refundable EITC and three states (Delaware, Maine, and Virginia) provided a nonrefundable credit. The states of Maryland and Rhode Island each offered a nonrefundable credit, but certain taxpayers were also eligible for an additional refundable credit. Washington is the first state without a state individual income tax to authorize an EITC.

The remainder of this paper presents detailed descriptions and eligibility requirements of the federal and Wisconsin earned income credits, program expenditure data regarding the Wisconsin credit, and a discussion of policy considerations relating to the credit.

Federal Earned Income Tax Credit

Calculation of the Credit

The federal EITC is a refundable credit based on income and family size. In addition, the credit has been affected by filing status since 2002.

The EITC is generally based on earned income, although the credit can also be affected by adjusted gross income (AGI). For claimants whose only income is earned income, the EITC is calculated based on a percentage of earned income up to certain thresholds. The credit gradually increases until earned income reaches the first threshold amount, at which a claimant receives the maximum allowable credit. This income level is referred to as the maximum credit income.

Such claimants are eligible for the maximum credit over a range of income levels, starting at the maximum credit income and ending at a specified phase-out income. For such a claimant whose income exceeds the phase-out income, the credit is gradually reduced as follows: (a) a phase-out rate is applied to the amount by which income exceeds the phase-out income; and (b) the resulting figure is subtracted from the maximum credit to arrive at the allowable credit for a particular claimant. The level of income at which the credit is eliminated is referred to as the maximum income level.

If a claimant has unearned income in addition to earned income, the credit is initially calculated using only earned income, but the phase-out calculation is made using AGI or earned income, whichever is greater. The components of earned income are described below in the section on "Income Used in Determining the Credit."

The maximum credit income, phase-out income, and maximum income amounts are adjusted each year for changes in inflation, while the credit percentages and phase-out rates remain the same. The parameters for the federal EITC for tax year 2010 are shown in Table 1.

As shown in the footnote to Table 1, the phase-out income and maximum income amounts are higher for married-joint filers than for other filers. Prior to tax year 2002, filing status was not a factor in the EITC computation. However, EGTRRA provided higher phase-out income levels for joint filers in order to reduce the marriage penalty experienced by married individuals claiming the EITC. The adjustment for joint filers was initially set at $1,000, beginning in tax year 2002, and two additional increases of $1,000 each, beginning in tax years 2005 and 2008, were also provided. Beginning in 2009, the $3,000 adjustment was to be indexed annually for inflation, but instead, ARRA increased the adjustment to $5,000. Because the indexing component was retained, the phase-out income levels for joint filers were $5,010 higher in 2010, than for other types of filers.

Table 1: 2010 Federal Credit Provisions*

	No Children	One Child	Two Children	3 or More Children
Credit Percentage	7.65%	34.00%	40.00%	45.00%
Maximum Credit Income	$5,980	$8,970	$12,590	$12,590
Maximum Credit	457	3,050	5,036	5,666
Phase-Out Income	7,480	16,450	16,450	16,450
Phase-Out Rate	7.65%	15.98%	21.06%	21.06%
Maximum Income	13,460	35,535	40,363	43,352

*For married-joint filers, the phase-out incomes and maximum income levels exceed those shown above by $5,010.

Table 2 shows the federal earned income tax credits for 2010 at various levels of income for filers who are single or heads-of-households (the credit is not available to married individuals filing separate returns). Table 3 shows similar information for married couples filing joint returns.

The credit for families with one child is calculated as 34% of earned income until income equals $8,970. If income is between $8,970 and $16,450 ($21,460 for joint filers), the maximum credit of $3,050 is provided. Once income exceeds $16,450 ($21,460 for joint filers), the credit is phased-out at a rate of 15.98% (the credit is reduced by 15.98¢ for every additional $1 in income) until it is eliminated when income exceeds $35,535 ($40,545 for joint filers). The same credit structure exists for the other family sizes. This pattern is illustrated in Figure 1, which shows the federal credit for 2010 for single and head-of-household claimants. [The pattern for married-joint filers would be identical to that shown in Figure 1. However, the income levels at which the credit would begin to be phased out and at which the credit would be completely phased

Table 2: 2010 Federal Credit Amounts
Single and Head-of-Household Filers

Earned Income*	No Children	One Child	Two Children	3 or More Children
$0	$0	$0	$0	$0
2,000	153	680	800	900
4,000	306	1,360	1,600	1,800
6,000	457	2,040	2,400	2,700
8,000	418	2,720	3,200	3,600
10,000	265	3,050	4,000	4,500
12,000	112	3,050	4,800	5,400
14,000	0	3,050	5,036	5,666
16,000	0	3,050	5,036	5,666
18,000	0	2,802	4,710	5,339
20,000	0	2,483	4,288	4,918
22,000	0	2,163	3,867	4,497
24,000	0	1,843	3,446	4,075
26,000	0	1,524	3,025	3,654
28,000	0	1,204	2,604	3,233
30,000	0	885	2,182	2,812
32,000	0	565	1,761	2,391
34,000	0	245	1,340	1,969
36,000	0	0	919	1,548
38,000	0	0	498	1,127
40,000	0	0	76	706
42,000	0	0	0	285
44,000	0	0	0	0

*For claimants other than married-joint filers, the credit is based on the greater of earned income or AGI beginning at $7,480 of income for claimants with no children and $16,450 of income for claimants with one or more children. The credit is eliminated at the following income levels: $13,460 for no children, $35,535 for one child, $40,363 for two children, and $43,352 for three or more children.

