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The Earned Income Tax Credit: A Powerful Tool for Making Our Tax Systems More Equitable

The Earned Income Tax Credit (EITC) is the largest anti-poverty policy in the U.S. and one of the greatest opportunities for building wealth among low-income working families. It is a cornerstone for efforts to turn both federal and state tax codes right-side up and create a more even distribution of the benefits granted to taxpayers. For households of color, these benefits extend beyond an annual savings boost to broader potential health effects that themselves can open doors to long-term improved family wealth. The states, through their ability to enhance the effects of the EITC beyond the bounds of the federal credit, have greater flexibility to create more equitable tax systems for low-income households and working families of color. The path to equitable opportunity begins with advocates ready to fight for new or stronger EITCs at both the state and federal levels. The following brief is designed to lay out the facts and provide tips for advocates ready to start these campaigns and create an inclusive and equitable tax code for all.

The U.S. Tax Code is Flawed, but the Earned Income Tax Credit Helps Uplift Working Families

More than just tools for collecting revenue to meet budgetary and program needs, our federal and state tax systems play a critical role in the economic lives of families throughout the country. At the federal level, the U.S. tax code is the single largest tool the federal government uses to boost economic outcomes and wealth for families, as it helps families buy a home, afford a higher education, make investments and save for retirement. Unfortunately, while the overall U.S. tax code is somewhat progressive, with high-income earners paying a larger share of their income in federal taxes, key provisions within the tax code—such as its preference for investment income over earned income—drives economic inequality and makes the system upside down and inequitable.

As a result, high-income earners and the wealthy tend to receive greater federal asset- and wealth-building tax support than working families do. For example, with the passage of the Tax Cuts and Jobs Act of 2017—which, among other changes, cut the corporate tax rate by 40% and lowered the highest individual income tax rate—the U.S. tax code now provides the richest 1% of households, those earning incomes of more than $590,000, with a tax benefit of more than $47,000.[1] By comparison, middle-class families earning incomes between $40,000-$110,000 receive a tax benefit of $1,000, while low-income households earning less than $23,000 receive just under $100 in tax benefits from the new tax law.[2] By race, White households now receive more than two times the support from the new federal tax system ($2,020) than Black ($840) and Latino ($970) households.[3]

Despite these and other glaring inequities within the U.S. tax system, other key provisions, such as the EITC work to flip the system right-side up by making it more progressive and equitable as it helps to offset federal payroll and income taxes paid for by low- and moderate-income workers. More importantly, because the EITC is “refundable”—meaning that if the value of the credit exceeds a worker’s federal income tax liability, the IRS will refund the balance—the EITC also helps to provide meaningful income-support to low- and moderate-income workers. For example, in the 2018 tax filing season, 25 million tax filers claimed the EITC, receiving an average benefit of $2,488.[4] For a married couple with two children earning an income of $40,000 per year, the EITC benefit they qualified for in 2018 was equivalent to 6% of their annual income.[5]

Overall, according to the Center on Budget and Policy Priorities (CBPP), in 2018 the EITC lifted 5.6 million people, including about 3 million children, out of poverty, while also lessening the poverty experienced by another 16.5 million people.[6] At the same time, demonstrating the power of targeted refundable tax credits for work, CBPP also estimated that in 2018 the Child Tax Credit (CTC)—which is partially refundable—lifted 4.3 million people, including about 2.3 million children, out of poverty,[7] while also lessening the poverty experienced for another 12 million people. [8]

