

RESEARCH REPORT

Federal and State Income Taxes and Their Role in the Social Safety Net

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Executive Summary

The federal personal income tax system's primary function is collecting taxes to fund government expenditures. Over the past 30 years it also has played an increasingly important role in providing income support for low-income households by administering refundable tax credits, such as the earned income tax credit (EITC). State personal income tax systems piggyback on both of these functions—albeit with many idiosyncratic twists.

This paper documents important aspects of the federal and state income tax systems that affect low- and moderate-income working families. State income tax systems tend to follow the federal system's lead. Recent examples include a move toward exempting people in poverty from owing income taxes and expansions to tax credits. Of most importance to low-income families are expansions to tax credits like the EITC and the child tax credit (CTC). In some cases, states have also provided larger income tax credits to low-income families than the federal government, most notably in allowing dependent care credits to be available to families even if they do not owe state income taxes.

As of 2014, 24 states and the District of Columbia augment the federal EITC with a state-level credit; four other states have a separate state-level child credit. Typically, these credits at the state level are smaller than those at the federal level. Child care credits offer an example of states providing larger benefits than the federal government. The federal income tax system provides a nonrefundable credit for child care (nonrefundable credits can only be used to offset taxes). Twenty-two states have their own child care credits, and, in 11 states, these child care credits are at least partially refundable (if a refundable credit exceeds taxes owed, families receive the excess as a tax refund). These refundable state credits benefit low-income families who pay for child care but owe little or no income tax—something nonrefundable credits are unable to do. A low-income family may not receive any benefit from the federal child care credit but receive some benefit from a state child care credit.

Using the Urban Institute's Net Income Change Calculator (NICC), which provides state- and federal-level information on tax and transfer programs in 2008, I calculate the impact of federal and state income taxes on low-income families with two children and a single parent working full time at the federal minimum wage along with Temporary Assistance for Needy Families (TANF) and Supplemental Nutrition Assistance Program (SNAP, formerly Food Stamps) benefits. In 2008, this type of family could have received close to \$6,700 in federal tax credits from the CTC and EITC (\$5,800) plus a special rebate recovery credit effective in 2008 of \$900. State tax credits could add an additional \$4,000. In almost all states, federal and state income tax credits were larger than the support available through TANF and SNAP. Combined benefits from TANF and SNAP varied from just over \$3,200 to \$9,400. The generosity of transfer programs is likely to return closer to prerecession levels following a temporary expansion. The prerecession analysis in this

report, based on 2008 tax and transfer policy, gives a sense of the importance of income support for low-income households through federal and state income taxes and how that support varies across states. In addition, this paper provides a baseline summary to compare with any updates to the NICC.

Federal and State Income Taxes and Their Role in the Social Safety Net

The federal income tax is the touchstone for most state income tax systems. In large part, the federal income tax system provides guidance to states in defining the income base for taxes and for setting the income level at which taxes begin. The Tax Reform Act of 1986 (TRA86) largely achieved its goal for the federal income tax system *not* to tax people in poverty. Following that legislation, several states also moved to exempt people in poverty from state income taxes. TRA86 represents the last significant income tax reform at the federal level. Since then, multiple changes have been made to the federal income tax code and aspects of the economic environment have changed. Many scholars argue that it is once again time for tax reform, but an out-of-balance federal budget may make it difficult to pass assistance in the tax code. Because of the interconnected nature of the federal and state income tax systems, federal reform likely would lead to state changes, just as it did in TRA86. State and federal policymakers ought to be aware of connections that would affect state taxes.

Federal income taxes play a critical role in supporting low-income working families. For example, in 2008, the combination of the earned income tax credit (EITC) and child tax credit (CTC) would have boosted the after-tax income of a single parent working full time at the federal minimum wage with two children by around \$5,800. By 2014, that number had risen to about \$7,200. For working families, federal refundable credits administered through the tax system can easily be the largest source of public support. State income tax credits could have added around \$4,000 more for this family in 2008 through state EITCs, CTCs, and child and dependent care tax credits (CDCTC). In a most states, state and federal income taxes provided as much or more assistance to low-income families as benefits from the Supplemental Nutrition Assistance Program (SNAP, formerly Food Stamps) and Temporary Assistance to Needy Families (TANF). Since 2008, traditional transfer programs have expanded with the recession, and they have shrunk as the recession abates. State income tax credits also have evolved over the recession years. Faced with reduced revenues, a few states have reduced or eliminated their EITC programs. In contrast, other states have responded to the greater economic needs of low-income households by increasing or enacting EITCs over this period and adopting federal expansions at the state level.