Table 3: 2010 Federal Credit Amounts
Married-Joint Filers

Earned Income*	No Children	One Child	Two Children	3 or More Children
$0	$0	$0	$0	$0
2,000	153	680	800	900
4,000	306	1,360	1,600	1,800
6,000	457	2,040	2,400	2,700
8,000	457	2,720	3,200	3,600
10,000	457	3,050	4,000	4,500
12,000	457	3,050	4,800	5,400
14,000	342	3,050	5,036	5,666
16,000	189	3,050	5,036	5,666
18,000	36	3,050	5,036	5,666
20,000	0	3,050	5,036	5,666
22,000	0	2,964	4,922	5,552
24,000	0	2,644	4,501	5,131
26,000	0	2,324	4,080	4,709
28,000	0	2,005	3,659	4,288
30,000	0	1,685	3,237	3,867
32,000	0	1,366	2,816	3,446
34,000	0	1,046	2,395	3,025
36,000	0	726	1,974	2,603
38,000	0	407	1,553	2,182
40,000	0	87	1,131	1,761
42,000	0	0	710	1,340
44,000	0	0	289	919
46,000	0	0	0	497
48,000	0	0	0	76
50,000	0	0	0	0

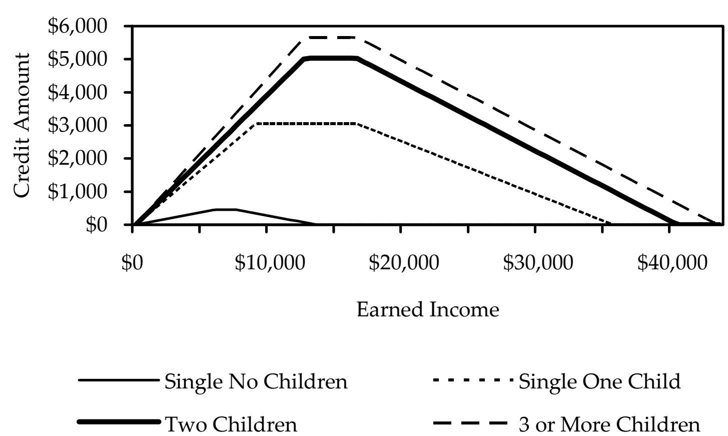
*For married-joint filers, the credit is based on the greater of earned income or AGI beginning at $12,490 of income for claimants with no children and $21,460 of income for claimants with one or more children. The credit is eliminated at the following income levels: $18,470 for no children, $40,545 for one child, $45,373 for two children, and $48,362 for three or more children.

out would exceed those shown in Figure 1 by $5,010.]

Income Used in Determining the Credit

Components of Earned Income. The following types of income are included in earned income for purposes of the EITC: wages; salaries; tips; and other forms of taxable employee compensation (which include net earnings from self-employment, strike benefits, long-term disability benefits received before retirement from an employer-provided plan, and income received as a statutory employee). In addition, since tax

Figure 1: 2010 Federal Earned Income Tax Credit
Single and Head-of-Household



year 2004, a taxpayer could choose to either include in, or exclude from, earned income combat pay that is excluded from gross income.

The definition of earned income excludes interest, dividends, social security and railroad retirement benefits, pensions and annuities, welfare benefits, alimony, child support, nontaxable foster care payments, unemployment compensation, veterans' benefits, workers' compensation, certain scholarship or fellowship grants, and income of nonresident aliens not connected with U.S. business.

Earned income also excludes amounts received for services from prison inmates while in prison and amounts received for service performed in work activities and from certain community service programs under the federal temporary assistance for needy families (TANF) program. Participants in the Wisconsin Works (W-2) program who are in unsubsidized employment and subsidized jobs are paid a wage, which is counted as earned income under the EITC. In contrast, the W-2 program also provides cash grants to community service job and transitional placement participants, which are not considered earned income under the credit.

Prior to 2002, earned income had included the following nontaxable items in addition to the components of earned income under current law: voluntary salary deferrals, mandatory contributions to a state or local retirement plan, nontaxable combat zone compensation and military allowances, meals and lodging provided by an employer, housing allowances or rental value of parsonage for the clergy, employer-provided dependent care and adoption benefits, and educational assistance benefits. EGTRRA provided that these items are excluded from earned income. However, the Working Families Tax Relief Act of 2004 provided that a claimant of the EITC could choose to either include in, or exclude from, earned income combat pay that is excluded from gross income for tax purposes. Initially, this provision applied for taxable years ending after October 4, 2004, and before January 1, 2006, but the federal Heroes Earnings Assistance and Relief Act has extended the treatment to apply permanently.

