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Policy Insights

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Summary

- The federal Earned Income Tax Credit (EITC) is the most effective anti-poverty program for working, low-income families.
- Each year, 4 million Americans are lifted out of poverty by the EITC.
- The federal EITC injected $630 million into Kentucky's economy in 2005.
- 22 states and the District of Columbia supplement the federal EITC with some form of state EITC credit.
- In 2005, nearly 682,000 Kentuckians were below the federal poverty line.
- 62% of poor families in Kentucky contain at least one worker.
- A refundable state EITC could encourage more low-income Kentuckians to work and assist more than 360,000 working poor.

A State Earned Income Tax Credit

Issues and Options for Kentucky

by Erica Meade and James P. Ziliak, Ph.D.*

The Issue

The federal Earned Income Tax Credit (EITC) has proven to be the most effective anti-poverty program for working low-income families in the United States. Established in 1975 to offset payroll taxes and to provide a modest supplement to low wages, the EITC is now a $40 billion program serving over 20 million Americans. Over the past decade, 22 states and the District of Columbia have reformed their tax codes to include a state EITC to offset state income tax liability, provide an additional financial boost to low-income working families, and lift families out of poverty while also offering an incentive to work. In this policy brief we discuss some of the issues and options of a state EITC for Kentucky.

The EITC as an Anti-Poverty Program for Workers

Millions of Americans work in the labor force each year, and yet many remain in poverty despite their efforts at self sufficiency. Indeed, in 2005 there were over 7.5 million families in poverty, and over two-thirds of those families contain at least one worker.[1] This means living on an income of just

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1. http://www.census.gov/prod/2006pubs/p60-231.pdf

* Erica Meade is an undergraduate major in economics at the University of Kentucky. James P. Ziliak is director of the University of Kentucky Center for Poverty Research (UKCPR) and is the Carol Martin Gatton Endowed Chair in Microeconomics in the Department of Economics at the University of Kentucky.

over $16,000 for a family of three or about $20,000 for a family of four. Several programs in the social safety net are designed to assist low-income working families, including the Food Stamp Program and the Supplemental Children's Health Insurance Program (SCHIP), but the EITC is unique among anti-poverty programs in the social safety net both in that it is targeted exclusively to individuals with labor market earnings and that it is one of only a few refundable credits in the sprawling U.S. tax code.

The EITC was designed not only to offset the regressive nature of the payroll tax but also to provide an incentive to work among low income individuals, and evidence suggests that expansions in EITC parameters were a key reason for the large increase in labor force participation among single mothers in the mid-1990s.[2] Moreover, there is strong evidence that the EITC is an effective policy to lift working families out of poverty.[3] Each tax year upwards of 4 million Americans are lifted out of poverty by the EITC, and of those still remaining below the poverty line, hardship is reduced.[4]

How does the federal EITC work? EITC refunds are dependent upon the amount of labor-market earnings and adjusted gross income, as well as the number of qualifying children. The largest refunds go to poor working families with incomes slightly below the federal poverty line. The credit has three ranges: the so-called subsidy range where the value of the EITC increases as earnings rise, the plateau range where the maximum credit is obtained, and the phase-out range where the size of the credit diminishes with increases in earnings. For every dollar of earnings for a family with at least two qualifying children in 2007 the credit initially provides a subsidy of 40 cents on the dollar until earnings reach $11,790. At this point the maximum credit of $4,716 is obtained, and it remains at that level until earnings reach $15,389. The credit is then reduced by 21.06 cents for every dollar above $15,389 until it falls to zero when earnings reach $37,783. If the dollar value of the credit reduces the family's tax liability below zero, then the excess amount is refunded to the taxpayer. For instance, a family with a tax liability of $100 and an EITC of $700 would receive a refund of $600. In the 2006 tax year the average EITC refund amounted to just over $1,800 (http://www.irs-eitc.info/SPEC/).