This report analyzes the effect of taxes and transfers on families with a full-time worker (2,080 hours a year) earning the 2008 federal minimum wage (\$7.25 per hour). I compare the relatively large impact of federal income taxes with the smaller impact from state income taxes and more traditional transfer programs, such as SNAP and TANF. Analyzing 2008 program rules allows an examination of a prerecession year that likely represents long-term benefit levels better than expanded transfers observed during the

recession (Moffitt 2013). In total, depending on which state she lived in and the her childcare expenses, a single parent of two children who worked full time at the federal minimum wage could have received support from state tax and transfer programs that ranged from \$3,000 to \$10,500 (of which, up to \$4,000 could have been from state income taxes). If a family had failed to claim or was ineligible for SNAP or TANF benefits (as was often the case) the tax system became an even more important part of the safety net. Coupled with federal income tax credits, the income tax system provides the majority of support to this hypothetical and other low-income working families.

Federal Income Tax Policy Influences State Tax Policy

State policymakers have looked to the federal income tax system as a guide for setting state income tax rules. Federal policy has informed who and what types of income ought to be taxed and whether tax incentives to support various activities ought to be implemented. Changes in federal taxes have led to state tax changes either because state tax statutes were tied directly to the federal income tax system or because state policymakers shared the principles advanced by federal policymakers.

Determining the Tax Base

In 2014, 42 states (including the District of Columbia)¹ have a broad-based personal income tax, similar to the federal income tax. Seven states—Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming—have no personal income tax system in 2014. The same was true in 2008.

Two states, New Hampshire and Tennessee, vary significantly from the federal income tax system by having a very narrow tax base (New Hampshire only taxes interest and dividends and Tennessee only taxes bond interest and stock dividends).

The starting point for defining the tax base in the federal income tax is adjusted gross income (AGI). AGI is a broad measure of income that includes wages and salaries, self-employment earnings, business income, interest, dividends, rents, capital gains, and other types of income, minus certain adjustments, such as alimony, moving expenses, student loan interest, and contributions to individual retirement accounts. Taxpayers then determine their taxable income by subtracting personal exemptions and either the standard deduction or itemized deductions from AGI.

Of the 42 states with a broad-based personal income tax, 32 states use federal AGI (32 states) and 5 states use federal taxable income as the starting point for their personal income tax base. The remaining 6

states—Alabama, Arkansas, Massachusetts, Mississippi, New Jersey, and Pennsylvania—use another measure of taxable income with significant overlaps to the federal definition.