AGI Measure. If a claimant's income exceeds the phase-out income amount, then the greater of AGI or earned income is used to calculate the credit. Prior to 2002, if a claimant's income exceeded the phase-out income level, then the credit amount was based on the greater of earned income and a modified AGI measure.

The modified AGI figure used under prior law required adding back the following amounts to AGI: (a) net capital losses if greater than zero; (b) net losses from trusts and estates; (c) net losses from nonbusiness rents and royalties; (d) 75% (50% before 1998) of net losses from business (unless the loss was from the performance of services as an employee); and (e) tax-exempt interest and nontaxable distributions from pensions, annuities, and IRAs (beginning in 1998).

The current use of AGI rather than modified AGI is the same method that was in place prior to 1996.

Disqualified Income. Beginning with tax year 1996, the credit is denied to individuals having disqualified income in excess of a certain limit. The disqualified income limit is $3,100 for 2010 and is adjusted each year for inflation. Disqualified income is defined as taxable and nontaxable interest income, dividends, net income from nonbusiness rents and royalties, capital gain net income, and net passive income (if greater than zero) that is not self-employment income.

In a ruling issued on November 23, 1998, the Internal Revenue Service (IRS) announced that gains realized on the sale of property used in a trade or business are not counted as investment income. Prior to the ruling, a number of individuals were unable to claim the EITC due to the limitation on disqualified income, particularly farmers who had income from the sale of livestock.

Non-Financial Criteria

In order to claim the federal EITC, an individual must either have a qualifying child or meet the following requirements: (a) not be the dependent or a qualifying child of another taxpayer; (b) be at least 25 years old and not more than 65 before the end of the tax year; and (c) have resided in the U.S. for more than half of the year. A qualifying child must meet all of the following conditions:

1. Relationship. A qualifying "child," for purposes of the EITC, may be a natural or adopted child, stepchild, sibling, or stepsibling of the claimant, or a descendant of any of these. In addition, a qualifying child may be the claimant's eligible foster child.

Prior to 2002, it was required that the child be the natural child, adopted child, grandchild, stepchild, or eligible foster child of the claimant. Brothers, sisters, nieces, and nephews could qualify as eligible foster children. Effective with 2002, brothers and sisters, including step- and half-siblings, along with their descendents are grouped as qualifying children rather than as eligible foster children.

2. Age. At the end of the year, the child must be: (a) under 19 years old; (b) a full-time student under the age of 24; or (c) any age and totally and permanently disabled. Unless the child is totally and permanently disabled, the child must be younger than the claimant.

3. Residence. The child must have lived with the taxpayer in the United States for more than six months during the year (prior to 2002, for the entire year if a foster child). A child who is born or dies during the year qualifies if the child lived with the claimant in the claimant's home during the entire part of the year the child was alive.

A qualifying child may not be used by more than one person to claim the EITC.

Required Returns

In order to receive the federal credit, claimants must file an income tax return (whether or not they would otherwise be required to file) and a separate earned income credit schedule that provides information on qualifying children. Individuals must provide the name and age of each child and the child's social security number.

Advance Payment

As of 1979, eligible credit recipients were permitted to receive the federal credit in advance, in their paychecks, rather than receiving the credit as a refund when they filed their federal tax return in the following year. Beginning in 2010, 2009 Wisconsin Act 28 permitted credit recipients to also receive their state credit in advance. However, the federal Education, Jobs, and Medicaid Assistance Act of 2010 eliminated advance receipt of the federal credit, as of January 1, 2011. Because state law sets advance payments of the state credit as a percentage of the advance payments of the federal credit, repeal of the federal advance payments effectively eliminated advance payments of state credits. The following material describes federal advance payment provisions prior to the repeal.

Employees with qualifying children who expect to qualify for the EITC could elect to receive payment of the federal credit in advance with their regular pay by filing a form with their employer (employees without children were not eligible for advance payment). Advance payment was made by the employer, based on tables provided by the IRS, out of the employee's withheld income tax and the social security payroll taxes of the employee and employer that would otherwise be remitted to the federal government. At the end of the year, the advance payments were reported on the employee's W-2 wage statement and entered as a tax due amount on the employee's income tax return. The full credit was then calculated without consideration of the advance payments. If the credit exceeded the advance payments, a refund was provided to the taxpayer. If the advance payments exceeded the credit, the claimant had to repay the difference.

