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## CT BUDGET CHOICES

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### **The Connecticut “Working Poor Family (EITC) Credit”: Key Facts**

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*A “poor working family credit” (also known as an Earned Income Tax Credit (EITC)) is an efficiently-targeted way to provide income supplementation to help low-wage working families escape poverty.....all of Connecticut’s neighboring states have adopted a state EITC based on the federal credit.*

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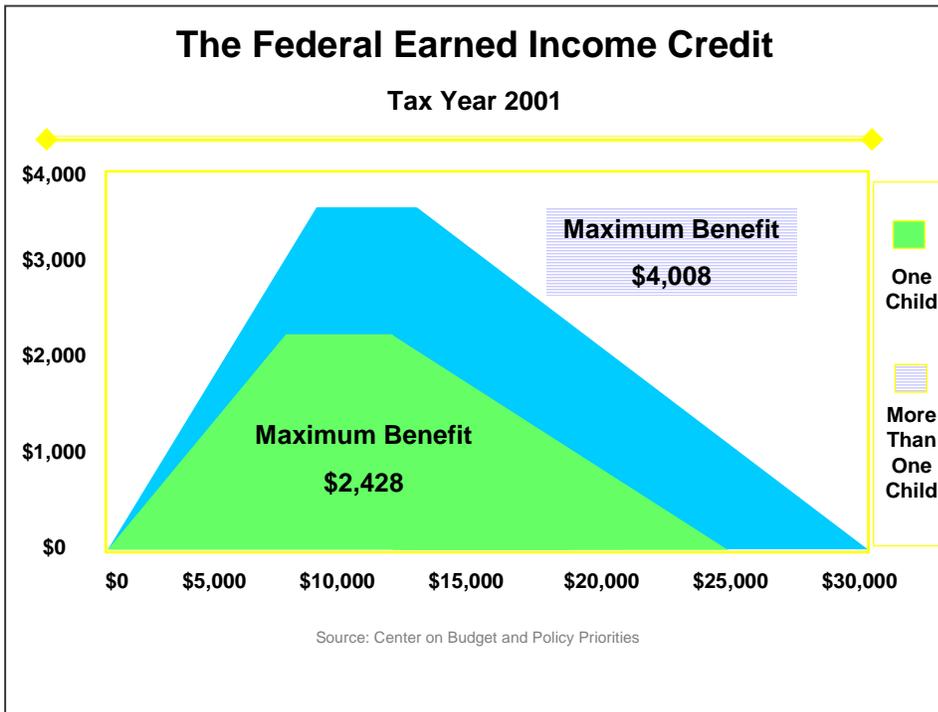
**What is the Connecticut Working Poor Family Credit?** The credit is a refundable credit against the state income tax. It reduces taxes and supplements wages for low-income working families. The credit piggybacks on the federal Earned Income Tax Credit (EITC), which has enjoyed broad bi-partisan support since enacted in 1975 during the presidency of Gerald Ford and expanded under the Reagan, Bush and Clinton administrations. In tax year 1999, the federal EITC helped about 141,000 Connecticut families, including thousands of poor children, and brought \$211 million dollars in federal funds into the pockets of Connecticut’s lower-income families. The credit rewards work and is an investment in the state’s less wealthy families, helping them provide their children with the chance for a healthy, secure childhood.

**Increasing numbers of states are passing working family credits.** Fifteen states – including NY, MA, RI, and VT -- have state EITCs that piggyback on the federal credit. In the 2000 legislative session alone, New Jersey, Maine, Illinois, and the District of Columbia enacted *new* EITCs, while Colorado, Maryland, Minnesota, New York, and Vermont substantially expanded their state EITCs. The National Governor’s Association notes:

The EIC has several positive features that make it an attractive vehicle for assisting low-income families. The wage supplement is credited with increasing labor participation rates for single parents whose incomes are in the phase-in range of the credit. The earnings supplement has also helped move families out of poverty. According to the U.S. Census Bureau, the EIC has moved 4.3 million people out of poverty – 2 million of them

children. Most families use the credit to provide basic necessities, such as buying food and clothing and paying bills. Many families use the credit to improve their social mobility, such as purchasing a car, paying college tuition, and improving their housing situation. [National Governors' Association Center for Best Practices, *Using State Tax Policy to Assist Low-Income Families*, 2000]

**How would a Connecticut Working Poor Family Credit work?** Only people who work and have earnings (i.e. “earned income”) in the targeted income range would qualify for the credit. The size of the credit varies, based on income and family size, but is set at some proportion of the federal credit. If a 10% credit were adopted in Connecticut, for tax year 2001 the maximum credit of \$401 would go to families with more than one child who are earning between \$10,020 and \$13,090/year. The credit phases out as income increases, with no credit for families with income greater than \$32,121. The maximum state credit for a family with one child would be \$243. The credit is *refundable*, which means that a family receives a check for the amount of the credit that is in excess of their tax liability.



**Why should Connecticut adopt a state EITC?**

- ◆ *An EITC rewards work.* The credit is only available to wage earners, and is well-targeted to provide its greatest support to families working at or near minimum wage.
- ◆ *An EITC helps working poor families raising children to reach economic self-sufficiency.* OPM’s *Self-Sufficiency Report* (1999) quantifies, for the first time, the added expenses parents face when raising children – for housing, child care, food, health care, education, and the like. For families with children, economic self-sufficiency requires a much higher annual income than for adults who are not raising children. For example, household expenses nearly

double for a single adult when that adult begins raising an infant (increasing, for example, from \$19,500/year to \$37,980/year in the Stamford-Norwalk region). Averaged across a child's lifetime, meeting a child's essential needs currently costs about \$8,000/year per child in the Hartford region and \$8,900/year in the Stamford-Norwalk region. However, despite these added costs, Connecticut's state income tax makes no adjustment for household size – there are no dependent exemptions, no credits for the costs of child-rearing. A state EITC would address this, and help families make ends meet.