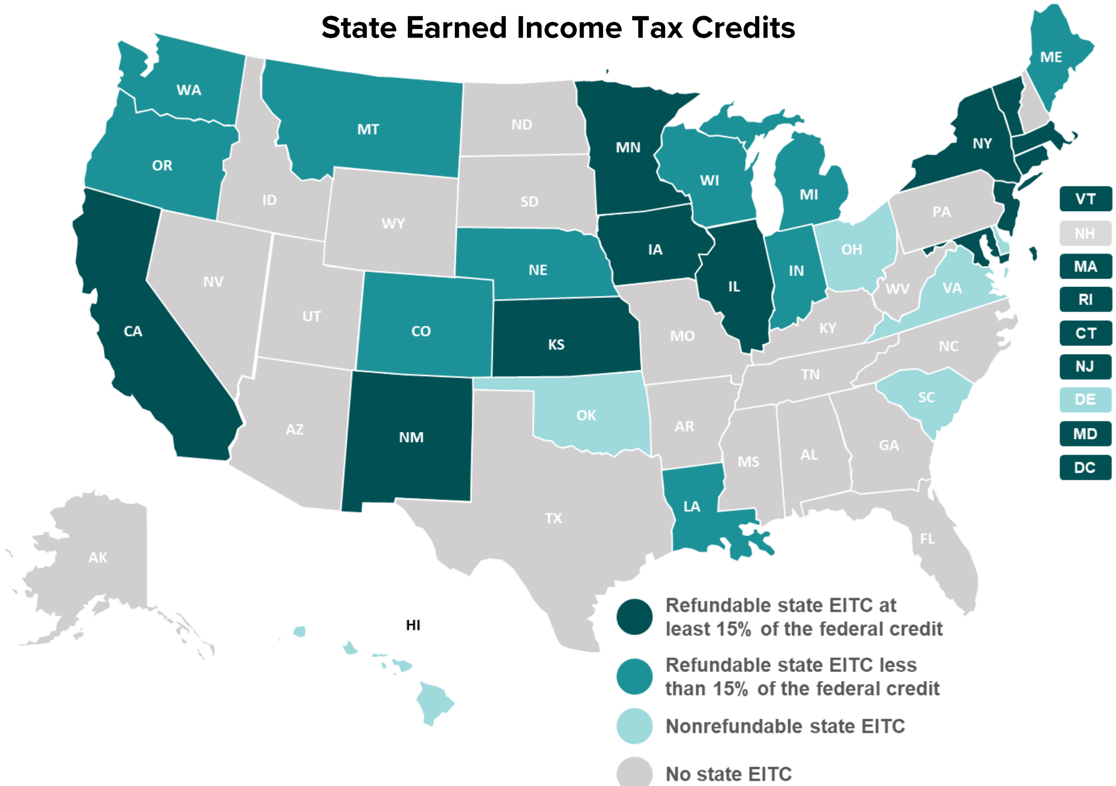
At the State Level, Where Tax Codes Have Historically Been More Regressive, the EITC Has Been a Critical Component for Fostering Progressivity

As with the federal government, state tax codes are designed to incentivize certain behaviors (e.g. make business investments that foster job creation) and collect revenue to fund essential services and programs. To achieve these outcomes, most states have historically relied on some combination of income, property and consumption (sales and excise) taxes, as well as other revenue sources. However, while income taxes help make state tax codes progressive in some respects, overreliance on consumption taxes have historically made state tax codes regressive and unfair. The reason for this is that while income taxes lead the wealthy to pay a larger share of their income in state taxes, consumption taxes—which are a critical source of revenue for state and local governments and which are applied to most goods—lead low- and moderate-income people to pay a larger share of their income in taxes than high-income families.

Overall, according to the Institute on Taxation and Economic Policy (ITEP), forty-five states have tax systems that make income inequality worse after the collection of consumption taxes.[9] However, whether a state’s tax system is progressive or regressive ultimately depends, in part, on how much the state relies on each of the three types of taxes listed previously. For example, according to ITEP, among the ten most regressive state tax codes in the country, six of them—Florida, Nevada, Tennessee, Texas, South Dakota and Washington—pull in half to two-thirds of their revenue from consumption taxes alone.[10] By comparison, the national average of revenue collected by states from consumption taxes is about one-third. Ultimately, as a result of this and other structural issues, such as the lack of an income tax in some of these six states, the poorest 20% of households in these states pay between a 4-6 times as much of their income on taxes than the wealthiest households (those in the top 1%) do.[11] From a racial equity perspective, this is particularly troubling since the poverty rate for households of color in each of these six states is 2-3 times higher than the poverty rate among White households, meaning that communities of color are more likely to be impacted by these, and other, regressive state tax codes.[12]

States can take several actions to create more equity in their tax codes, including instituting progressive marginal income tax rates and brackets. However, even without broad state tax reform, there are several policies that states can enact to make their tax systems more equitable for low- and moderate-income families, such as implementing refundable tax credits like the Earned Income Tax Credit. To this point, in nine of the ten states identified by ITEP as having the least regressive tax systems—California, the District of Columbia, Maine, Maryland, Minnesota, Montana, New Jersey, New York and Vermont—low- and moderate-income people have access to a refundable state Earned Income Tax Credit, which helps to offset the consumption taxes that are more heavily borne by low-income communities.[13] Overall, today twenty-nine states and the District of Columbia offer a state EITC.[14]

State Earned Income Tax Credits



The EITC Plays a Crucial Role in Advancing Racial Equity

Since the EITC helps boost the after-tax incomes of low- and moderate-income workers, especially those with children, it has been one of the most powerful anti-poverty tools the nation has ever created. From a state perspective, because workers of color are more likely to earn lower wages, and are thus more likely to have a greater proportion of their income taken up by state and local consumption taxes, state EITCs are crucial for advancing racial equity at the state level. To this point, researchers at the University of New Hampshire estimated that between 2010 and 2014, state EITCs not only provided greater support, on average, to households of color ($495) than White households ($375), but it also had a 3.5 times greater effect on lifting communities of color out of poverty than White households.[15]

Just as importantly, the EITC has also been a powerful tool for fostering racial economic equity at all levels of government. This is because, while the EITC supports more White households, it supports a higher proportion of families of color who have historically earned lower wages and have experienced poverty levels at higher rates than White households.[16] With this broader impact on families of color, the anti-poverty benefits of the EITC can have a greater proportional impact on households of color and potentially improve racial wealth equity.