Advance payment of the credit was limited to 60% of the maximum credit available to a claimant with one qualifying child. Due to the limitation, the maximum advance payment for tax year 2010 was $1,830 (60% of $3,050), or approximately $152 per month, regardless of family size. This provision was intended to prevent recipients of advance payments from incurring a large tax liability at the end of the year if their income had increased and they no longer qualified for the credit. The IRS was directed to notify eligible taxpayers of the advance payment provisions and employers were required to notify their employees about the availability of advance payments of the credit.

Historical data regarding the federal earned income credit is presented in Appendix 1.

State Earned Income Tax Credit

The state earned income tax credit is calculated as a percentage of the federal credit and is claimed on Wisconsin's individual income tax form. The credit is similar to the federal EITC in that it varies by income and family size. Appendix 2 outlines the history of the state earned income tax credit.

Table 4 shows the state credit percentages and maximum credit amounts for 2010. The percentages shown in the table apply for all tax years after 1996. However, the maximum credit amounts change each year as the federal credit structure changes due to indexing for inflation and federal law changes. Families without children and part-year residents are not eligible for the state EITC.

Table 4: 2010 State Credit Provisions

	One Child	Two Children	3 or More Children
Percentage of Federal Credit	4%	14%	43%
Maximum State Credit	$122	$705	$2,436

The 2010 state credits for claimants at various income levels are outlined in Tables 5 and 6. Table 5 shows the state credits by income level for single and head-of-household claimants, while Table 6 shows the credits by income levels for married-joint filers.

Table 5: 2010 State Credit Amounts
Single and Head-of-Household Filers

Earned Income	One Child	Two Children	3 or More Children
$0	$0	$0	$0
2,000	27	112	387
4,000	54	224	774
6,000	82	336	1,161
8,000	109	448	1,548
10,000	122	560	1,935
12,000	122	672	2,322
14,000	122	705	2,436
16,000	122	705	2,436
18,000	112	659	2,296
20,000	99	600	2,115
22,000	87	541	1,934
24,000	74	482	1,752
26,000	61	423	1,571
28,000	48	364	1,390
30,000	35	306	1,209
32,000	23	247	1,028
34,000	10	188	847
36,000	0	129	666
38,000	0	70	485
40,000	0	11	304
42,000	0	0	122
44,000	0	0	0

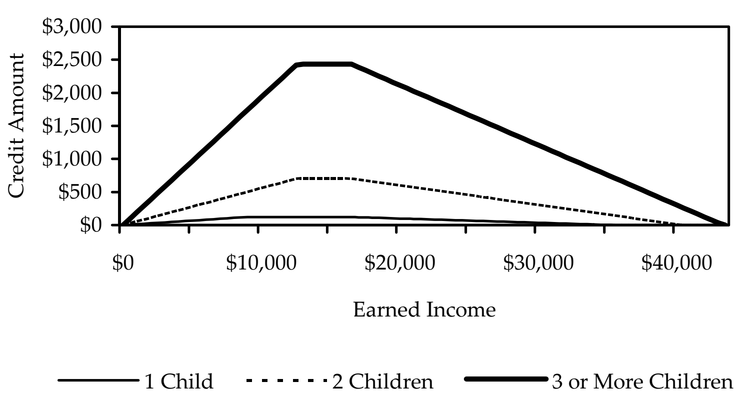
The family size adjustment is significantly greater at the state level than under federal law. The maximum state credit for families with three or more children is nearly 20 times the maximum one-child credit and the maximum credit for two children is nearly six times the one-child credit. At the federal level, the maximum credit for three or more children is only 1.86 times the maximum one-child credit.

Table 6: 2010 State Credit Amounts Married-Joint Filers

Earned Income	One Child	Two Children	3 or More Children
$0	$0	$0	$0
2,000	27	112	387
4,000	54	224	774
6,000	82	336	1,161
8,000	109	448	1,548
10,000	122	560	1,935
12,000	122	672	2,322
14,000	122	705	2,436
16,000	122	705	2,436
18,000	122	705	2,436
20,000	122	705	2,436
22,000	119	689	2,387
24,000	106	630	2,206
26,000	93	571	2,025
28,000	80	512	1,844
30,000	67	453	1,663
32,000	55	394	1,482
34,000	42	335	1,301
36,000	29	276	1,119
38,000	16	217	938
40,000	3	158	757
42,000	0	99	576
44,000	0	40	395
46,000	0	0	214
48,000	0	0	33
50,000	0	0	0

Because the state credit is calculated as a percentage of the federal credit, the state earned income credit exhibits the same pattern as that seen for the federal credit. For families with one child, the credit increases until income reaches $8,970, the credit levels off at the maximum amount ($122) until income reaches $16,450 ($21,460 for joint filers) and then decreases until it reaches zero at income of $35,535 or more ($40,545 or more for joint filers).

Figure 2: 2010 State Earned Income Tax Credit Single and Head-of-Household



These characteristics are depicted in Figure 2, which shows the state earned income tax credit for 2010 for claimants other than married-joint filers. The pattern for married-joint filers would be identical to that shown in Figure 2, except that the phase-out income and maximum income levels would exceed those shown in Figure 2 by $5,010.