However, upon reaching the plateau range, families receive no additional credit for additional earnings, and then receive a smaller percentage of each additional dollar as a credit in the phase-out range, and thus face reduced work incentives. Because of this, some individuals may be compelled to work less in order to maintain an income level within the plateau range, where the maximum credit is received. For example, a single mother with two children nearing the phase out earnings level of $15,390 may reduce her work hours to remain in the plateau range and qualify for the maximum credit of $4,716. The work disincentive tends to be more pronounced among married couples filing jointly where a dual income places them in the phase out range of the EITC. In such cases, one of the individuals is more likely to cut back on work hours in order to make the family eligible for a higher credit.[5] One possible policy solution to this "marriage penalty" is to base the EITC on individual earnings instead of family earnings, which would offset the negative incentive for secondary earners to leave the labor force. However, despite some possible negative work incentives in some ranges of the credit, the EITC

2. Meyer, Bruce and Dan Rosenbaum. 2001. "Welfare, the Earned Income Tax Credit, and the Labor Supply of Single Mothers." *Quarterly Journal of Economics* 116(3): 1063–1114.

3. Gundersen, Craig, and James P. Ziliak. 2004. "Poverty and Macroeconomic Performance across Space, Race, and Family Structure." *Demography* 41(1): 61–86. Hotz, V. Joseph, and John Karl Scholz. 2003. "The Earned Income Tax Credit." In *Means-Tested Transfer Programs in the United States*, R. Moffitt (ed.), Chicago: The University of Chicago Press and NBER, 141–197.

4. Ziliak, James P. 2003. "Filling the Poverty Gap, Then and Now." *University of Kentucky Center for Poverty Research Discussion Paper 2003-06*.

5. Eisa, Nada, and Hilary Hoynes. 2004. "Taxes and the Labor Market Participation of Married Couples: The Earned Income Tax Credit," *Journal of Public Economics*, (88:9-10): 1931-1958.

has been lauded across the political spectrum for aligning anti-poverty assistance with self sufficiency based upon work among the able bodied population.

The Case for a State EITC

In 2005, an estimated 681,850 Kentuckians lived below the poverty level, leading the state to have the ninth highest poverty rate in the nation at 16.8 percent. In 2007 dollars, that means living on an income of just over $16,000 for a family of three or about $21,000 for a family of four. In the same year, an estimated 22.5 percent of Kentucky's children lived in poverty, ranking the state 11th nationally. Of Kentucky's poor families, 62 percent include at least one working member. Furthermore, 41 percent of Kentucky's poor individuals over the age of 16 work (U.S. Census Bureau, 2005 American Community Survey). Thus, in spite of work, many Kentucky families face the daily hardship of poverty.

The federal EITC goes some way in helping families in Kentucky and across the nation escape from poverty; however, it does not lift all poor working families out of poverty, and thus many states have adopted a state EITC to further the anti-poverty gains of the federal credit. Similar to its federal counterpart, the state EITC complements Welfare-to-Work strategies through supporting families who enter and remain in the workforce. A combination of federal and state EITC has the potential to close the poverty gap for many welfare recipients and other low-income workers as they move into the workforce.

Whereas the federal EITC aims to offset the burden of payroll taxes — a burden that has grown over the past two decades and which now accounts for between 35 and 40 percent of all federal taxes — most state EITCs provide relief from income, sales, excise, and property taxes.[6,7] Sales and excise taxes provide vital revenue to states. Even so, for households with earnings less than $23,700, the most burdensome tax is that levied on expenditures where state and local sales and gross receipts taxes account for 32 cents of every dollar paid in taxes.[8] Indeed, Kentucky is one of the few states in which near poor families must pay income taxes. In 2006, Kentucky levied the highest income tax on families of four with incomes at 125% of the poverty line.[9] This occurs as a result of the quick phase out of the Commonwealth's family size tax credit just above the poverty threshold. Although the addition of the family size tax credit in 2005 more than tripled income tax thresholds and removed poor families from the income tax rolls, near-poor working families still face high income taxes.[10] State EITCs can offset state and local taxes, easing the tax burden on low-income households and, if made refundable, can lift more families out of poverty.

Issues in the Design of a State EITC

The federal EITC has proven to be an efficient mechanism for propelling individuals to work and lifting more working families out of poverty than any other government program. As a consequence, most of the states that have enacted EITCs piggyback the state credit onto the federal credit. This is cost effective because the established rules and eligibility

6. Mitrusi, Andrew and James Poterba. (2000). "The Distribution of Payroll and Income Tax Burdens, 1979–1999," *National Tax Journal* 53, 765–794.

