OREGON CENTER FOR PUBLIC POLICY

# EXECUTIVE SUMMARY

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*February 25, 2003*

## Making Ends Meet:
### Improving Oregon's Earned Income Credit

By John Lewis

Both the federal government and Oregon have Earned Income Credits (EICs). The federal EIC is a tax credit for low- and moderate-income workers, primarily families with children. It is designed to offset federal Social Security, and Medicare payroll taxes, to supplement earnings from work, and to help families make the transition from welfare to work.

**The federal Earned Income Credit is significant for Oregon's economy and its low-income workers.** The federal EIC brings $300 million to Oregon's economy and its low- and moderate-income workers. Over 12 percent of Oregon's taxpayers claimed the federal EIC in 2000 and the average claim was $1,538.

The federal EIC recognizes that work is not enough to lift families out of poverty. By providing a refund, even if a family owes no taxes, the federal EIC helps working families to make ends meet.

**Oregon's EIC would better help working families if it were refundable.** Currently Oregon's EIC, set at five percent of the federal EIC, is only available to the extent a taxpayer has tax liability. If it were refundable, thousands of very low-income families would have additional money to make ends meet. The Legislative Revenue office estimates that a five percent refundable EIC would cost approximately $8.3 million above the cost of the current credit in the 2003-05 biennium. Working Oregonians are not receiving $8.3 million because the current credit is non-refundable.

**Oregon could eliminate the income tax on families in poverty by increasing the EIC.** Oregon is one of a handful of states taxing the income of families well below poverty. Families with one or two children, single or two-parent, pay income taxes even if their incomes are below 90 percent of the federal poverty guidelines. Increasing the Oregon EIC to 12 percent of the federal EIC would eliminate state income taxes on most families with one or two children living below poverty. Increasing Oregon's EIC from five percent to 12 percent, and making it refundable, would cost Oregon approximately $45.3 million in the 2003-05 biennium.

Making the Oregon Earned Income Credit refundable, and expanding it to eliminate taxes on poor families with children, reflects Oregon's statutory goals that our tax system be based on "ability to pay," and that it shield genuine subsistence income from taxation.

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# Making Ends Meet:
## Improving Oregon's Earned Income Credit

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The federal Earned Income Credit (EIC) is a refundable tax credit for low- and moderate- income workers, primarily families with children. It is designed to offset federal Social Security and Medicare payroll taxes, to supplement earnings from work, and to help families make the transition from welfare to work. Congress created the credit in 1975 and it has since been expanded significantly. The EIC has been popular across the political spectrum; President Ronald Reagan referred to it as the best anti-poverty measure to come out of Congress, and in 1993 President Bill Clinton signed the largest expansion of the EIC in its history.[1]

The federal EIC recognizes that work is not enough to lift families out of poverty. In 1999-00 there were 57,200 poor families with children in Oregon, and in 82 percent of these families the parents worked more than 13 weeks during the previous year. On average, the parents in these families worked 44 weeks of the previous year, but still did not make enough income to rise above poverty.[2] From the late 1970s to the late 1990s, the poverty rate among working families with children in Oregon doubled. At the peak of Oregon's economic expansion, 11 percent of working families with children were poor, despite their work effort.

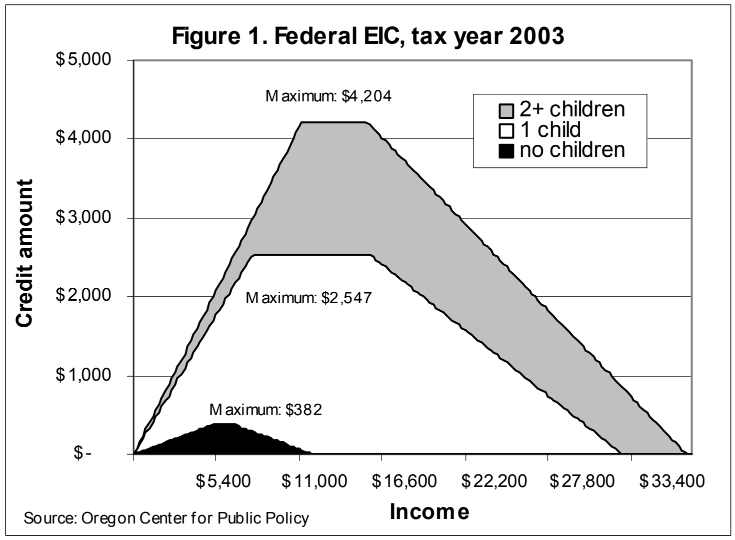
In 1997, the Oregon Legislature created the Oregon Earned Income Credit (Oregon EIC). Rather than create a unique structure, the Legislature chose to follow the path of 15 other states and link Oregon's credit to the rules of the federal Earned Income Credit. They set the credit equal to five percent of the federal credit. Unlike the federal credit, however, the state credit is non-refundable; filers may only claim the credit on taxes owed.

This paper discusses the value of the federal and state EICs in Oregon and explores two options for improving the state credit: making it refundable and increasing the rate to a level that would eliminate the income tax burden on most poor families with children.