Wisconsin Program Expenditures

The state earned income tax credit is currently paid from two sources: (a) a sum sufficient, general purpose revenue (GPR) appropriation; and (b) federal funding from the temporary assistance for needy families (TANF) program.

TANF funding was first used to cover a portion of the cost of the EITC in the 1998-99 fiscal year, when it became clear that federal regulations permitted the use of TANF funds for this purpose. According to federal regulations for the TANF program, TANF funding may be used to cover the share of the EITC that is refunded to the claimant (rather than used to reduce the claimant's income tax liability). However, TANF funds may not be used to provide the credit to certain legal immigrants. Based on the federal requirements and on past experience with refundable credits, and allowing for amounts paid to legal immigrants, it had been estimated that slightly more than 80% of EITC costs could be paid with TANF funds. Table 7 reports the EITC funding mix by fiscal year and reveals that the share of the credit funded by TANF ranged between 75.4% and 80.8% in the six-year period between 1999-00 and 2004-05. As expenditures for other programs receiving TANF funding have grown, the use of TANF funding has shifted to those programs from the EITC. As a result, the percentage of EITC expenditures funded through TANF began to decline in 2005-06 and equaled 20% in 2009-10.

Table 7 shows historical state EITC payments by fiscal year. Between 1999-00 and 2009-10, total EITC payments increased 116.1%. Year-to-year increases vary considerably, ranging from lows of 1.5% in 2001-02 and 2003-04 to highs of 14.7% in 2002-03 and 31.8% in 2009-10. Similar factors likely contributed to the increases in both 2002-03 and 2009-10. Most important were federal law changes. Law changes effective with tax years 2002 and 2009 increased the phase-out thresholds for married-joint filers, thereby increasing the range of income over which claimants were eligible for the EITC. In addition, the definition of earned income was changed in 2002. For 2009, a third tier was created at the federal level for families with three or more children. Even though Wisconsin already offered a credit for those families, any expansion of the federal credit automatically increases state tax credit payments because the state credit is set as a percentage of the federal credit.

Table 7: Historical Wisconsin EITC Expenditures ($ in Millions)

Fiscal Year	GPR	TANF	Total	% Change	% TANF
1999-00*	$11.5	$48.3	$59.8	-1.0%	80.8%
2000-01	11.9	49.9	61.8	3.3	80.7
2001-02	11.5	51.2	62.7	1.5	81.7
2002-03	17.7	54.2	71.9	14.7	75.4
2003-04	15.1	57.9	73.0	1.5	79.3
2004-05	18.0	59.5	77.5	6.2	76.8
2005-06	28.8	53.2	82.0	5.8	64.9
2006-07	59.9	25.2	85.1	3.8	29.6
2007-08	71.5	21.1	92.6	8.8	22.8
2008-09	91.3	6.7	98.0	5.8	6.8
2009-10	103.3	25.9	129.2	31.8	20.0

*During 1999-00, $51.0 million in TANF funding was budgeted and expended for the EITC. However, an adjustment was made in 2000-01 to reduce the total TANF amount for 1999-00 to $48.3 million to comply with federal requirements.

A less significant factor was a weaker economy, under which some Wisconsin residents would have earned less income than in prior years, making them eligible for the EITC even if they had not been eligible previously. The effect of these factors is also illustrated in Table 8, but for tax years 2002 and 2009. The table reports, by tax year, the number of EITC claimants, total credit amounts, and the average EITC since 1999.

Table 8: Historical Wisconsin EITC Claimants

Tax Year	Count	% Change	Amount (Millions)	% Change	Average	% Change
1999	185,442	-1.9%	$59.1	-1.3%	$318	0.3%
2000	185,499	0.0	59.1	0.0	318	0.0
2001	189,586	2.2	60.3	2.0	318	0.0
2002	210,624	11.1	69.0	14.4	328	3.1
2003	214,164	1.7	69.8	1.2	326	-0.6
2004	216,707	1.2	73.5	5.3	339	4.1
2005	223,518	3.1	78.8	7.2	353	3.9
2006	227,497	1.8	83.2	5.6	366	3.7
2007	236,691	4.0	89.5	7.6	378	3.4
2008	243,131	2.7	95.8	7.0	394	4.2
2009	273,939	12.7	127.9	33.5	467	18.5

Table 9 presents the distribution of the state earned income credit for tax year 2009 by Wisconsin adjusted gross income. The table shows 273,939 families claimed $127.9 million under the state earned income tax credit in 2009. Just under half of the total credit for 2009 was received by households with income above $20,000; 45.3% of the total benefit went to the 50.4% of claimants in this range of income. Claimants with AGI under $10,000 received 14.8% of the benefit and made up 21.2% of the credit recipients, while the remaining 39.9% of the benefit was received by the 28.4% of claimants with AGI of $10,000 to $20,000.