7. Freidman, Joel, Isaac Shapiro, and Robert Greenstein. 2006. "Recent Tax and Income Trends Among High-Income Taxpayers. Center on Budget and Policy Priorities. <http://www.cbpp.org/4-10-06tax5.htm#_ftn3>

8. Chamberlain, Andrew and Gerald Prante. 2007. "Which Taxes Weigh Most Heavily on Americans with Different Incomes?" Fiscal Facts. Tax Foundation. <http://www.taxfoundation.org/news/show/22287.html>

9. According to the Center on Budget and Policy Priorities, a Kentucky family of four with an income at 125 percent of the poverty line ($25,769) had an income tax liability of $891—the highest in the nation for the year 2006. <http://www.cbpp.org/states/3-27-07sfp-fact-ky.pdf>

10. Center on Budget and Policy Priorities, The Impact of State Income Taxes on Low-Income Families in 2006. http://www.cbpp.org/3-27-07sfp.htm.

requirements of the federal program enable ease of administration at the state level and limit confusion for those claiming the credit. Still, states may choose to alter aspects of the federal program to better serve the needs of their residents. In general, states face five major issues is designing a state EITC: 1) the credit must be deemed refundable or non-refundable; 2) the rate must be set; 3) a target population must be chosen; 4) family size adjustments (if any) must be made; and 5) it must be determined whether the credit can be received in advance. The following discussion will sort through the five topics as well as the pros and cons of each option. Appendix 1 (page 9) summarizes the current plans adopted by the states.

Refundable vs. Non-refundable Credits

A refundable credit is one that allows a family to receive a refund check in instances where the credit amount is larger than a family's income tax liability. Such a credit allows families to take full advantage of the EITC even when they owe little or nothing in state income taxes, as is the case with most poor working families. As the name implies, a non-refundable credit can only offset taxes owed. That is, when the amount of the EITC exceeds a family's income tax liability, the portion of the credit exceeding the tax liability is forfeited. Consequently, families who owe little to nothing in state income taxes receive little to no benefit from a non-refundable EITC. A non-refundable credit does not have the potential to act as a wage supplement to earnings and, therefore, is not as effective in lifting families with below poverty wages out of poverty.

Tax filers who claim the refundable EITC often spend their refunds within their local communities to meet to meet short- to medium-term needs.[11] This spending creates a multiplier effect with the money put back into the local area, benefiting the community as a whole and producing economic activity that may reduce the cost to the state of providing the credit. While refundable credits are the more costly of the two types because refund checks are issued, most states (20 of the 23 states with an EITC) offer refundable credits because of the enhanced anti-poverty effectiveness and economic activity relative to non-refundable credits.[12]

The Credit Rate

When states set the percentage of the federal credit for EITCs a number of factors must be taken into account, including the level of desired tax relief, the desired level of income supplement if the credit is made refundable, and the attendant cost to the state. Refundable EITCs generally range from 5-35% of the federal credit, with an average rate of around 13%. Non-refundable credits range anywhere from 5-50% of the federal credit, with an average of about 20%. The higher non-refundable credit rate owes to the lower cost of the program because refund checks are not issued. A discussion of the estimated cost of a refundable state EITC for Kentucky follows.

The Target Population

The key issue regarding who qualifies for the state EITC is whether to include childless workers as part of the target population or to restrict it to families with qualifying children. Current federal law includes childless workers, and this group accounted for 22.9% of all recipients in 2006 (http://www.irs-eitc.info/SPEC/). The experience with currently established state EITCs is that workers without children generally receive small amounts from the credit, and many do not claim it because of the extra reporting requirements.[13] As a

11. Berube, Alan. 2006. "Using the Earned Income Tax Credit to Stimulate Local Economies." The Brookings Institution. <http://www3.brookings.edu/metro/pubs/Berube20061101eitc.pdf>

12. Louisiana became the 20th state with a refundable EITC in July 2007.

13. Nagel, Ami and Nicholas Johnson. 2006. "A Hand Up: How State Earned Income Tax Credits Help Working Families Escape Poverty in 2006." Center on Budget and Policy Priorities. http://www.cbpp.org/3-8-06sfp.htm.

result, the cost of including workers without children in state EITC is likely to be minimal. Still, workers without children who claim the credit do benefit from it, and thus it does function as a valuable anti-poverty program. Of the states (and DC) with EITCs, 20 of 23 offer a credit to individuals without children (Maryland, New Jersey, and Wisconsin are the exceptions).

Family-size Adjustments

The size of the federal EITC depends on whether the taxpayer has 0, 1, or 2 or more qualifying children. Most states with an EITC have instead chosen to set the credit at the same percentage of the federal credit for all family sizes. This approach is easier to administer, is less confusing among those claiming the credit, and also is the likely lower cost alternative for the state. The magnitude of the additional costs would be dependent upon the number of families in each size category who claim the credit.