This effect on poverty has also been critical due to the well-established links between poverty and health outcomes.[17] Through this connection between health, wealth and poverty alleviation, the EITC can reverse negative social determinants of health and improve health outcomes overall, with the Centers for Disease Control and Prevention raising both the federal and state EITCs as health interventions with the greatest potential to positively impact American's health.[18]

For example, as a share of women who benefited from the federal EITC and CTC in 2019, researchers found that women of color were far more likely to receive support from this tax credit than White women. Overall, in 2019 the EITC was credited with increasing the incomes of 9 million women of color, while the CTC provided support to 7 million women of color.[19] In this way, the EITC's impact in advancing racial equity extends beyond the immediate support of a tax time income boost to long-term socioeconomic effects including higher earnings and better health for children of EITC recipients. A study published by the National Center for Biotechnology found a positive association between receiving a state EITC and increased birth weight, especially for Black mothers and in states with more generous EITCs.[20] The reduction in low birth weights among Black mothers receiving an EITC is crucial for advancing racial equity in both health and wealth, as Black mothers are disproportionately affected by this health issue.[21] State EITCs can, therefore, be an effective way to help reverse this negative health trend while simultaneously creating opportunities to build wealth.

Improved birth weight and other health-related outcomes for Black mothers can also lead to broader benefits, as studies have found a relationship between infant birth weight and adult income earnings.[22] A paper using the Panel Study of Income Dynamics from the University of Michigan finds that low-birth weight children are likely to have worse outcomes in childhood and adulthood health, academic scores, high school graduation rates and hourly earnings.[23] Due to the previously mentioned link between improved birth weights, state EITCs and their effects on Black mothers and children, the credit's benefits should lead to greater health equity impacts on the lives of Black families. The implications of this link have the potential to foster better long-term financial well-being among Black families in particular and an opportunity to help address the racial wealth divide.

Despite the Success of the EITC, Its Impact on Equity at the State Level is Limited by Several Factors

While the EITC is a critically important tax credit for low-income workers, there are several issues that are limiting its impact. At the federal level, low-income adults without children are, in effect, pushed further into poverty since the EITC support they are eligible to receive is too small to fully offset federal taxes for these workers.[24] As a result, today over 5 million workers are taxed further into poverty.[25] Adding to this, the federal credit also completely excludes young childless workers below the age of 25 and those over age 65.

In response to these issues, some states have used their EITCs to fill in the gaps in the federal EITC. For example, Maryland recently eliminated the minimum age requirement, expanding coverage to many low-income workers without children.[26] This led to the inclusion of over 40,000 new Maryland workers benefitting from the EITC.[27] In California, the state expanded the EITC to include childless workers age 18 to 24, and gave a higher percentage of the federal EITC to the lowest-earning workers before phasing out in the federal phase-in range.[28] This effectively bolsters the incomes of younger, lower-earning workers not as highly covered by the federal EITC. And in Maine, the state created a fully refundable state EITC with two different rates—25% of the federal credit for childless workers, and 12% otherwise—which alleviates some of the disproportionate tax burden on childless workers.[29]

However, as much progress as states have made to enhance the federal EITC and to lower tax burdens on low-income families, six states—Delaware, Hawaii, Ohio, Oklahoma, South Carolina and Virginia—offer only a nonrefundable EITC, meaning that the credit can only help lower the tax liability of a family instead of providing a much-needed boost to their incomes. At the same time, in 10 states that offer a refundable state EITC, eligible taxpayers receive a credit that is worth less than 15% of the federal EITC.[30] But perhaps most unfortunately, a large swath of the 21 states that do not offer a state EITC can be found in parts of the country where large numbers of communities of color reside, including in the South and parts of the West. To resolve both the lack of state EITCs in significant portions of the country and strengthen the state credits where they are currently available, state-level EITC advocacy campaigns and coalitions have become key to policy victories for building greater tax equity.