Table 10 shows the distribution of the 2009 state credits by number of children. The table illustrates how the state credit is targeted to families with three or more children. These households made up 20.1% of the claimants, but received 62.5% of the program's benefits in 2009. In contrast, families with one qualifying child accounted for 47.1% of the claimants, but received 7.9% of the benefits.

Table 9: State Earned Income Tax Credit in 2009 by Adjusted Gross Income

Adjusted Gross Income Amount	Count	Percent of Count	Credit Amount	Percent of Amount	Average Credit
Under $5,000	24,252	8.8%	$5,826,015	4.6%	$240
5,000-10,000	33,918	12.4	13,016,614	10.2	384
10,000-15,000	39,238	14.3	25,484,145	19.9	649
15,000-20,000	38,505	14.1	25,553,243	20.0	664
20,000-25,000	38,543	14.1	21,911,902	17.1	569
25,000 or more	99,483	36.3	36,076,320	28.2	363
Total	273,939	100.0%	$127,868,239	100.0%	$467

Source: 2009 Individual Income Tax Aggregate Data

Table 10: State Earned Income Tax Credit in 2009 by Number of Children

Number of Children	Count	Percent of Count	Credit Amount	Percent of Amount	Average Credit
One	129,001	47.1%	$10,118,293	7.9%	$78
Two	89,994	32.8	37,801,630	29.6	420
Three or more	54,944	20.1	79,948,316	62.5	1,455
Total	273,939	100.0%	$127,868,239	100.0%	$467

Source: 2009 Individual Income Tax Aggregate Data

The average credit was $78 for claimants with one child, $420 for two children, and $1,455 for three or more children.

The total credit amounts shown in Tables 8, 9, and 10 differ from the amount in Table 7 because Tables 8, 9, and 10 reflect tax year aggregate data and Table 7 shows fiscal year data.

Policy Considerations

Prior to 1975, assistance to the poor was directed primarily to those who did not have income from work--the elderly, the disabled, and children in families with an absent parent. The earned income credit provides assistance to the working poor through a refundable tax credit that acts as a wage supplement.

At the federal level, the earned income tax credit was originally established as a "work bonus" and was rationalized, in part, as a means of offsetting the impact of the social security tax on low-income families. An additional goal was to increase the incentive to work for such families and lessen the inequities between the working poor and recipients of other categorical aid programs such as aid to families with dependent children (now TANF). Further, by reducing the tax burden of low-income persons, the progressivity of the income tax structure was increased.

In the last half of the 1990s, revisions were made to the federal credit in an attempt to ensure that the credit was directed to lower-income families. Starting with tax year 1996, the disqualified income test was instituted, as was the modification to AGI for purposes of calculating the credit in the phase-out range of income. Effective with the 1998 tax year, the definition of earned income was expanded to include tax-exempt interest and nontaxable distributions from pensions, annuities, and IRAs. However, as described in this paper under "Income Used in Determining the Credit," the modifications to AGI for purposes of calculating the credit and the inclusion of nontaxable income as earned income have been eliminated in order to simplify the credit calculation.

At the state level, the earned income credit provides income tax relief to low-income families in a manner that is less costly than increasing the standard deduction or personal exemptions--provisions that could provide a benefit to taxpayers at higher income levels. Also, because it is refundable, the state credit can be viewed as an offset to state and local sales and property taxes. As noted, the state credit incorporates a proportionately greater family size adjustment than the federal provisions.

Other methods to assist the working poor include education and job training, increases in the minimum wage, subsidized child care for low-income workers, and direct grants. The earned income credit is believed to possess several advantages over these programs. First, funding is targeted directly to those in need of assistance. In addition, administrative efficiency is achieved through the use of the existing income tax system. Finally, the credit's association with the tax system may lessen any stigma associated with traditional welfare-type grant programs.

However, there are a number of criticisms of the earned income credit. First, it is argued that appropriate job training and greater employment opportunities are more important factors in promoting the employment of low-income individuals. In addition, the federal and state credits do not directly account for other wealth of the claimant or non-taxed income. Further, higher benefit amounts require a greater phase-out rate in order to exclude higher-income families from eligibility. This results in a higher effective marginal tax rate on recipients within the phase-out income range and may provide a disincentive to earn additional income from wages or self-employment.

It is also argued that the credit may discourage marriage in certain situations. For example, two unmarried individuals might each qualify for the credit if their incomes were considered separately yet not qualify if their incomes were combined on a joint tax return. As noted, the phase-out ranges for joint filers have been increased over those for single individuals, which reduces, but does not eliminate, this aspect of the marriage penalty.

Another aspect of the marriage penalty is the way in which the size of the EITC varies with the number of dependent children. Except for the temporary increase authorized for 2009 through 2012, the federal EITC has not increased when a filer has more than two dependent children, so a marriage that creates a family with more than two children may have resulted in a lower EITC than if the individuals had remained unmarried. (The same would be true with the state EITC if a combined family resulted in more than three dependent children).