At the same time, adjusting the state credit for family size may be desirable in light of the fact that the poverty rate among children in families with three or more children is more than double the poverty rate among children in smaller families. Proponents of increased family size distinction argue that the federal EITC alone cannot fully compensate for the higher cost of living among larger families. While the poverty line continues to increase with family size, the federal EITC does not distinguish between families with two or more children and those families with three or more children. The difference between the maximum credit benefit for a family with one child and family with two or more children is a little over $1,800. At the same time the poverty line for a family of four is about $4,000 higher than it is for a family of three. The belief is that adjusting a state EITC for family size beyond the federal guidelines can help larger low- and moderate-income families cover basic living expenses. Two states, Wisconsin and Minnesota, adjust their credits beyond the federally established guidelines.

Advanced Credit Option

A final issue when designing a state EITC is whether to allow the credit to be paid out over the course of the tax year or only as a lump-sum payment. Families receiving the federal EITC have the option of participating in the Advance Earned Income Tax Credit (AEITC) program that permits the taxpayer to collect installment payments of their EITC throughout the year. The AEITC amounts to no more than 60% of a family's maximum credit and is segmented into equal payments which are simply added to the affected employees' paychecks. Receiving the additional money on a regular basis has the potential to consistently help families in ways that the lump-sum EITC refund payment cannot, as a number of families receiving EITC struggle to make ends meet.[14] For instance, the supplementary funds may be used, to ensure that the electricity, water, and phone bills can be paid each month. Others may opt to spend the added income on groceries, clothing, or routine maintenance.

Even though the AEITC often offers a more steady form of assistance, nearly 99% of EITC filers continue to opt for the lump-sum payment. Why this occurs is not entirely understood, as it contradicts a number of standard models of economic behavior that suggest that a larger share of filers would choose the AEITC. One reason may be that individuals are concerned that they may be overpaid throughout the year and, thus, end up owing the IRS when taxes are filed. Another reason is that some potential recipients may fear being stigmatized by employers for receiving federal aid, given that the AEITC must be received through normal payroll provided by the employer. Finally, most recipients may view the EITC as a forced savings mechanism to make large purchases such as a down payment on a car or new household appliances.

14. Romich, Jennifer L. and Thomas Wesiner. 2000. "How Families View and Use the EITC: The Case for Lump-sum Delivery." *National Tax Journal* 53(4) (part 2) (December 2000): 1107-1134.

Expected Costs and Benefits

Generally, the cost of a state EITC is dependent upon how many residents claim the federal EITC credit, the percentage of the federal credit at which the state credit is set, whether or not the state credit is refundable, and how many recipients of the federal credit also claim the state credit. Data from the IRS and the Brookings Institution on the total value of federal EITC claims filed by Kentucky residents along with data on the total number of individual federal tax returns by Kentuckians presents a mechanism for estimating the cost of a refundable state EITC in Kentucky.[15]

Since 2003, the number of federal EITC claims by Kentuckians as a percentage of total returns from the state has remained constant at 20%. In 2004, 337,492 people claimed the federal EITC for a combined total benefit of $599.5 million.[16] The comparable figures in 2005 were 348,533 and a total benefit of $630 million.[17] This is a large injection of income into the state each year which creates significant economic activity and improves the fiscal health of the Commonwealth. Assuming that the number of EITC claims remains

15. Ideally we could present estimates on the cost of a non-refundable credit but we lack sufficient data to make such a comparison. Recall that a non-refundable credit reduces the tax liability to zero, and those with negative liabilities forfeit the extra amount in the case of non-refundable credits. Absent actual tax return data we do not have an estimate of the amount of credit dollars that would be forfeited by a non-refundable credit relative to a refundable credit, thus inhibiting our ability to provide accurate estimates of the cost of a non-refundable credit.