## The federal Earned Income Credit explained.

The value of the federal EIC depends on the eligible family's earnings and on the number of children. For families with very low incomes, the value of the credit rises with earnings. When earnings reach a certain point, the value of the credit plateaus, ultimately falling to zero at the maximum earnings level.

For a family with two children (two parents, married filing jointly) the federal credit increases from $0 at no earnings to $4,204 with earnings of $10,510. It stays at that level until earnings reach $14,730, then the value of the credit decreases gradually to zero when earnings reach $34,692 (Figure 1). For unmarried families, the maximum earnings level and the highest earnings level to receive the maximum credit are $1,000 less than the limits for married families (Table 1).[3]




*The federal EIC is refundable.*

The federal Earned Income Credit is a *refundable* credit. Even if a family owes no income taxes, or owes less in income taxes than the credit is worth, the family will still receive the full credit. Take for example, Anna Mae, a single mother with one child. Anna Mae earns $20,000 in 2003. Anna Mae is eligible for a federal EIC of $1,545 and she owes $90 in federal income taxes. The EIC reduces her taxes to zero *and* she will receive the remaining $1,455 credit as a refund.

*The State EIC is not.*

**Table 1. Federal EIC, tax year 2003**

| | Number of Children | | |
|---|---|---|---|
| | **0** | **1** | **2+** |
| Families receive the maximum federal EIC when income reaches: | $4,990 | $7,490 | $10,510 |
| **Married** | | | |
| Families receive the maximum federal credit until income is over: | $7,240 | $14,730 | $14,730 |
| Maximum income to receive EIC: | $12,230 | $30,666 | $34,692 |
| **Unmarried** | | | |
| Families receive the maximum federal credit until income is over: | $6,240 | $13,730 | $13,730 |
| Maximum income to receive EIC: | $11,230 | $29,666 | $33,692 |
| **Maximum federal EIC:** | **$382** | **$2,547** | **$4,204** |
| Maximum Oregon EIC: | $19 | $127 | $210 |

Source: Oregon Center for Public Policy

The state credit follows the same income guidelines and the same eligibility rules as the federal credit. However, there are two key differences: the value of the state credit is equal to five percent of the federal credit (Table 1), and the state EIC is *non-refundable;* the value of the state EIC is subtracted from the taxpayer's tax liability and the taxpayer loses any remaining credit. For example, if Anna Mae earns only $9,000 in 2003, she would be eligible for a state EIC of $127 (five percent of the federal EIC). However, because she only owes $44 in state income taxes, she loses $83 of the credit's value. The lowest income Oregonians do not receive the full value of the state EIC because it is non-refundable.

## The EIC helps Oregon's economy.

The federal EIC is important for almost 200,000 low- and moderate-income families in Oregon and for Oregon's economy. For the 2001 tax year, the IRS estimates that the federal EIC returned over $300 million to Oregon.[4] Much of that likely was spent in the communities in which it was received, as EIC recipients—one out of eight taxpaying families—used their refunds to pay bills and buy essential items.

In 2000, 193,296 taxpayers in Oregon claimed the federal Earned Income Credit for an average credit of $1,538 (Table 2). The number of taxpayers claiming the credit has been falling slightly since 1997, likely reflecting the fact that lower-income workers were just beginning to see the effects of Oregon's booming economy. However, in the years ahead the number of taxpayers filing for the EIC will likely increase, as will the amount claimed, due to annual inflation and the softening of Oregon's economy. Preliminary data for the 2001 tax year show the number of returns claiming an EIC is already up by 4,000, and the amount claimed is over $300 million.[5]

*Every County Benefits from the EIC.*

Taxpayers in every county in Oregon receive the federal EIC. In 2000, in all but three Oregon counties, at least 10 percent of tax filers claimed the federal EIC.[6] In three-quarters of Oregon counties (27 out of 36), the percentage of filers who claimed the EIC was above the statewide average of 12.4 percent (Table 3). Malheur County in eastern Oregon has the highest EIC claim rate; over one-fifth (22 percent) of tax filers claimed the federal Earned Income Credit in 2000, while Washington County had the lowest participation rate: 7.9 percent of taxpayers (one out of 13) receive the federal EIC. Table 4 shows the percent of taxpayers who receive the federal EIC by legislative district.