While Advocates Continue to Push for Tax Equity through the Creation or Expansion of State EITCs, It's Important to Keep in Mind Strategies to Advance Equity through Tax Codes

Since 1986, when Rhode Island enacted the first credit of its kind, advocates have continued to work to create or expand state EITCs. Many of those successes have been anchored in long-term campaigns that begin years in advance and continue long after the initial victory—enactment of a new state EITC—has been secured. in California, for example, after ensuring that the state's EITC, CalEITC, included as many demographic groups that could benefit as possible in 2015, advocates focused their efforts to expand the value of the CalEITC by utilizing a multi-pronged approach that included engaging lawmakers, coordinating grassroots efforts and developing extensive research to support their case. Ultimately, during this past legislative session, those efforts led to increases in the credit's income limits as well as changes that made childless workers ages 18 to 24 and over 65 eligible for the CalEITC.[31]

In other parts of the country, such as Arkansas and Georgia, while advocacy efforts have not yet resulted in the creation of a state EITC, useful information has been gleaned on how best to message and develop this work to reach a broader audience. Arkansas Advocates for Children and Families found that crafting policy in their state that was revenue-neutral—done by offsetting the cost of creating a state EITC with taxes on e-cigarettes and tobacco—helped them appeal to a bipartisan group of lawmakers.

In Georgia, the Georgia Budget and Policy Institute (GBPI) found that the most effective way toward enacting a state EITC is to first seek enactment of a nonrefundable tax credit, which could then be enhanced in future legislative sessions. This incremental approach, supported by a multi-year education campaign to build awareness among key legislators and advocates, has yielded a bipartisan bill that has the potential to become law. As in Arkansas, GBPI found that framing their policy with bipartisan appeal is one of the most affordable ways to cut taxes on people and the right approach to building support with conservative legislators. Advocates were able to demonstrate, for example, that while cutting the top income tax rate would cost the state hundreds of millions of dollars to benefit just a few thousand people, the 10% nonrefundable credit they advocated for would cut taxes for 700,000 working families and only cost $300 million.

As advocates continue to work to create and expand state EITCs, they should keep in mind a few best practices. The following strategies reflect lessons learned from recent campaigns shared with Prosperity Now through interviews conducted in 2019 as well as Prosperity Now's own state-level policy engagements. These simple, initial steps are designed to help advocates formulate a new state EITC campaign.

1. **Start Early:** Advocates have found the greatest success with awareness campaigns that build a base of support over several legislative sessions. Education and outreach efforts that inform legislators about the direct impacts on their constituents were effective at drumming up support for the bill. While many state legislatures only meet for a few months out of the year or less, it is key to use the out-of-session time to refine and get out messages through media campaigns, building alignment with other key advocates and meeting directly with legislators to talk about the importance of a state EITC. The lead-up time is also good to try out different approaches and see which messages and tactics could work best based on the current political environment.

2. **Focus on Key Policymakers and Influencers:** Identifying and engaging key players—legislative leaders on the political inside and influential stakeholder groups on the outside who can help amplify advocacy messages and legislative pressure—is necessary for effective EITC campaigns. Finding the right policymakers who can champion a bill and drive conversations among fellow legislators helps build momentum around the policy. A strong legislative champion can also raise the EITC's profile and prioritize it among the multitude of other policy priorities that often compete for attention in broad tax or budget bills.

3. **Build an Inclusive and Diverse Coalition:** Identifying and securing a legislative champion can be challenging, but the process can be helped with the support of a network of influential coalition partners—e.g., funders, Volunteer Income Tax Assistance programs, health professionals and researchers—who are willing to share resources and partner in an engagement strategy.

   If a state EITC is being proposed to support and build wealth within particular groups of individuals, especially communities of color, the policy should be developed with and directly informed by partnerships with individuals who represent these groups. Coalitions are often essential to building the broadest base of support, but to be most successful in an inclusive campaign, they must make space for the communities the policy is designed to benefit to be heard directly throughout all stages of the campaign.

   To tell a complete and compelling story of the benefits of the EITC including its health-wealth effects, coalitions should also include groups with specific expertise on certain aspects of the credit in their campaigns such as public health-focused agencies and organizations. Broadening a coalition by partnering with diverse organizations that represent the various needs of effected communities will ensure the credit will have the greatest possibility of achieving its equity goals while also building common ground for future engagements.

4. **Know Your Audience:** Advocates have found that tailoring messages to emphasize different points about the EITC is critical to campaign success. This applies to all reaching audiences, whether that means targeting legislators across the political spectrum to support an action, potential coalition partners to join a campaign, or the public at large to lend their voices as advocates themselves. While the EITC enjoys bipartisan support, individuals from both sides of the aisle often support the policy for slightly different reasons. Understanding the many ways that the EITC can be positively framed for different audiences—as an affordable tax cut for working families, as an anti-poverty policy, as a work incentive, as a savings boost, etc.—and knowing which frame the target audience supports the most is very important. It is essential to know which strategies will find support among different political environments. Establishing different strategies that best engage politically "red," "blue" or "purple" environments at the outset will best position a campaign for the great possible success with the broadest support.

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