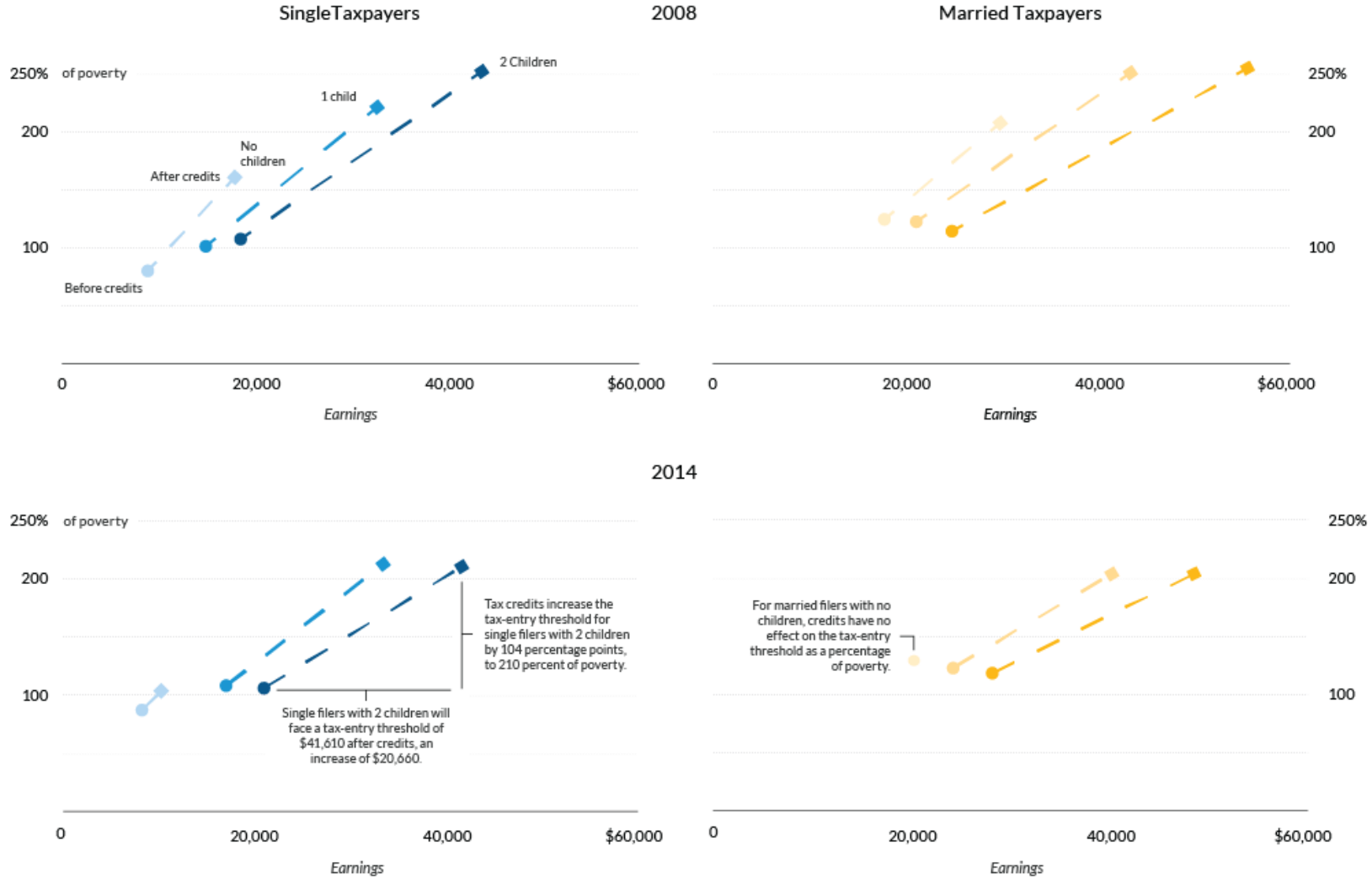
Tax Entry Threshold

Before the last major federal tax reform effort—the Tax Reform Act of 1986 (TRA86)—families in poverty paid some amount of federal income tax and also state income tax in 36 states. TRA86 set an explicit goal to no longer tax people in poverty. Twenty-four states immediately followed the federal lead and stopped taxing families in poverty (Gold 1988). With respect to low-income families, analysts have documented a complementary relationship between state and federal taxes (Chernick and Tennant 2010). When federal income taxes fell, state income taxes followed suit. In theory, reducing federal taxes frees up more money for states to tax, but states did not appear to take full advantage of this. When states collected more money than they had planned for after a broader tax base was implemented in TRA86, states retained approximately 40 percent of these revenues and used the other 60 percent to cut state income taxes (Ladd 1993). Some of that 60 percent of revenues is what states used to pay for cuts in state income taxes so people in poverty would no longer be taxed (Gold 1987).

The federal income tax system exempts a base amount of income from taxation using the standard deduction (a set amount of income based on filing status) and personal exemptions (a set amount of income for each person in the tax unit, with additions for people who are elderly or blind). The sum determines the tax entry threshold before credits, the first point at which a person would owe income tax, assuming they did not qualify for any tax credits. It provides one way to look at how the income tax system treats low-income families. Before factoring in credits, the federal income tax system exempts most poor families from taxation (figure 1 and table 1). Only single people with no qualifying children cannot exempt all income below poverty. Married couples and families with children can exempt more than poverty-level income from taxation. The tax thresholds are relatively stable between 2008 and 2014. Relative to a full-time minimum wage job, the federal income tax system became more generous between 2008 and 2014, a result of tax entry threshold increasing because of inflation adjustments, while the federal minimum wage remained unchanged.