**Table 2. State and federal tax credits in Oregon, tax years 1997-2000**

| | Tax Year | | | |
|---|---|---|---|---|
| **Federal Earned Income Credit** | **1997** | **1998** | **1999** | **2000** |
| **TOTAL Fed. Returns** | **1,501,235** | **1,522,027** | **1,533,824** | **1,562,323** |
| Claims | 204,819 | 202,177 | 194,030 | 193,296 |
| Amount (thousands) | $289,491 | $298,801 | $297,045 | $297,350 |
| Avg. Credit | $1,413 | $1,478 | $1,531 | $1,538 |
| Pcnt. Of Returns | 13.6% | 13.3% | 12.7% | 12.4% |
| **Oregon Earned Income Credit** | | | | |
| **TOTAL State Returns*** | **1,381,479** | **1,403,128** | **1,414,966** | **1,435,203** |
| Claims | 153,844 | 155,978 | 148,775 | 148,106 |
| Amount (thousands) | $9,575 | $10,056 | $9,771 | 9766 |
| Avg. Credit | $62 | $64 | $66 | $66 |
| Pcnt. Of Returns | 11.1% | 11.1% | 10.5% | 10.3% |

* Statistics are full-year Oregon resident returns only, representing about 90% of all returns. State source: Oregon Department of Revenue, "Oregon Personal Income Tax Annual Statistics," tax years 1997-2000. Federal source: IRS. Oregon Individual Income and Tax Data, by State and Size of Adjusted Gross Income, Tax Years 1997, 1998, 1999, 2000, Expanded Unpublished Versions.

**Table 3. Federal tax returns claiming the Earned Income Credit in Oregon; dollars returned to county economies, tax year 2000**

| County | Total Returns | Returns Claiming EIC | Percent claiming EIC | $ Returned to County |
|---|---|---|---|---|
| Baker | 6,854 | 1,075 | 15.7% | $1,653,350 |
| Benton | 31,234 | 2,489 | 8.0% | $3,828,082 |
| Clackamas | 147,594 | 12,117 | 8.2% | $18,635,946 |
| **Clatsop** | **15,056** | **1,977** | **13.1%** | $3,040,626 |
| **Columbia** | **19,576** | **2,001** | **10.2%** | $3,077,538 |
| **Coos** | **25,393** | **3,989** | **15.7%** | $6,135,082 |
| Crook | 7,560 | 1,078 | 14.3% | $1,657,964 |
| Curry | 9,793 | 1,373 | 14.0% | $2,111,674 |
| Deschutes | 54,956 | 6,636 | 12.1% | $10,206,168 |
| **Douglas** | **42,809** | **6,620** | **15.5%** | $10,181,560 |
| **Gilliam** | **847** | **85** | **10.0%** | $130,730 |
| **Grant** | **3,214** | **475** | **14.8%** | $730,550 |
| Harney | 3,140 | 551 | 17.5% | $847,438 |
| Hood River | 8,985 | 1,429 | 15.9% | $2,197,802 |
| Jackson | 80,866 | 12,270 | 15.2% | $18,871,260 |
| **Jefferson** | **8,909** | **1,693** | **19.0%** | $2,603,834 |
| **Josephine** | **31,987** | **5,787** | **18.1%** | $8,900,406 |
| **Klamath** | **26,277** | **4,634** | **17.6%** | $7,127,092 |
| Lake | 3,051 | 517 | 16.9% | $795,146 |
| Lane | 144,093 | 18,370 | 12.7% | $28,253,060 |
| Lincoln | 19,794 | 2,836 | 14.3% | $4,361,768 |
| **Linn** | **46,043** | **6,145** | **13.3%** | $9,451,010 |
| **Malheur** | **10,854** | **2,388** | **22.0%** | $3,672,744 |
| **Marion** | **119,091** | **17,609** | **14.8%** | $27,082,642 |
| Morrow | 4,099 | 697 | 17.0% | $1,071,986 |
| Multnomah | 319,308 | 36,164 | 11.3% | $55,620,232 |
| Polk | 25,561 | 2,979 | 11.7% | $4,581,702 |
| **Sherman** | **841** | **92** | **10.9%** | $141,496 |
| **Tillamook** | **10,817** | **1,506** | **13.9%** | $2,316,228 |
| **Umatilla** | **28,087** | **4,898** | **17.4%** | $7,533,124 |
| Union | 10,580 | 1,428 | 13.5% | $2,196,264 |
| Wallowa | 3,310 | 439 | 13.3% | $675,182 |
| Wasco | 9,905 | 1,538 | 15.5% | $2,365,444 |
| **Washington** | **209,921** | **16,612** | **7.9%** | $25,549,256 |
| **Wheeler** | **584** | **98** | **16.8%** | $150,724 |
| **Yamhill** | **34,447** | **4,374** | **12.7%** | $6,727,212 |
| **Statewide average, percent of returns claiming EIC: 12.4%**** | | | | |

*Based on an average 2000 EIC of $1,538. **Statewide average based on IRS Oregon Individual Income and Tax Data for Tax Year 2000, expanded unpublished verison. Source: OCPP analysis of IRS county & zip code data: "E-file Demographics" Tax Year 2000.