Noncompliance (inappropriately claimed credits) has also been a significant problem with the federal credit. In order to address noncompliance, federal law now requires claimants to provide social security numbers for themselves and their children when filing for the credit. This is intended to reduce fraudulent claims by individuals who do not have qualifying children and individuals who are not authorized to work in the U.S.

APPENDIX 1

Federal Earned Income Tax Credit History

A. Tax Years 1975 Through 1990	1975-1978	1979-1984	1985-1986	1987	1988	1989	1990
Credit Percentage	10.00%	10.00%	11.00%	14.00%	14.00%	14.00%	14.00%
Maximum Credit Income	$4,000	$5,000	$5,000	$6,075	$6,225	$6,500	$6,810
Maximum Credit	400	500	550	851	874	910	953
Phase-Out Income Threshold	4,000	6,000	6,500	6,925	9,850	10,250	10,730
Maximum Income	8,000	10,000	11,000	15,432	18,576	19,340	20,264
Phase-Out Rate	10.00%	12.50%	12.22%	10.00%	10.00%	10.00%	10.00%

	1991				1992				1993			
	Basic Credit		Supplemental Credits		Basic Credit		Supplemental Credits		Basic Credit		Supplemental Credits	
B. Tax Years 1991 Through 1993	One Child	2 or More Children	Young Child	Health Insurance	One Child	2 or More Children	Young Child	Health Insurance	One Child	2 or More Children	Young Child	Health Insurance
Credit Percentage	16.70%	17.30%	5.00%	6.00%	17.60%	18.40%	5.00%	6.00%	18.50%	19.50%	5.00%	6.00%
Maximum Credit Income	$7,140	$7,140	$7,140	$7,140	$7,520	$7,520	$7,520	$7,520	$7,750	$7,750	$7,750	$7,750
Maximum Credit	1,192	1,235	357	428	1,324	1,384	376	451	1,434	1,511	388	465
Phase-Out Income Threshold	11,250	11,250	11,250	11,250	11,840	11,840	11,840	11,840	12,200	12,200	12,200	12,200
Maximum Income	21,250	21,250	21,250	21,250	22,370	22,370	22,370	22,370	23,050	23,050	23,050	23,050
Phase-Out Rate	11.93%	12.36%	3.57%	4.29%	12.57%	13.14%	3.57%	4.29%	13.22%	13.93%	3.58%	4.29%

APPENDIX 1 (continued)

Federal Earned Income Tax Credit History

C. Tax Years 1994 Through 2008	No Children	One Child	2 or More Children	No Children	One Child	2 or More Children	No Children	One Child	2 or More Children
		1994			1995			1996	
Credit Percentage	7.65%	26.30%	30.00%	7.65%	34.00%	36.00%	7.65%	34.00%	40.00%
Maximum Credit Income	$4,000	$7,750	$8,425	$4,100	$6,160	$8,640	$4,220	$6,330	$8,890
Maximum Credit	306	2,038	2,528	314	2,094	3,110	323	2,152	3,556
Phase-Out Income Threshold	5,000	11,000	11,000	5,135	11,290	11,290	5,280	11,610	11,610
Maximum Income	9,000	23,760	25,300	9,230	24,396	26,673	9,500	25,078	28,495
Phase-Out Rate	7.65%	15.98%	17.68	7.65%	15.98%	20.22%	7.65%	15.98%	21.06%
		1997			1998			1999	
Credit Percentage	7.65%	34.00%	40.00%	7.65%	34.00%	40.00%	7.65%	34.00%	40.00%
Maximum Credit Income	$4,340	$6,510	$9,140	$4,460	$6,680	$9,390	$4,530	$6,800	$9,540
Maximum Credit	332	2,210	3,656	341	2,271	3,756	347	2,312	3,816
Phase-Out Income Threshold	5,430	11,930	11,930	5,570	12,260	12,260	5,670	12,460	12,460
Maximum Income	9,770	25,760	29,290	10,030	26,473	30,095	10,200	26,928	30,580
Phase-Out Rate	7.65%	15.98%	21.06	7.65%	15.98%	21.06%	7.65%	15.98%	21.06%
		2000			2001			2002*	
Credit Percentage	7.65%	34.00%	40.00%	7.65%	34.00%	40.00%	7.65%	34.00%	40.00%
Maximum Credit Income	$4,610	$6,920	$9,720	$4,760	$7,140	$10,020	$4,910	$7,370	$10,350
Maximum Credit	353	2,353	3,888	364	2,428	4,008	376	2,506	4,140
Phase-Out Income Threshold	5,770	12,690	12,690	5,950	13,090	13,090	6,150	13,520	13,520
Maximum Income	10,380	27,413	31,152	10,710	28,281	32,121	11,060	29,201	33,178
Phase-Out Rate	7.65%	15.98%	21.06%	7.65%	15.98%	21.06%	7.65%	15.98%	21.06%
		2003*			2004*			2005*	
Credit Percentage	7.65%	34.00%	40.00%	7.65%	34.00%	40.00%	7.65%	34.00%	40.00%
Maximum Credit Income	$4,990	$7,490	$10,510	$5,100	$7,660	$10,750	$5,220	$7,830	$11,000
Maximum Credit	382	2,547	4,204	390	2,604	4,300	399	2,662	4,400
Phase-Out Income Threshold	6,240	13,730	13,730	6,390	14,040	14,040	6,530	14,370	14,370
Maximum Income	11,230	29,666	33,692	11,490	30,338	34,458	11,750	31,030	35,263
Phase-Out Rate	7.65%	15.98%	21.06%	7.65%	15.98%	21.06%	7.65%	15.98%	21.06%
		2006*			2007*			2008*	
Credit Percentage	7.65%	34.00%	40.00%	7.65%	34.00%	40.00%	7.65%	34.00%	40.00%
Maximum Credit Income	$5,380	$8,080	$11,340	$5,590	$8,390	$11,790	$5,720	$8,580	$12,060
Maximum Credit	412	2,747	4,536	428	2,853	4,716	438	2,917	4,824
Phase-Out Income Threshold	6,740	14,810	14,810	7,000	15,390	15,390	7,160	15,740	15,740
Maximum Income	12,120	32,001	36,348	12,590	33,241	37,783	12,880	33,995	38,646
Phase-Out Rate	7.65%	15.98%	21.06%	7.65%	15.98%	21.06%	7.65%	15.98%	21.06%