FIGURE 1

Federal Income Tax Entry Thresholds for Various Family Types, 2008 and 2014



Notes: Assumes all income is from wages, children qualify for the Earned Income Tax Credit and Child Tax Credit, and there are no childcare expenses. A Recovery Rebate Card was in effect in 2008 that was not in effect in 2014, which is included in these calculations.

TABLE 1A

Relationship between Tax Entry Thresholds and Poverty

	Tax Entry Threshold Before Credits							
	Poverty Threshold		Dollars		Percentage of Poverty		Percentage of Federal Full-Time Minimum Wage Job	
	2008	2014	2008	2014	2008	2014	2008	2014
Single, no children	\$11,201	\$11,670	8,950	10,150	80	87	59	67
Single, one child	\$14,840	\$15,730	15,000	17,000	101	108	99	113
Single, two children	\$17,346	\$19,790	18,600	20,950	107	106	123	139
Married, no children	\$14,417	\$15,730	17,900	20,300	124	129	119	135
Married, one child	\$17,330	\$19,790	21,400	24,250	123	123	142	161
Married, two children	\$21,834	\$23,850	24,900	28,200	114	118	165	187

TABLE 1B

Relationship between Tax Entry Thresholds and Poverty

	Tax Entry Threshold After Credits							
	Poverty Threshold		Dollars		Percentage of Poverty		Percentage of Federal Full-Time Minimum Wage Job	
	2008	2014	2008	2014	2008	2014	2008	2014
Single, no children	\$11,201	\$11,670	17,984	11,880	161	102	119	79
Single, one child	\$14,840	\$15,730	32,779	32,929	221	209	217	218
Single, two children	\$17,346	\$19,790	43,654	41,040	252	207	289	272
Married, no children	\$14,417	\$15,730	29,904	20,000	207	127	198	133
Married, one child	\$17,330	\$19,790	43,419	39,626	251	200	288	263
Married, two children	\$21,834	\$23,850	55,586	47,840	255	201	369	317

Sources: Urban-Brookings Tax Policy Center, 2014. "Poverty Thresholds, 1990-2012".

<http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=472>, accessed on June 11, 2015; Office of the Assistant Secretary for Planning and Evaluation "2014 Poverty Guidelines," accessed June 2, 2015, <http://aspe.hhs.gov/poverty/14poverty.cfm>; and author's calculations.

Notes: Calculations assume earnings of \$15,080. Assumes all income is from wages; children qualify for earned income tax credit (EITC) and child tax credit (CTC) and there are no child care expenses. The tax entry threshold is the income level at which a household begins to owe income tax. The first panel shows the income level at which tax is owed before credits; the second panel shows the point at which tax begins to exceed EITC and the CTC. A Recovery Rebate Credit was in effect in 2008 that was not in effect in 2014, which is included in these calculations. Full-time minimum wage job is calculated by multiplying the minimum wage by 2,080 hours (52 weeks of work, 40 hours of work per week). Starting in 2007, the minimum wage began to increase to \$7.25. That level was reached in 2009. I use \$7.25 in this report since that is the fully phased in rate. For 2014, I use the federal poverty guideline, thresholds have not yet been developed.

In 2008, all states with a broad-based state income tax system, except Connecticut and Pennsylvania, followed the federal lead and exempted a base amount of income from taxation. States typically applied a lower standard deduction and personal exemptions than the federal amounts. The few states that simply used taxable income directly from the federal income tax had the same exemptions and deductions as the

federal income tax system (Colorado, Minnesota, North Dakota, South Carolina, and Vermont). In some cases, a state offered a personal credit instead of a personal exemption. The credit reduces tax liability rather than explicitly exempting a fixed amount of income. These states were Arkansas, California, Delaware, Iowa, Kentucky, Nebraska, Oregon, and Utah. Some states use other tools, such as no-tax floors, to exempt a base amount of income from taxation. Tax credits can also serve this purpose.