16. http://webapps.brookings.edu/eitc/

17. http://www.taxpolicycenter.org/TaxFacts/TFDB/TF-Template.cfm?Docid=364

Table 1: Estimated Cost of a Refundable State EITC in Kentucky

					Estimated cost of state EITC ($ millions)			
Tax year	Total KY Returns	Federal EITC claims	% EITC returns	Federal EITC claims ($ millions)	Set at 5% of federal	Set at 10% of federal	Set at 15% of federal	Set at 35% of federal
2003	1704147	338504	20	578.7	26.0	52.1	78.1	182.3
2004	1712401	337492	20	599.5	27.0	54.0	80.9	188.8
2005	1757500	348533	20	634.7	28.6	57.1	85.7	199.9
2006 (est)	1775075	355504	20	660.1	29.7	59.4	89.1	207.9
2007 (est)	1792826	362614	20	686.5	30.9	61.8	92.7	216.2
2008 (est)	1810754	369866	20	714.0	32.1	64.3	96.4	224.9

Table 2: Estimated EITC Benefits for Kentucky Families

Family size	Income where EITC is greatest	Break even point	Maximum federal credit	Maximum state credit (10% of federal)	Maximum state credit (15% of federal)
Single, no children (1)	$5,590-7,000	$12,590	$428	$43	$64
Joint, no children (2)	$5,590-9,000	$12,590	$428	$43	$64
Single, 1 child (2)	$8,390-15,390	$33,241	$2,853	$285	$428
Joint, 1 child (3)	$8,390-17,390	$33,241	$2,853	$285	$428
Single, 2+ children (3+)	$11,790-15,390	$37,783	$4,716	$472	$707
Joint, 2+ children (4+)	$11,790-17,390	$37,783	$4,716	$472	$707

Table 3: Estimated EITC Benefits for Kentucky Families by Income Levels in 2007

	Gross Earnings	Federal EITC	10% state EITC	15% state EITC
Family of four with two children				
Half-time minimum wage	$6,084	$2,434	$243	$365
Full-time minimum wage	$12,168	$4,716	$472	$707
Wages equal to federal poverty line	$20,444	$4,073	$407	$611
Wages equal to 150% of federal poverty line	$30,666	$1,920	$192	$288
Family of three with one child				
Half-time minimum wage	$6,084	$2,069	$207	$310
Full-time minimum wage	$12,168	$2,853	$285	$428
Wages equal to federal poverty line	$16,277	$2,853	$285	$428
Wages equal to 150% of federal poverty line	$24,341	$1,742	$174	$261

constant, approximately 362,614 Kentuckians will claim EITC in TY 2007. Multiplying the State's expected federal claims by the percentage at which the state credit is to be set provides an estimate of what a refundable state credit would cost Kentucky in a given fiscal year. Table 1 (page 6) provides a range of estimates for various tax years and credit rates for a refundable state EITC. As is often the case, not all recipients of federal EITC claim the state EITC; hence, we assume that 90% of federal EITC claimants file for a state EITC. For example, in 2007 it is estimated that Kentuckians will claim $686.5 million in federal EITC benefits. Thus, a state EITC set at 10% of the federal credit would yield state claims amounting to about $61.8 million.

In Table 2 (page 6) we present the estimated credit amounts in 2007 of a state EITC in Kentucky in terms of the maximum state EITC for each family size and filing status based on state rates set at 10 and 15% of the federal credit and an income level within the plateau range. As an example, a state EITC set at 15% of the federal credit would provide a maximum benefit of $707 to those families who have at least two qualifying children and earnings between $11,790 and $15,390. These figures apply whether the credit is made refundable or non-refundable.

In Table 3 (above), the federal and state EITC benefits are categorized according to family size and earnings level, ranging from half-time minimum wage to 150% of the poverty line. One can see that a full-time minimum wage worker receives the greatest benefit, which is currently the case under Kentucky's Family Size Tax Credit (FSTC). However, unlike the FSTC, the state EITC is potentially refundable and even families with incomes equal to 150% of the poverty threshold would qualify for tax relief in the form of an EITC between $260 and $290 with a state EITC benefit set at 15% of the federal credit.

Financing a State EITC

A number of alternatives exist for financing a state EITC, though most involve tapping the state's general fund. One option that has been adopted by several states consists of using federal funds from the Temporary Assistance for Needy Families (TANF) block grant. States began using surplus TANF funds to finance EITCs as welfare caseloads fell significantly in the late 1990s. Another similar mechanism is to consider state funds expended for an EITC as going toward meeting the "maintenance of effort" (MOE) required under TANF. Federal law stipulates that TANF and MOE funds may only be used to finance the

Table 4: Where does Kentucky's FSTC Phase out in Relation to the Poverty Threshold?