- ◆ *An EITC would reduce the number of Connecticut children living in poverty.* Currently, about 12% of Connecticut children live in poverty (\$17,029 annual income for a family of four), up from 7% in 1989. The EITC acts as a wage supplement, increasing the family's available income. It has been found, at the federal level, to be the single most effective mechanism for lifting children out of poverty.
- ◆ *The EITC complements welfare reform.* The credit will help cushion the transition from cash assistance to economic self-sufficiency for families leaving welfare and smooth the current “benefits cliff” that exists, where families abruptly lose eligibility for certain benefits (such as food stamps) as their incomes increase.
- ◆ *The EITC makes Connecticut's tax code fairer.* Our poorest families pay almost twice the proportion of their income in state and local taxes as our most affluent families. While most of the families eligible for the EITC have no current state income tax liability, all pay sales and property taxes and yet have received no benefit from the income tax rebate *or* the increases in the property tax credit against the state income tax. The EITC helps to address this inequity. Also, because the credit is so well-targeted, it is a less expensive way to provide tax relief to low-income families than more broad-based tax changes, such as sales tax holidays.
- ◆ *The EITC helps Connecticut businesses.* Research on the federal EITC shows that the credit will be returned quickly to the Connecticut economy, as families with low income find themselves better able to pay their utility and rent bills, buy clothing for their children, and meet other essential needs.

### **What are the important elements of a Connecticut EITC?**

- ◆ *The credit must be refundable.* Because Connecticut's poorest families have no state income tax liability, the EITC must be refundable or it will not benefit those in greatest need.
- ◆ *The credit should consider family size.* Connecticut has a high cost of living and our tax code makes no adjustment for family size and the additional costs families raising children face. Families with more children have greater economic need; the credit should reflect this.

**Why should Connecticut give a refundable credit against the income tax when many of the state's poorer families do not pay any income tax?** While many of Connecticut's working poor families have incomes so low they have no state income tax liability, these families nonetheless pay a disproportionate share of their incomes in sales and property tax, and incur

many additional child-rearing expenses for which no accommodation is made in our state income tax by dependent exemptions or credits.

The General Assembly recently passed a law that allows small businesses to sell back certain research and development credits to the state and get a “cash payment that is equal to sixty-five per cent of the value of the credit.” [PA. 99-173, sec. 38). The law provides important financial help to smaller, start-up Connecticut companies that are making investments in research and development but which cannot take full advantage of R&D credits because *their* income is too low to have corporation business tax liability. The General Assembly understood that a *refundable* credit was the only way to provide these lower-income, high-expense companies with the same financial benefit that is currently provided to businesses with greater income who are incurring similar expenses.

Like start-up businesses, Connecticut’s lower-income working families are struggling to make ends meet. Like start-up businesses, they might have insufficient income tax liability to receive the financial benefit of tax credits. Yet, the capacity of these families to support their children and enable them to reach their full potential is an essential element of Connecticut’s workforce preparedness. Our state’s “new” workers for the next 20 years have all been born – and at this point about 1 in 8 of these children live in poverty, jeopardizing their health and educational success. A refundable credit for these families, like the refundable R&D credit for smaller, low-income businesses, is an important shared investment in the state’s continued economic prosperity.

**What would a Connecticut EITC cost?** A 25% EITC would cost approximately \$52 million (based on the amount claimed in 1999 for tax year 1998 by Connecticut residents claiming the federal EITC). A 10% credit would cost approximately \$20.8 million. However, the actual cost in the first years is likely to be less; only an estimated 85% of state taxpayers who claim the federal EITC will also claim a state EITC. Administrative costs are minimal since the credit piggybacks on the federal credit

Among states with a refundable state EITC, four set the credit at 10% of the federal credit (Colorado; Washington DC; Kansas; New Jersey, increasing to 20% of the federal credit by 2003), Maryland’s and Massachusetts’ credits are 15%, New York’s 22.5%, Minnesota’s 25%-45% (depending on earnings), Vermont’s 32%, and Wisconsin’s 4% (for one child), 14% (for two children), and 43% (three children).

**A CT EITC would NOT be subject to the state spending cap.** To the extent a state EITC reduces the amount of income tax due from a family who has state income tax liability, the EITC is clearly like any other tax expenditure -- the “cost” of the EITC is a revenue loss rather than an appropriated expenditure. In addition, based on the precedent set in the treatment of refundable R & D credits for businesses, the refundable portion of the EITC (that which exceeds the family’s income tax liability) is likewise an adjustment to revenue, rather than an appropriated expenditure.

Specifically, section 38 of PA 99-173 permits companies with sales of less than \$70 million in gross sales to sell back to the state at 65% of their value any unused Research and Experiment

and Research and Development tax credits. In its December, 1999 Connecticut Tax Expenditure Report, OFA characterizes the sale of these credits to the state as tax expenditures (p. 80), as – more recently -- has the Governor’s Proposed Budget for FY 2001-2003 (p. 34 of Budget Summary).

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