



Earned Income Credit Improvement Brings Broad Economic Benefits

By Mitchell Cole, Sara Okos, and Michael J. Cassidy

Low-wage workers in Virginia have endured more than a decade of stagnant and declining wages, while also contending with the rising cost of food, housing, child care, and other household expenses, making it increasingly difficult for them to get by. Virginia lawmakers have a critical opportunity to help these working men and women meet their challenges by strengthening a key state income tax credit, at no direct expense to their employers.

A stronger Earned Income Credit (EIC) would give working families more resources to ensure they can get to their jobs, keep the lights and heat on, and put food on the table.

Virginia's EIC gives a modest boost to the work effort and earnings of working families across the commonwealth. One simple improvement to the credit would help it to do so much more, strengthening its benefits not only for Virginia's families, but also for the state's businesses and economy.

How to Improve the EIC

The Virginia EIC is based on the federal earned income tax credit (EITC), for which over half a million Virginians were eligible in 2011. The federal tax credit is the country's most successful anti-poverty tool for children, lifting over 3 million out of poverty each year. It's also good for businesses at tax time and the economy in the short and long run.

But the federal credit has one important feature that makes it so effective and that distinguishes it from Virginia's EIC: those who qualify for it can get a refund if the amount of their credit is greater than the income tax they owe, otherwise known as refundability.

In order to bring Virginia's EIC to its full potential in helping working families and our state's businesses, the state credit should also be made refundable.

Why Refundability Matters

Working families who don't owe income tax still pay a lot in other taxes, like payroll taxes and the federal gas tax. The federal EITC helps to reduce these and other federal taxes these families pay by providing a refund of their share of the tax credit. If that sounds like a giveaway, it isn't. It just recognizes that these taxes take a larger share of their income than that of the wealthiest households.

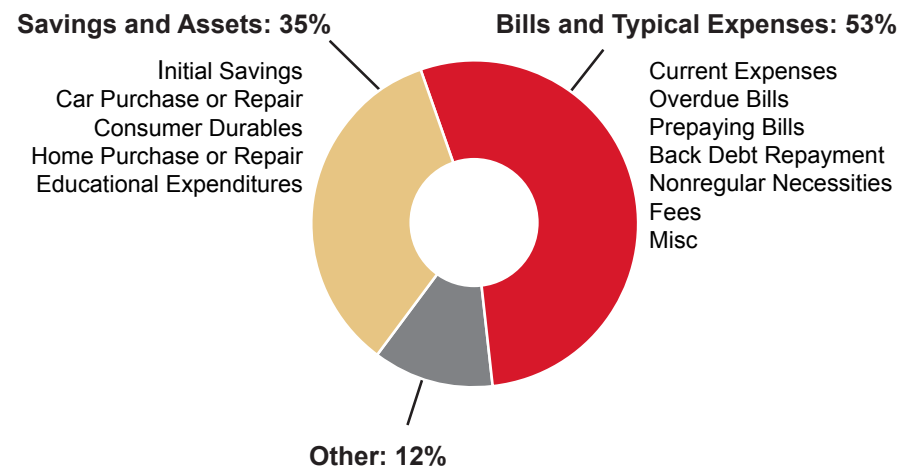
The same is true at the state level. Low-income working families in Virginia pay a larger share of their income in state and local taxes like sales and property taxes than wealthier households. And Virginia recently increased the statewide sales tax as part of the transportation funding package adopted in 2013. If Virginia's credit were refundable, it could help lower the substantial state taxes paid by working families with low earnings.

Making the credit refundable would dramatically enhance the difference the credit makes to these families. By lowering the state and local taxes paid by low-wage earning families in our state, we can help

Boosting Economic Security

Research shows that families receiving federal EITC refunds use those dollars to help make ends meet.

Use of Total EITC Refund Dollars by Category



Source: TCI analysis of "The Role of Earned Income Tax Credits in the Budgets of Low-Income Families," The National Poverty Center Working Paper Series, #10-05, June

them meet basic needs and give a boost to local businesses and local economies.

The Earned Income Credit Gets and Keeps People Working

The earned income credit can only be claimed by Virginians who work, and it is structured to encourage people to work more hours because the more a family earns, the bigger the size of the credit, up to a maximum amount. As income rises beyond the maximum, the amount of the credit is capped and then slowly phased-out for each additional dollar earned.

This boost in work effort is particularly strong among single mothers. In fact, research shows that, during the 1990s, the refundable federal credit was the most important factor in making it possible for more single mothers to go to work. On top of that, women who benefited from the federal EITC expansions experienced higher wage growth in later years than did otherwise similarly situated women.

Refunds Pay for Necessities and Help Build Assets

Research shows that refundable earned income credits help families meet their needs. More than half of families' refunds go toward paying their bills and other

basic household expenses, with the vast majority going toward overdue bills, debt repayment, or current expenses like electricity or telephone service.

In addition, a refundable EIC can give families financial security and allow them to build assets. More than a third of the typical family's federal credit is either socked away as savings or invested in assets. These investments – mostly in car and home repair or purchase, or education – are good for the economy and for employers because they help ensure that workers can continue to get to their jobs, have sturdy roofs over their heads, and are better positioned for future opportunities.

Stronger EIC, Stronger Poverty Relief, Stronger Economy

In addition to helping families make ends meet and contributing to the local economy, strengthening the EIC by making it refundable would increase its power as an effective tool to reduce poverty in Virginia with long-term economic benefits to Virginia families.

The federal EITC keeps over 6.5 million Americans out of poverty each year. It does that because it is refundable, effectively boosting the wages of very

low-income individuals and raising their income above the income thresholds that define poverty. In Virginia, the EITC, along with the Child Tax Credit – another credit helping low-income families offset the cost of raising kids – helped lift 165,000 Virginians out of poverty, 85,000 of them children.

Lifting families – especially kids – out of poverty has substantial economic benefit in the near and long term. Children living in families that receive these tax credits do better in school, avoid many of the disabilities associated with childhood poverty. And they earn higher incomes in adulthood compared to low-income non-recipients.

People who work hard should be able to support their families and stay out of poverty. Making the state EIC refundable would be a key improvement to making sure that people who are willing to work are able to make ends meet, provide for their families, keep up with their bills and give their kids a better chance at success.

A stronger Earned Income Credit (EIC) would give working families more resources to ensure they can get to their jobs, keep the lights and heat on, and put food on the table.

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