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Why Make the Oregon Working Family and Earned Income Credits Refundable?

I. Introduction

In 1997 the Oregon State Legislature created two new tax credits aimed at providing child care relief and tax relief to the working poor: the Working Family Credit (WFC) and the Earned Income Credit (EIC). In the original legislation both credits were to take effect in the 1999-2001 biennium and both were, like the Federal EIC, **refundable** -- that is, if a family's credit(s) exceeds the amount of taxes they owe, they would receive the excess as a refund. The legislature subsequently chose to make both credits take effect two years earlier in 1997, making them part of the budget debate. To alleviate the immediate revenue impact, both credits were made **non-refundable**. That is, if a family's total tax credits exceed the total tax owed, the excess is lost. The lowest income families lose out on receiving the full benefit of the credits.[1]

II. The Working Family Credit

The Working Family Credit was designed to help alleviate the costs of child care for low-income families. Families may be eligible to take a credit, a subtraction from their taxes, for up to 40 percent of their child care expenses, depending on income. The credit is equal to 40 percent of child care expenses for families with incomes up to 150 percent of poverty ($20,475 per year for a three person family). As a family's income increases from 150 to 200 percent of the federal poverty level, the credit phases down from 40 to 0 percent.

Chart 1 and **Chart 2** (page 3) illustrate how the current non-refundability provision of the Working Family Credit prevents families from receiving the full benefit of the credit.

The charts demonstrate that because the Working Family Credit is non-refundable at most income levels families receive only a fraction of the credit the law was designed to provide.[2] Families are not able to take full advantage of the credit, except at higher income levels. For example, **Chart 1** shows that a family working at 1999's minimum wage and *using* the state's child care subsidy program (Employment Related Day Care or ERDC) receives only a 5 percent credit even though they are supposed to receive a 40 percent credit. The family receives only 12.5 percent of what the Working Family Credit is supposed to provide. A family earning $10 per hour gets less than half of the credit's intended benefits. Only when the family's income rises to over $12 per hour do they begin to realize the full effect of the credit.

[1] Other Oregon tax credits, such as the Child and Dependent Care Credit, have "carry-forward" provisions, allowing the unused portion to be carried forward to future tax years, because tax liability is often less than the credits. Neither the Working Family Credit nor the Earned Income Credit has such provisions because they would be unsuitable for low income families.

[2] On average, only 36% of the credit could be used in 1997 because it is non-refundable (State of Oregon, 1999-2001 Tax Expenditure Report, p.128).

It is important to note that the vast majority of working families do not utilize the ERDC program; only about 15,000 families use the state subsidy program. A single-parent family with two children working full-time at $9 per hour who *does not* participate in the state's child care subsidy program (ERDC) would normally be entitled to a credit equal to 40 percent, or $3005, of their $7,512 ($626 per month) in child care costs. Instead, because the credit is non-refundable, the credit covers only 8 percent of their child care costs. With a non-refundable credit the family pays $2,432 more for child care.

Charts 1 and 2 also illustrate how non-refundability undermines the legislative plan to treat all families below 150 percent of poverty the same, and to decrease the size of the credit (in terms of percent of costs) as income rises above 150 percent of poverty. For families who do not participate in ERDC, **Chart 1** illustrates how a non-refundable Working Family Credit is a regressive credit because as income rises, so does the amount of the credit the family actually receives.

III. The State Earned Income Credit

At Oregon's new $6.50 per hour minimum wage, a family working full time throughout the year will receive the full benefit of the state EIC. However, if the parent works part-time, or for only part of the year (for example, a parent who leaves welfare in July would have only six months of full time income), the family may not receive the full EIC benefit.[3]

Chart 3 (page 3) illustrates how part-time workers do not receive the full benefit of the Oregon EIC because it is non-refundable. A parent who works half time for a full year or full time for six months, at Oregon's new $6.50/hr. minimum wage, will not receive any benefit from Oregon's non-refundable credit. Similarly, at a higher wage of $10/hr the state EIC returns only 2% of the Federal EIC. This is 60% less than the same person would receive with a refundable credit.

For the 1997 tax year, the maximum Federal Earned Income Credit was $3,656 for a family with two children. Oregon's credit is five percent of the Federal credit; thus Oregon's maximum was $183. The lowest income at which a family becomes eligible for the maximum credit is $9,100 per year, or 27 hours per week at Oregon's 1999 minimum wage (two-thirds time). Such a family would receive a refund of $3,656 from the Federal credit, but would receive nothing from the state non-refundable credit.[4]

Individuals entering work from welfare do so throughout the year, and some low-income families have only seasonal income. A refundable state EIC would provide additional assistance to those families without twelve months of full time income; it would also assist those families who are working but who do not claim the Working Family Credit.