Every taxpayer claiming the federal Earned Income Credit is eligible to claim the Oregon EIC. However, because it is not refundable, not every taxpayer will be able to claim the Oregon EIC or will not claim it completely. Some Oregon taxpayers may not know about the Oregon credit or may forget to claim it. In 2000, only 148,106 Oregon taxpayers, or about 77 percent of the number who claimed the federal credit, claimed the state EIC.[7] Based on federal EIC claims, the average Oregon EIC should have been about $77, but the average state credit actually *claimed* was just $66 (Table 2). Moreover, because the credit is non-refundable, the average amount of credit actually *received* (the "tax benefit") in 2000 was just $46.[8]

**Table 4. Estimated number & percent of federal returns claiming the federal Earned Income Credit in 2000, by 2003 Oregon legislative district**

| House Dist. | Representative | Returns | Claiming EIC | % Claiming EIC | Senate Dist. | Senator | Returns | Claiming EIC | %Claiming EIC |
|---|---|---|---|---|---|---|---|---|---|
| 1 | Krieger | 24,523 | 3,816 | 15.6% | | | | | |
| 2 | Morgan | 23,718 | 3,557 | 15.0% | 1 | Fisher | 48,241 | 7,373 | 15.3% |
| **3** | **Anderson** | **22,001** | **4,051** | **18.4%** | | | | | |
| **4** | **Richardson** | **25,521** | **4,044** | **15.8%** | **2** | **Atkinson** | 47,522 | 8,095 | **17.0%** |
| 5 | Bates | 27,674 | 4,263 | 15.4% | | | | | |
| 6 | Patridge | 24,602 | 3,404 | 13.8% | 3 | Hannon | 52,276 | 7,667 | 14.7% |
| **7** | **Kruse** | **24,428** | **3,691** | **15.1%** | | | | | |
| **8** | **Prozanski** | **25,217** | **2,612** | **10.4%** | **4** | **Corcoran** | 49,645 | 6,303 | **12.7%** |
| 9 | Verger | 23,645 | 3,578 | 15.1% | | | | | |
| 10 | Brown | 25,900 | 3,702 | 14.3% | 5 | Messerle | 49,545 | 7,280 | 14.7% |
| **11** | **Barnhart** | **27,103** | **3,244** | **12.0%** | | | | | |
| **12** | **Beyer** | **22,187** | **3,764** | **17.0%** | **6** | **Morrisette** | 49,290 | 7,008 | **14.2%** |
| 13 | Ackerman | 26,978 | 2,651 | 9.8% | | | | | |
| 14 | Farr | 25,369 | 3,687 | 14.5% | 7 | Walker | 52,347 | 6,338 | 12.1% |
| **15** | **Close** | **25,159** | **3,067** | **12.2%** | | | | | |
| **16** | **Wirth** | **22,626** | **1,706** | **7.5%** | **8** | **Morse** | 47,785 | 4,773 | **10.0%** |
| 17 | Kropf | 23,320 | 3,221 | 13.8% | | | | | |
| 18 | Smith, T. | 24,256 | 3,111 | 12.8% | 9 | Beyer | 47,576 | 6,332 | 13.3% |
| **19** | **Doyle** | **25,038** | **3,144** | **12.6%** | | | | | |
| **20** | **Berger** | **23,989** | **2,675** | **11.2%** | **10** | **Winters** | 49,027 | 5,819 | **11.9%** |
| 21 | Dalto | 21,777 | 3,609 | 16.6% | | | | | |
| 22 | Zauner | 17,139 | 3,149 | 18.4% | 11 | Courtney | 38,916 | 6,758 | 17.4% |
| **23** | **Shetterly** | **24,598** | **3,032** | **12.3%** | | | | | |
| **24** | **Nelson** | **23,998** | **3,184** | **13.3%** | **12** | **George** | 48,596 | 6,216 | **12.8%** |
| 25 | Backlund | 24,730 | 3,495 | 14.1% | | | | | |
| 26 | Krummel | 28,259 | 2,201 | 7.8% | 13 | Starr, C. | 52,989 | 5,696 | 10.7% |
| **27** | **Hass** | **28,963** | **2,051** | **7.1%** | | | | | |
| **28** | **Barker** | **24,734** | **2,070** | **8.4%** | **14** | **Deckert** | 53,697 | 4,121 | **7.7%** |
| 29 | Gallegos | 20,425 | 2,466 | 12.1% | | | | | |
| 30 | Kitts | 27,026 | 2,270 | 8.4% | 15 | Starr, B. | 47,451 | 4,736 | 10.0% |
| **31** | **Johnson** | **24,591** | **2,655** | **10.8%** | | | | | |
| **32** | **Hopson** | **25,298** | **3,182** | **12.6%** | **16** | **Dukes** | 49,889 | 5,837 | **11.7%** |
| 33 | Greenlick | 31,475 | 1,720 | 5.5% | | | | | |
| 34 | Avakian | 26,758 | 2,169 | 8.1% | 17 | Ringo | 58,233 | 3,889 | 6.7% |
| **35** | **Williams** | **26,440** | **1,740** | **6.6%** | | | | | |
| **36** | **Nolan** | **30,694** | **1,498** | **4.9%** | **18** | **Burdick** | 57,134 | 3,238 | **5.7%** |
| 37 | Miller | 26,795 | 1,400 | 5.2% | | | | | |
| 38 | Macpherson | 29,521 | 1,100 | 3.7% | 19 | Devlin | 56,316 | 2,500 | 4.4% |
| **39** | **Scott** | **24,476** | **2,349** | **9.6%** | | | | | |
| **40** | **Hunt** | **25,450** | **2,497** | **9.8%** | **20** | **Schrader** | 49,926 | 4,846 | **9.7%** |
| 41 | Tomei | 27,721 | 3,179 | 11.5% | | | | | |
| 42 | Rosenbaum | 30,244 | 2,841 | 9.4% | 21 | Brown | 57,965 | 6,020 | 10.4% |
| **43** | **Kafoury** | **26,474** | **3,603** | **13.6%** | | | | | |
| **44** | **Hansen** | **23,544** | **4,103** | **17.4%** | **22** | **Carter** | 50,018 | 7,706 | **15.4%** |
| 45 | Dingfelder | 28,425 | 3,234 | 11.4% | | | | | |
| 46 | March | 27,600 | 3,087 | 11.2% | 23 | Gordly | 56,025 | 6,321 | 11.3% |
| **47** | **Merkley** | **26,442** | **3,968** | **15.0%** | | | | | |
| **48** | **Schaufler** | **24,087** | **3,475** | **14.4%** | **24** | **Shields** | 50,529 | 7,443 | **14.7%** |
| 49 | Minnis | 23,993 | 2,969 | 12.4% | | | | | |
| 50 | Monnes-Anderson | 24,192 | 2,503 | 10.3% | 25 | Minnis | 48,185 | 5,472 | 11.4% |
| **51** | **Flores** | **26,517** | **2,770** | **10.4%** | | | | | |
| **52** | **Smith, P.** | **25,551** | **2,860** | **11.2%** | **26** | **Metsger** | 52,068 | 5,630 | **10.8%** |
| 53 | Westlund | 27,215 | 3,538 | 13.0% | | | | | |
| 54 | Knopp | 24,992 | 2,773 | 11.1% | 27 | Clarno | 52,207 | 6,311 | 12.1% |
| **55** | **Gilman** | **25,287** | **4,133** | **16.3%** | | | | | |
| **56** | **Garrard** | **23,953** | **4,190** | **17.5%** | **28** | **Harper** | 49,240 | 8,323 | **16.9%** |
| 57 | Smith, G. | 25,644 | 3,913 | 15.3% | | | | | |
| 58 | Jenson | 22,406 | 3,732 | 16.7% | 29 | Nelson | 48,050 | 7,645 | 15.9% |
| **59** | **Mabrey** | **24,309** | **3,930** | **16.2%** | | | | | |
| **60** | **Butler** | **21,134** | **4,057** | **19.2%** | **30** | **Ferrioli** | 45,443 | 7,987 | **17.6%** |
| **Statewide average, percent of returns claiming EIC: 12.4%*** | | | | | | | | | |