Tax credits further increase tax entry thresholds. The federal income tax system provides substantial assistance to low-income families via tax credits (Maag, Rennane, and Steuerle 2011). Tax credits can offset taxes owed and transfer additional income to low-income families if they are refundable. Refundable credits can benefit families even if they do not owe income taxes.

The tax entry threshold after credits shows the amount of earnings a family can have before they owe more in federal income taxes than they receive in tax credits. Though higher income families who do not qualify for tax credits may owe taxes on all income above the tax entry threshold before credits, low-income families often can earn more income that is tax-free. After credits were accounted for in 2008, no family type shown in figure 1 owed federal income tax at less-than-poverty-level wages. Relative to poverty, families without children owe income taxes much sooner than families with children.

A single person earning \$11,670 (the poverty threshold for a single person with no children in the household) could qualify for a federal EITC worth \$223 in 2014, raising the tax entry threshold to just over the poverty threshold (102 percent). The tax entry threshold with and without credits in 2014 is nearly identical for a married couple with no children because they qualify for only a very small EITC. The tax entry threshold for a married couple with no children is much higher in 2008 relative to poverty than in 2014 because of the recovery rebate credit, which was available in 2009 on tax returns for income earned in 2008 but not in 2014.²

Beyond simply raising the point at which low- and moderate-income families begin to owe taxes, the federal EITC and CTC—both at least partially refundable—make up a substantial part of the social safety net for working families by not only offsetting federal income taxes but also providing a tax refund of any credit beyond those taxes. A third credit for working families, the child and dependent care tax credit (CDCTC), can be used to offset childcare expenses. The credit is nonrefundable so benefits from the CDCTC cannot exceed income taxes owed. In 2008, the combined value of these credits for a single parent with two children with either poverty-level or full-time minimum wage earnings was approximately \$5,800.³ In 2014, that number rose to just over \$7,000 for the single parent with two children earning poverty-level wages and almost \$7,300 for the single parent with two children working a full-time minimum wage job. State EITCs are the primary lever states use to increase the tax entry threshold for low-income families and to provide assistance in the tax code. These EITCs are often calculated as a percentage of the federal EITC.

According to research by the Center on Budget and Policy Priorities, in 2008, 16 states levied income taxes on two-parent families with two children with poverty-level wages, and 12 states taxed single parents with two children with poverty-level wages. Their calculations include broad-based tax credits available to low-income families, standard deductions, exemptions, and other features of the tax code that do not rely on having specific expenses (such as child care or education) (Johnson and Williams 2011).

Tax Credits: Federal Influence on States

The remainder of this analysis focuses on 2008 to take advantage of work by other researchers and the Urban Institute's Net Income Change Calculator (NICC). I focus on families with children, the main beneficiaries of tax credits at the federal and state level.