Family size	2006 poverty threshold	125%	150%	2006 KY income threshold for FSTC	125%	133% (FSTC phases out)	150%
1	$10,488	$13,110	$15,732	$9,800	$12,250	$13,034	$14,700
2	$13,500	$16,875	$20,250	$13,200	$16,500	$17,556	$19,800
3	$16,227	$20,284	$24,341	$16,600	$20,750	$22,078	$24,900
4	$20,444	$25,555	$30,666	$20,000	$25,000	$26,600	$30,000

refundable portion of a state EITC.

In a typical month in 2006 there were 69,928 TANF recipients in Kentucky, 53,109 of whom were children. The TANF block grant supporting this caseload was just over $181 million, and according to a 2006 Congressional Research Service Report to Congress, 38% of Kentucky's block grant went to providing basic cash assistance to needy families while 20% was transferred to the Child Care Development Fund (CCDF). The remaining 42% went toward funding work programs, child care, and miscellaneous other expenditures.[18] As TANF funds are committed to other purposes, the proposal of using the funds to finance an EITC has a real cost in terms of reduced services to TANF clients, and it grows less practical over time as inflation causes the real value of the federal TANF grant to decline. This form of redistribution from the poorest poor to the less poor is generally viewed as an undesirable reallocation of resources.

As an alternative to using TANF funds, states with refundable EITCs are financing them through additional sales tax revenue. When state EITCs are designed to offset increases in regressive taxes, additional revenue resulting from an increase in sales tax may be set aside and used to finance the EITC. Since the increase often occurs in the form of a higher sales tax, the initial tax increase may burden poor families. Though they receive the credit eventually, the increased sales and excise taxes present problems upon purchasing goods. However, using revenue which is purposefully generated for the EITC, eliminates the need to take TANF funds from those who are most destitute. Again, the practicality of the option comes down to costs and benefits. Questions to consider include: Will the additional tax revenue be enough to finance an EITC? Is it worth further straining already financially strapped families by raising sales tax to collect the additional revenue? How will residents react to a tax increase?

According to the 2006-2008 Budget of the Commonwealth, Kentucky will collect an estimated $8,609.7 million in tax revenue during the 2007 fiscal year. For the 2008 fiscal year, tax revenue is expected to increase to $8,902.3 million. Sales tax alone is estimated to contribute $2,832.6 million in FY 2007 and increase by 4.4% to $2,958.5 million in FY 2008. For FY 2007, a refundable state ETIC set at 15% of the federal credit is expected to cost $92.7 million, about 1% of the estimated total tax revenue for the year, which is a typical percentage outlay for states with refundable credits.

Family Size Tax Credit vs. an EITC

Kentucky's non-refundable family size tax credit (FSTC), the current income tax relief program for the poor, replaced the State's low income tax credit in 2005. The credit aims to provide income tax relief for individuals and married couples whose modified gross income is less than 133% of the threshold amount determined under KRS 141.066. Currently, that amount is set just below the federal poverty level established for each family unit size up to four.

Because the FSTC is not refundable it does not provide a wage supplement to low-income working families. Even so, FSTC provides significant benefits to those

18. CRS Report for Congress, January 23, 2007, Appendix B: Table B2, Table B4. <http://www.nationalaglawcenter.org/assets/crs/RL32760.pdf>

families with income levels at or below the poverty line, as their tax liabilities are often reduced to zero by the credit. However, for those families who have income levels that are at 125-150% of the poverty threshold, the FSTC offers little help in lowering their tax liabilities.

A refundable EITC has the potential to offer assistance to working families below the poverty line as well as to those working families who receive little to no relief from the FSTC. A family of four with two children and an earnings level of $14,000 currently receives an FSTC equal to 100% of its income tax liability, lowering the amount owed to zero. However, with a state EITC set at 15% of the federal credit, the family would receive a $680 credit. A family of four with two children and an earnings level at 125% of the poverty threshold ($25,555) is eligible for a FSTC equal to 20% of its income tax liability, lowering the approximate taxes owed to $946.[19] However, with a state EITC set at 15% of the federal credit, the same family would receive an EITC of $341, lowering the tax liability to about $840. While the family may still owe taxes, the amount with an EITC is significantly lower than the amount with the FSTC.

The quick phase out of Kentucky's FSTC just above the poverty threshold limits the number of poor working families that it can help. A single parent with two children and an income level equal to 150% of the poverty threshold ($24,363) makes too much money to qualify for the FSTC. Even so, with a state EITC set at 15% of the federal credit, a single working parent with at least two children would qualify for a state EITC of $379, lowering the family's approximate tax liability from $1,112 to $733.