* Statewide average based on IRS Oregon Individual Income and Tax Data for Tax Year 2000, expanded unpublished version. Source: OCPP analysis of IRS zip code data: "E-File Demographics" tax year 2000. Where a zip code crossed legislative boundaries, data were split using a formula based on the percentage of registered voters in each zip code, in each district.

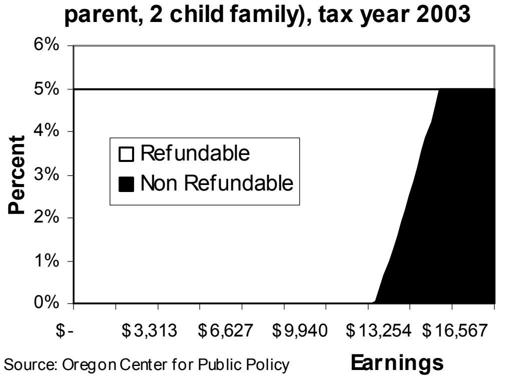
The federal EIC provides a significant economic boost to Oregon's economy. The $300 million it brings in annually is one of the biggest federal transfer payments to the state; by contrast, Oregon's annual welfare block grant is about $169 million. The economic benefits of the EIC are also well distributed to every Oregon county. For example, 2,388 taxpayer families in Malheur County (22 percent of the taxpayers) received an average EIC of $1,538 in 2000. Thus, the federal Earned Income Credit returned approximately $3.7 million to Malheur County's economy and working families through reduced taxes and refunds. Multnomah County's economy and its low-income workers received approximately $55.6 million from the federal Earned Income Credit in 2000 (Table 3).

## Improving the state EIC: refundability.

The Earned Income Credit is designed to provide tax relief and income support to lower income families who work. In theory, as a family's earnings rise, the value of the EIC will diminish. Unfortunately, because the state EIC is non-refundable – the credit is available only to the extent of tax liability – families with very low incomes are either denied the full credit or unable to take the credit at all.

A two-parent, two-child family will not derive any value from the state EIC until their earnings reach about $13,250, despite being eligible for the maximum federal credit at this level. Even then the family cannot take advantage of the full five percent credit until they earn about $16,000, which is more than full time work at the minimum wage (Figure 2). A two-parent, two-child family, with one full-time minimum wage earner will receive a state EIC equal to about 1.9 percent of the federal EIC.