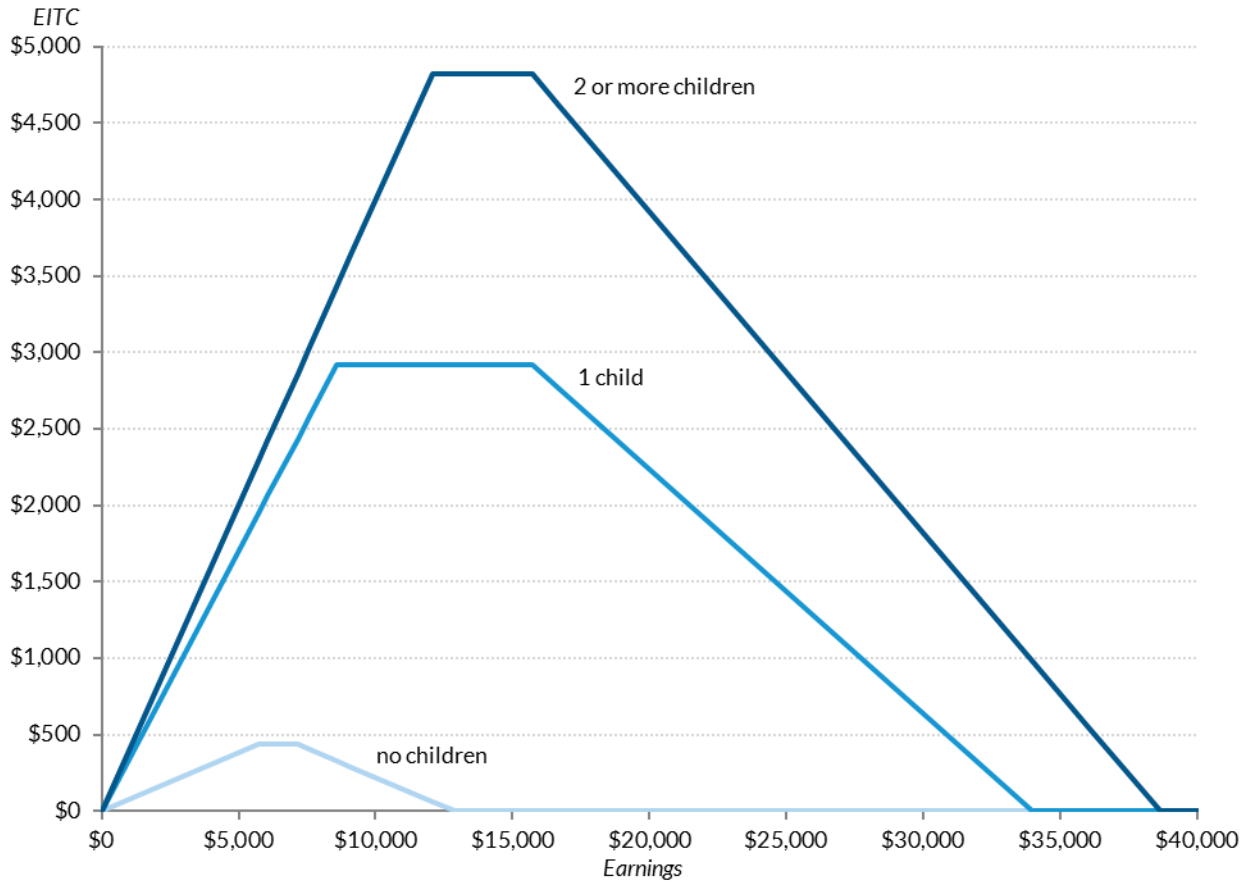
EARNED INCOME TAX CREDIT

Federal

The federal EITC is the largest cash assistance program targeted at low-income families. Annually, it lifts millions of people out of poverty (Marr, Huang, and Sherman 2014).⁴ The credit equals a fixed percentage of earnings from the first dollar of earnings until the credit reaches a maximum; both the percentage and the maximum credit depend on the number of children in the family. The credit then stays flat at that maximum as earnings continue to rise. Eventually, the credit starts to phase out with additional earnings until it disappears entirely (figure 2). The point where the credits begin to phase-out is at a higher income for married couples than for single parents. The credit is fully refundable; any excess beyond a family's income tax liability is paid as a tax refund. The credit is fully indexed for inflation. Since 2008, a larger subsidy has been added for families with at least 3 children, but that expires after 2017.

FIGURE 2

Federal EITC, 2008



Source: Urban-Brookings Tax Policy Center, “Historical EITC Parameters,” last modified November 3, 2014, accessed June 15, 2015, <http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=36>.

Notes: All income comes from wages. EITC begins to phase out at incomes \$3,000 greater than shown in figure for married couples.

The largest tax credit a single parent with two children with poverty-level or federal minimum wage earnings can receive is the EITC (\$4,490 and \$4,824 in 2008, respectively) (table 4). Although adults without children can receive the credit, the lion’s share of the credit goes to families with children because the EITC for adults without custodial children covers a very narrow income range and the maximum credit is much smaller than that for families with children.

State

In 2008, 24 states had an operating state-level EITC.⁵ Of these, 23 were set as a percentage of the federal credit. Only Minnesota had a structure that differed from the federal credit (table 2). Of the credits set as a

percentage of the state EITC, for a family with two children the state EITC varied from 3.5 percent of the federal credit in Louisiana and North Carolina to 40 percent of the federal credit in DC.⁶ The largest state-level EITC (DC) adds an additional \$1,930 (if the parent is working full time at the federal minimum wage) or \$1,796 (if the parent has poverty-level wages) to the federal credit.