Table 4 (page 8) compares the federal thresholds with Kentucky's thresholds at the levels of 125% and 150%. The phase out level of FSTC, 133% of the threshold amount, is just slightly above an income level of 125% above the federal poverty threshold. At an income level which is 150% of the poverty line, families of every size are no longer eligible for the FSTC. However, families with at least one qualifying child are eligible to receive an EITC with earned income levels at 150% of the poverty line.

Summary

The federal EITC, established in 1975, has proven to be the most effective antipoverty program to date for working families with dependent children. Much of its success stems from the expanded parameters of the credit in the 1990s that presented families with a strong incentive to work and file taxes. Despite its accomplishments, the federal EITC alone is not enough to eradicate poverty among many working families with very low incomes. Consequently, 22 states and the District of Columbia have enacted state EITCs to further the goals of the federal credit and enable more families to be lifted from lives of poverty. Piggybacking on the federal EITC's framework provides for ease of administration and understanding while leaving states the power to determine credit rates, eligibility requirements, family size adjustments, refundability, and advance payment options.

It is estimated that over 360,000 residents claiming the federal EITC could be helped by the introduction of an EITC in Kentucky. A credit that is made refundable will be more effective in eradicating poverty than a nonrefundable credit. Although a refundable state EITC is not a panacea for all forms that poverty takes among Kentuckians, the credit could effectively reduce financial hardship among many in the Commonwealth who remain poor even though they are employed.

19. Tax liability estimates were calculated based on a taxable income equal to the given earnings level minus the 2006 Kentucky standard deduction. The 2006 Kentucky Individual Income Tax Table provided the corresponding tax liabilities for the estimated taxable income. FSTC and EITC for 2006 were then subtracted from the tax liability estimates given in the table to arrive at the final post-credit estimates.

Summary of State EITC Plans

State	Refundable	Structure
Colorado	Refundable	10% of Federal EITC
Delaware	Non-Refundable	20% of Federal EITC
District of Columbia	Refundable	35% of Federal EITC
Illinois	Refundable	5% of Federal EITC
Indiana	Refundable	6% of Federal EITC
Iowa	Refundable	7% of Federal EITC
Kansas	Refundable	17% of Federal EITC
Louisiana	Refundable	3.5% of Federal EITC
Maine	Non-Refundable	5% of Federal EITC
Maryland	Refundable OR Non-Refundable	20% of Federal EITC for Refundable, 50% Non-Refundable
Massachusetts	Refundable	15% of Federal EITC
Michigan	Refundable	10% of Federal EITC in 2008, 20% in 2009 and after
Minnesota	Refundable	Based on Income, chldren, etc. Average 33% of Federal EITC
Nebraska	Refundable	8% of Federal EITC
New Jersey	Refundable	20% of Federal EITC if Income below $20,000
New Mexico	Refundable	8% of Federal EITC
New York	Refundable	30% of Federal EITC
Oklahoma	Refundable	5% of Federal EITC
Oregon	Refundable	5% of Federal EITC, Will Increase to 6% in 2008
Rhode Island	10% Refundable	25% of Federal EITC
Vermont	Refundable	32% of Federal EITC
Virginia	Non-Refundable	20% of Federal EITC
Wisconsin	Refundable	4% of Federal if 1 child, 14% if 2 children, 43% if 3 or more children

Source: http://www.stateeitc.com/

About the University of Kentucky Center for Poverty Research

The University of Kentucky Center for Poverty Research (UKCPR) was established in October 2002 as one of three federally designated Area Poverty Research Centers, with core funding from the Office of the Assistant Secretary for Planning and Evaluation (ASPE) in the U.S. Department of Health and Human Services. The UKCPR is a nonprofit and non-partisan academic research center housed in the Gatton College of Business & Economics, Department of Economics at the University of Kentucky. The opinions and conclusions in this brief do not necessarily represent those of the federal government or the University of Kentucky.

The Center's research mission is a multidisciplinary approach to the causes, consequences, and correlates of poverty and inequality, with a special emphasis on the southern United States. To learn more about the programs of the UKCPR please visit our Web site at http://www.ukcpr.org. If you would like to support the mission of UKCPR, offer comments on this publication, or make suggestions e-mail us at jspra2@uky.edu, or write UK Center for Poverty Research, 302D Mathews Building, Lexington, KY 40506-0047. Phone: (859) 257-7641.

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