**Figure 2. Oregon EIC: percent of federal credit actually taken vs. a 5% refundable credit (2 parent, 2 child family), tax year 2003**




Source: Oregon Center for Public Policy

A single-parent family, working full time (2080 hours per year) and earning the 2003 minimum wage of $6.90, will have an annual income of $14,352 and will likely take full advantage of the state EIC (as Figure 2 demonstrates, a two-parent family at that income would not). However, not all families work the entire year or have a full-time job. A family may have just left welfare or may be reentering the work force. A family may only have access to seasonal jobs such as farm work. A single parent with two children who earns a full time minimum wage for only nine months (about $10,764) in 2003 would be *eligible* for the maximum state EIC of $210. That parent's tax liability is only $21. Under current law the parent will *lose* the $189 that is not used to offset her tax liability. If the state EIC were refundable, that parent would have an extra $189 to help make ends meet. Without a refundable EIC, those most in need, workers at the lowest income levels, do not receive the full benefits of the credit.

The Oregon Legislative assembly has previously recognized the need for refundable credits for low-income families. The bill creating the Oregon Earned Income Credit in 1997 (Senate Bill 388) included a refundability provision when the Oregon Senate endorsed it. The Oregon House of Representatives subsequently removed the provision. In 2001, the Legislature made the Working Family Child Care Credit refundable beginning in 2003 (House Bill 2716).[9] That credit provides some relief from childcare costs for families with incomes up to 250 percent of poverty.

As an added benefit, making Oregon's Earned Income Credit refundable would help keep Oregon in compliance with the "maintenance-of-effort" (MOE) requirement in the Temporary Assistance for Needy Families (TANF) block grant. Under current TANF rules, states must meet a minimum spending level for needy families, called a "maintenance-of-effort." Oregon barely has been able to meet its MOE requirement. In 1999, the U.S. Department of Health and Human Services issued rules allowing states to count the *refundable portion* of an EIC toward maintenance-of-effort requirements. In order to do so the state would only need to establish EIC specific criteria in its state TANF plan.[10]

Refundability is an easy-to-administer way to help Oregon's lowest income workers. Some Oregon credits, such as the Child and Dependent Care Credit and most business tax credits, have a "carry forward" provision where unused credit can be used in later tax years when the taxpayer has increased tax liability, fewer costs related to the credit, or both. Such a provision is not appropriate for low-income tax credits like the Oregon EIC. First, a "carry forward" would provide no help to Oregon's welfare maintenance-of-effort requirement; only a refundable credit can do that. Second, it places an additional record-keeping burden on low-income taxpayers who do not generally use accountants who can track the carry-forward (poor record-keeping can lead to taxpayer errors). Third, it does not provide immediate tax relief, but instead defers it until the taxpayer has more income and thus more tax liability. If income does not increase substantially, the carry-forward is never used completely.

## Improving the state EIC: eliminating the tax burden.

The majority of the 42 states with income taxes (including the District of Columbia) do not tax families in poverty. As of 2001, 17 states continued to tax single parent families of three below the poverty level and 19 states continued to tax two-parent families of four living in poverty.[11] Despite the state's Earned Income Credit, which does increase the tax threshold and decreases low-income tax burden slightly, Oregon remains among those states taxing families in poverty (Table 5). For the 2003 tax year, Oregon will levy an income tax on two-parent, two-child families with incomes as low

**Table 5. Oregon income tax burden, percent of poverty, tax year 2003.**

| | 80% | 90% | 100% | 110% |
|---|---|---|---|---|
| **2 parents/2 children** | | | | |
| Income | $14,720 | $16,560 | $18,400 | $20,240 |
| Tax | $0 | $53 | $238 | $423 |
| **2 parents/1 child** | | | | |
| Income | $12,208 | $13,734 | $15,260 | $16,786 |
| Tax | $0 | $55 | $167 | $300 |
| **1 parent/2 children** | | | | |
| Income | $12,208 | $13,734 | $15,260 | $16,786 |
| Tax | $0 | $19 | $141 | $292 |
| **1 parent/1 child** | | | | |
| Income | $9,696 | $10,908 | $12,120 | $13,332 |
| Tax | $0 | $51 | $135 | $220 |

Source: Oregon Center for Public Policy.

| Table 6. At what level would Oregon need to set the EIC to eliminate taxes on families with children living in poverty (tax year 2003)? | | | | | |
|---|---|---|---|---|---|
| | 2 parents 2 children | 2 parents 1 child | 1 parent 2 children | 1 parent 1 child | 1 parent, 1 child at full time min. wage ($6.90/hr) |
| Income - 100% of poverty | $18,400 | $15,260 | $15,260 | $12,120 | $14,352 |
| Federal EIC at that income | $3,431 | $2,462 | $3,882 | $2,547 | $2,448 |
| State Tax before EIC | $409 | $290 | $336 | $263 | $419 |
| Percent of EIC needed | 12% | 12% | 9% | 10% | 17% |