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[3] On average only 55% of the credit was taken in 1997 because it is non-refundable. (State of Oregon 1999-2001 Tax Expenditure Report, p.116).

[4] The family's state tax liability is $365. The state allows a personal exemption credit of $384 for a family of three, eliminating the tax liability. The excess personal exemption credit ($19) is also not refundable. For a two-parent, two-child family the tax liability is reduced to $337 but the exemption credit increases to $512. The family loses $175 of the personal exemption credit, and is not eligible for any of the $183 in state EIC benefits.

IV. Charts

In Charts 1-3, the light gray area represents the portion of the tax credit a family would receive if the credits were refundable.

Chart 1. No ERDC. Assumes a family of three (one parent, two children), full-time employment, no child-support, and no participation in Employment Related Day Care (ERDC). Also assumes the family claims the Oregon earned income tax credit. X-Axis is wage in dollars/hour. Y-Axis is the percentage of child care costs. "Rate" refers to the rate of the tax credit in statute. "Effective Rate" is the percentage of child care costs actually covered by the tax credit.

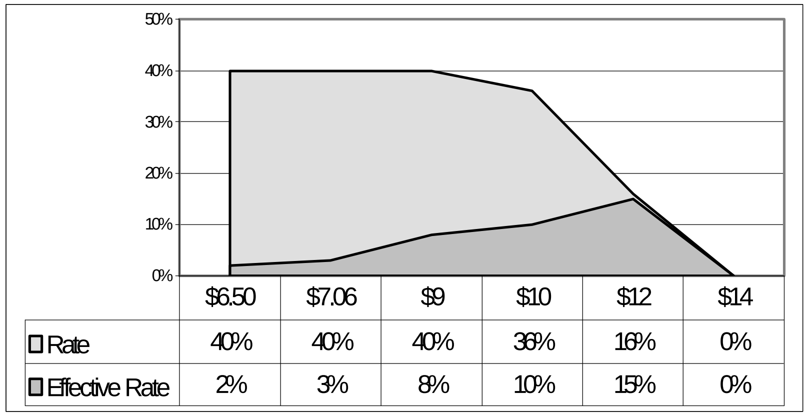

Chart 2. With ERDC. Assumes a family of three (one parent, two children), full time employment, no child support, and participation in Employment Related Day Care (ERDC). Also assumes the family claims the Oregon earned income tax credit. X-Axis is wage in dollars/hour. Y-Axis is the percentage of child care costs. "Rate" refers to the rate of the tax credit in statute. "Effective Rate" is the percentage of child care costs actually covered by the tax credit.

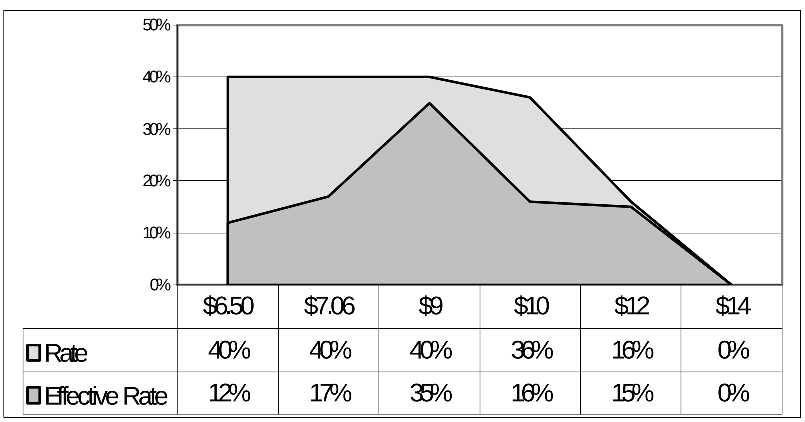

Chart 3. Oregon Earned Income Tax Credit, current law (5% of Federal EITC, non-refundable). Assumes family of three (one parent two children) working for 12 months half time or 6 months full time. Assumes family does not have child care costs. "Rate" refers to the rate of the tax credit in statute. "Effective Rate" is the actual rate of the state EITC due to its being non-refundable.