TABLE 2

Description of State EITCs, 2011

State	Year enacted	Refundable	Percentage of federal EITC
Colorado	1999 (but currently suspended)		10
Connecticut	2011	Yes	25
Delaware	2005	No	20
District of Columbia	2000	Yes	40
Illinois	2000	Yes	5
Indiana	1999	Yes	9
Iowa	1989	Yes	7
Kansas	1998	Yes	18
Louisiana	2007	Yes	3.5
Maine	2000	No	5
Maryland	1987	Yes	Refundable: 25; nonrefundable 50
Massachusetts	1997	Yes	15
Michigan	2006	Yes	20
Minnesota	1991	Yes	Varies
Nebraska	2006	Yes	10
New Jersey	2000	Yes	20
New Mexico	2007	Yes	10
New York	1994	Yes	30
North Carolina	2007	Yes	5
Oklahoma	2002	Yes	5
Oregon	1997	Yes	6
Rhode Island	1986	Partially	25
Vermont	1988	Yes	32
Virginia	2004	No	20
Washington	2008 (but not yet implemented)	Yes	10 (or \$50, whichever is greater) 4 for families with one child; 11 for families with two children; 34 for families with three children
Wisconsin	1989	Yes	

Source: Tax Credits for Working Families, "States with EITCs," Hatcher Group, accessed January 15, 2012, <http://www.taxcreditsforworkingfamilies.org/earned-income-tax-credit/states-with-eitcs/>.

CHILD TAX CREDIT

Federal

Taxpayers can claim a federal CTC of up to \$1,000 per child under age 17. The credit is reduced by 5 percent of adjusted gross income over \$110,000 for married couples (\$75,000 for single parents). If the credit exceeds taxes owed, taxpayers can receive some or all of the balance as a refund, known as the additional child tax credit (ACTC) or refundable CTC. The ACTC is limited to 15 percent of earnings above a threshold

that is indexed to inflation; the threshold was temporarily reduced to \$8,500 in 2008 and reduced again in 2009 to \$3,000, where it is scheduled to remain through 2017. In 2008, the maximum CTC a working parent with two children could receive was \$2,000. In 2008, a single parent with two children working at the poverty level could receive a CTC worth \$1,327. If she worked full time at the minimum wage, her CTC would be \$987.⁷

State

The CTC, especially in recent years, plays a large role in federal income tax policy for low-income families, but few states follow the federal lead. In 2008, only New York, North Carolina, and Oklahoma had a state-level CTC. A handful of other states have a personal credit in lieu of a personal exemption. The New York credit is the largest for a single parent with two children earning poverty-level wages or working full time at the minimum wage. The New York state CTC provides a subsidy of \$660 for the former family and about \$600 for the latter. For most families, the New York CTC is one-third of the federal credit. Oklahoma allows families to claim a CTC worth 5 percent of their federal credit, and North Carolina allows a credit of \$100 per child for families with low enough incomes.

CHILD AND DEPENDENT CARE TAX CREDIT

Federal

Working parents can offset a portion of their child care expense with the Child and Dependent Care Tax Credit (CDCTC). To receive the CDCTC, parents can claim up to \$3,000 of expenses per child (to a maximum of \$6,000) and receive a credit of between 20 and 35 percent of that amount, depending on their AGI. The federal CDCTC is nonrefundable, so almost no benefits go to families whose income puts them in the lowest fifth of the population. In 2008, a single mother with two children working full time at the minimum wage or with poverty-level wages could not benefit from the CDCTC, because she did not owe federal income taxes after accounting for the personal exemption and standard deduction.

State

Although states often model their CDCTCs on the federal credit, a substantial number of states have child care credits that provide *more progressive* subsidies than the federal CDCTC. States follow the federal lead in determining eligible expenses but sometimes go a step further than the federal income tax system by making the credits refundable. In addition, some states limit income eligibility for the credit. More low-income families can receive the credit and middle- and high-income households are ineligible. In total, there are 28 states with 33 child care credits. Of these, 13 states have a refundable child care credit which works to offset child care costs for people who do not owe state income taxes, unlike the federal credit which is limited to a family's income tax liability (table 3). Twelve states place an upper-income limit on eligibility for

their child care credits, unlike the federal credit. A single parent of two children who works at poverty-level wages with the maximum allowed expenses (\$6,000 per year) can receive a child care credit worth almost \$2,800 in Oregon. If she works full time at the minimum wage, her child care credit can be worth around \$2,600. States with small child care credits are those with nonrefundable credits. They are typically worth nothing or very little to low-income families.