Source: Oregon Center for Public Policy.

as about 88 percent of the federal poverty guidelines, and families with one child with incomes as low as about 85 percent of poverty. Single-parent families with two children will pay income taxes with incomes as low as about 89 percent of the federal poverty level.[12]

Reducing taxes on working poor families encourages work and helps move families off public assistance by improving self-sufficiency and "making work pay." Eliminating the income tax burden on low-income, working families helps to offset high work-related taxes and expenses, such as gas taxes, that families incur as they work to become self-sufficient. Excise taxes like the gas tax account for 2.9 percent of the overall state and local tax burden for the lowest 20 percent income group, but only one-tenth of one percent (0.1 percent) for the wealthiest one percent.[13] Reducing the income tax burden on low-income families helps those who did not benefit from the economic boom of the 1990s and who were hardest hit by the recent recession and current sluggish recovery.[14]

The current 5 percent Oregon EIC helps to decrease, but not eliminate, the income tax burden on families below the poverty level. Allowing Oregon taxpayers to claim a state EIC equal to 12 percent of the Federal EIC would eliminate the state tax burden on most poor, working families with one or two children (Table 6).[15] To eliminate the state income tax burden on a single parent with one child earning a full time, minimum wage income, Oregon's EIC would need to be set at about 17 percent.

Refundability, coupled with expansion, will help to reverse Oregon's trend of an increasing tax burden on low-income households. From 1989 to 2002, the tax burden on Oregon's low-income families grew 2.2 percent, while it shrank by 0.4 percent for the highest income one percent.[16]

| Table 7. States with Earned Income Credits, tax year 2003 | | | | | |
|---|---|---|---|---|---|
| **State** | **% of Federal EIC** | **Refundable** | **State** | **% of Federal EIC** | **Refundable** |
| Colorado* | 10% | Yes | Minnesota | Varies – average 33% | Yes |
| Dist. of Columbia | 25% | Yes | New Jersey | 20% (if income < $20,000) | Yes |
| Illinois | 5% | No | New York | 30% | Yes |
| Indiana | 6% | Yes | Oklahoma | 5% | Yes |
| Iowa | 6.5% | No | **Oregon** | **5%** | **No** |
| Kansas | 15% | Yes | Rhode Island | 25% | No |
| Maine | 5% | No | Vermont | 32% | Yes |
| Maryland** | 20% | Yes | Wisconsin | 4% - 1 child<br>14% - 2 children<br>43% - 3 children | Yes |
| Massachusetts | 15% | Yes | | | |

*Colorado suspeneded their EIC in 2002 and may again in 2003. **Maryland also offers a 50% non-refundable credit; taxpayers may claim either the refundable or the non-refundable credit but not both. Source: Center on Budget and Policy Priorities.

## How much will it cost?

The current, five percent non-refundable Oregon EIC will cost Oregon $17.2 million in the 2003-05 biennium.[17] According to the Legislative Revenue Office (LRO), making the existing five percent Oregon EIC refundable in the 2003-05 biennium will cost approximately $8.3 million over the cost of the current, non-refundable, credit.[18] In other words, under current law Oregon's working poor families are being denied $8.3 million, or one-third, of the tax credit. The LRO currently estimates that a refundable earned income credit designed to eliminate the tax burden on two-parent families, a 12 percent credit, would cost approximately an additional $45.3 million.[19]

## Conclusion.

The high costs of housing, childcare, and health care make it difficult for low- and many moderate-income families to make ends meet. Despite high unemployment, Oregon continues to move people off public assistance and into a low-wage job market where opportunities are scarce. Even now, having just gone through a recession and with Oregon's economy in a period of, at best, slow growth, access to traditional public assistance sources is either discouraged or unavailable.[20]

Both the federal and the state Earned Income Credits recognize that employment does not equal financial stability or true self-sufficiency. Low-income, working families need help if they are to remain in the workforce and to survive without other forms of cash assistance. Making the state Earned Income Credit refundable, and expanding it to eliminate income taxes on poor families with children, reflects Oregon's statutory goals that our tax system be based on "ability to pay," and that it shield genuine subsistence income from taxation.[21] These changes would demonstrate a solid commitment to those who missed out on the boom of the 1990s and are struggling to achieve self-sufficiency.

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## End notes.

[1] Johnson, Nicholas. *A Hand Up: How State Earned Income Tax Credits Help Working Families Escape Poverty in 2001* (Center on Budget and Policy Priorities, 2001). Available at: http://www.cbpp.org/12-27-01sfp.pdf. For information on the Clinton expansion see "President Clinton Proposes To Expand The Earned Income Tax Credit In Order To Increase The Reward For Work And Family," (The White House Office of the Press Secretary, January 12, 2000). Available at: http://clinton4.nara.gov/WH/New/html/20000112_2.html. The author thanks Robert Zahradnik of the Center on Budget and Policy Priorities for providing data on state EICs and cost estimation.