D. Tax Years 2009 and 2010	2009* No Children	2009* One Child	2009* Two Children	2009* 3 or More Children	2010* No Children	2010* One Child	2010* Two Children	2010* 3 or More Children
Credit Percentage	7.65%	34.00%	40.00%	45.00%	7.65%	34.00%	40.00%	45.00%
Maximum Credit Income	$5,970	$8,950	$12,570	$12,570	$5,980	$8,970	$12,590	$12,590
Maximum Credit	457	3,043	5,028	5,657	457	3,050	5,036	5,666
Phase-Out Income Threshold	7,470	16,420	16,420	16,420	7,480	16,450	16,450	16,450
Maximum Income	13,440	35,463	40,295	43,279	13,460	35,535	40,363	43,352
Phase-Out Rate	7.65%	15.98%	21.06%	21.06%	7.65%	15.98%	21.06%	21.06%

* For married-joint filers, the phase-out income thresholds and maximum income levels exceed those shown above by $1,000 from 2002 through 2005, $2,000 for 2006 and 2007, $3,000 for 2008, $5,000 for 2009, and $5,010 for 2010.

APPENDIX 2

State Earned Income Tax Credit History

Tax Years 1984-2010*

	1984	1985	1986-88	1989	1990	1991	1992	1993	1995	1996	1997	1998
Percentage of Federal Credit												
One Child	30%	30%	None	5%	5%	5%	5%	5%	4%	4%	4%	4%
Two Children	30%	30%	None	25%	25%	25%	25%	25%	16%	14%	14%	14%
Three or More Children	30%	30%	None	75%	75%	75%	75%	75%	50%	43%	43%	43%
Maximum State Credit												
One Child	$150	$165	None	$46	$48	$60	$66	$72	$84	$86	$88	$91
Two Children	150	165	None	228	238	309	346	378	498	498	512	526
Three or More Children	150	165	None	683	715	926	1,038	1,133	1,555	1,529	1,572	1,615
Refundable	No	No	None	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Percentage of Federal Credit												
One Child	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%
Two Children	14%	14%	14%	14%	14%	14%	14%	14%	14%	14%	14%	14%
Three or More Children	43%	43%	43%	43%	43%	43%	43%	43%	43%	43%	43%	43%
Maximum State Credit												
One Child	$92	$94	$97	$100	$102	$104	$106	$110	$114	$117	$122	$122
Two Children	534	544	561	580	589	602	616	635	660	675	704	705
Three or More Children	1,641	1,672	1,723	1,780	1,808	1,849	1,892	1,950	2,028	2,074	2,432	2,436
Refundable	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Tax Year 1994*

	One Child	Two Children	3 or More Children
Credit Percentage	1.15%	6.25%	18.75%
Maximum Credit Income	$7,980	$7,980	$7,980
Maximum Credit	92	499	1,496
Phase-Out Income Threshold	12,570	12,570	12,570
Maximum Income	23,740	23,740	23,740
Phase-Out Rate	0.82%	4.47%	13.40%
Refundable	Yes	Yes	Yes

*The credit for tax years 1984 through 1993 and tax years 1995 and after is calculated as a percentage of the federal credit. In 1994, a stand-alone state credit was provided.