[2] Thompson, Jeff and Michael Leachman, *Boom, Bust, and Beyond: The State of Working Oregon 2002* (Oregon Center for Public Policy, 2002), pp. 109-110. Available at: http://www.ocpp.org/2002/nr021103.htm.

[3] The differential between one and two parent families is how the federal EIC promotes marriage.

[4] E-mail from Steve Matthews (Taxpayer Education Specialist, Internal Revenue Service, Portland, Oregon) to the author on 12/18/2002. As of 10/25/2002, 197,339 taxpayers had claimed almost $303.9 million federal EIC in Oregon, an average claim of approximately $1,540.

[5] *ibid.*

[6] Benton, Clackamas, and Washington Counties had the lowest rates of filers claiming the credit. These counties are among Oregon's wealthiest and benefited most from the economic expansion of the 1990s.

[7] The 77 percent figure is low because it represents only full-year resident returns, about 90 percent of all returns.

[8] *Tax Expenditure Report, 2003-05* (Oregon Department of Administrative Services), section 1.142, p. 147.

[9] House Bill 2716 was supported by 45 members of the House and 22 members of the Senate. Of those who supported making the measure refundable, 31 are members of the House in 2003 (Representatives Ackerman, Backlund, Barnhart, Bates, Brown, Butler, Doyle, Garrard, Hansen, Hass, Hopson, Jenson, Johnson, Kafoury, Knopp, Krieger, Kropf, Kruse, March, Merkley, Miller, Minnis, Monnes-Anderson, Nelson, Nolan, Patridge, Rosenbaum, Shetterly, Smith T., Westlund, and Wirth) and 24 are now members of the Senate (Senators Atkinson, Burdick, Carter, Corcoran, Courtney, Deckert, Devlin, Dukes, Ferrioli, Fisher, George, Gordly, Harper, Messerle, Metsger, Minnis, Morrisette, Nelson, Ringo, Shields, Starr B., Starr C., Walker, and Winters).

[10] See Sheketoff, Charles, *Tax Credits and Maintenance-of-Effort: Using Refundable State Earned Income and Working Family Child Care Credits to Meet Welfare Spending Rules* (Oregon Center for Public Policy, April 20, 1999). Available at http://www.ocpp.org/1999/esmoe0499.htm. Also Johnson, Nick, *A Hand Up,* pp. 29-31.

[11] Johnson, Nicholas, et. al. *State Income Tax Burdens on Low-Income Families in 2001* (Center on Budget and Policy Priorities, February 26, 2002). Available at: http://www.cbpp.org/2-26-02sfp.htm.

[12] Oregon taxes individuals without children down to about 54 percent of the federal poverty guidelines. Married couples without children pay taxes down to about 76 percent of poverty.

[13] McIntyre, Robert, et. al. *Why Pays? A Distributional Analysis of the Tax Systems in All 50 States.* 2nd ed. (Institute for Taxation and Economic Policy, January 2003), pp. 90-91.

[14] For additional analysis of the 1990s boom see Thompson, Jeff and Michael Leachman, *Boom, Bust, and Beyond: The State of Working Oregon 2002*.

[15] The table only examines families with up to two children. Larger families in poverty would require a higher credit amount to eliminate their state tax burden because, while the poverty level continues to increase for families of 3 or more children, the value of the federal (and therefore the state) Earned Income Credit does not. Larger families can qualify for substantial additional federal relief through the refundable Additional Child Tax Credit.

[16] McIntyre, Robert, et. al., *Who Pays?*

[17] *Tax Expenditure Report, 2003-05*, section 1.142, p. 147.

[18] E-mail from Lizbeth Mahar (Economist, Legislative Revenue Office, Salem, Oregon) to the author on February 11, 2003. Using figures from the Joint Committee on Taxation (*Estimates of Federal Tax Expenditures for Fiscal Years 2003-2007,* December 19, 2002), and from the *2003 Earned Income Tax Credit Outreach Kit* (Center on Budget and Policy Priorities, 2003) for the federal Earned Income Credit, the OCPP estimates that the LRO figures may be low. Assuming a 90 percent participation rate, the OCPP estimates a five percent *refundable* credit will cost an additional $14 million over current law.

[19]. E-mail from Lizbeth Mahar (Economist, Legislative Revenue Office, Salem, Oregon) to the author on February 10, 2003. Using the methodology in the note above, the OCPP estimates a 12 percent *refundable* credit will cost an additional $61.3 million. Increasing the current, non-refundable credit to 12 percent would eliminate the tax burden on many families in poverty; however, doing so ignores the fact that some Oregon workers are already unable to claim all or part of the current five percent credit. Increasing the non-refundable credit to 12 percent would only increase the amount of credit they *could not* claim.

[20] Leachman, Michael & Charles Sheketoff, *Oregon's Shrinking Safety Net: Welfare's Decreasing Role in Meeting the Needs of Families with Dependent Children During Recessions* (Oregon Center for Public Policy, April 29, 2002). Available at: http://www.ocpp.org/2002/es020429.htm.

[21] *Oregon Revised Statutes* 316.003, sections 2(a) and 2(E)(a).