TABLE 3

Description of State Child Care Credits, 2010

State	At least partially refundable	Percentage of the federal EITC	Phases out before federal CDCTC?
Arkansas	No	20% of allowable federal CDCTC in effect on January 1, 2007.	No
Arkansas	Yes	20% of allowed federal CDCTC in effect on January 1, 1993.	No
California	Yes	34%–50% of federal CDCTC expenses.	Yes
Delaware	No	50% of the allowable federal CDCTC.	Yes
District of Columbia	No	32% of the allowed federal CDCTC.	No
Georgia	No	30% of claimed and allowed federal CDCTC.	No
Hawaii	Yes	15%–25% of federal eligible CDCTC expenses.	No
Idaho	No	Deduction of expenses eligible for federal CDCTC	No
Iowa	Yes	30%–75% of federal CDCTC.	Yes
Kansas	No	25% of allowed federal CDCTC.	No
Kentucky	No	20% of allowed federal CDCTC.	No
Louisiana	Yes	10%–50% of federal CDCTC.	Yes
Louisiana	Yes	50%–200% of state CDCTC.	No
Maine	Yes	25%–50% of allowable federal CDCTC.	No
Maryland	No	Deduction of federal CDCTC expenses.	No
Maryland	No	3.25%–32.5% of federal CDCTC.	Yes
Massachusetts	No	Deduction of expenses eligible for federal CDCTC; pre EGTRRA expansion	No
Minnesota	Yes	Federal CDCTC, with limits.	Yes
Montana	No	Deduction of eligible expenses.	No
Nebraska	Yes	25%–100% of federal CDCTC.	No
New Mexico	Yes	Up to 40% of eligible federal CDCTC expenses.	Yes
New York	Yes	20%–110% of allowable federal CDCTC.	No
North Carolina	No	7%–13% of eligible federal CDCTC expenses.	No
Ohio	No	25%–100% of eligible federal CDCTC.	Yes
Oklahoma	No	20% of allowed federal CDCTC expenses.	Yes
Oregon	No	4%–30% of allowable federal CDCTC expenses.	Yes
Oregon	Yes	8%–50% of child care expenses.	Yes
Rhode Island	No	25% of federal CDCTC.	No
South Carolina	No	7% of eligible federal CDCTC expenses.	No
Vermont	No	24% of allowed federal CDCTC.	No
Vermont	Yes	50% of allowed federal CDCTC.	Yes
Virginia	No	Deduction of federal CDCTC expenses.	No

Source: Campbell et al., 2011, appendix A.

ADDITIONAL STATE CREDITS FOR LOW-INCOME FAMILIES

Though states often follow the lead of the federal government, many state income tax systems provide tax credits that are not based on federal credits. In some cases, states use income tax credits to offset other often more regressive state taxes, such as property taxes or sales taxes. In the case of property tax credits administered through state income tax systems, the credits are typically based on a person's income as well as either property taxes paid or rent paid, under the assumption that property owners pass at least part of the property tax onto renters. By implementing the tax credit through the income tax system, states are able to more easily target the credits to lower-income families than they would be able to do through the property tax system, which lacks information about a person's income. Some states offset a portion of the sales tax with credits, such as "grocery credits," which provide a fixed credit to families at varying income levels, with larger credits typically going to lower-income families.

Combined Effects of Federal and State Tax Credits

Combined, the federal EITC and CTC boosted the income of a single parent with poverty-level wages with two children by just over \$5,800 in 2008 (table 4). Benefits from the credits were slightly lower if this parent worked full time at the minimum wage.

The combination of state EITCs, CTC, and child care credits can add just over \$3,500 of income for a single parent with two children working at poverty level wages or almost \$4,000 to the same family with the parent working full-time at the minimum wage in New York, the most generous of the states with respect to these three tax credits. All of these credits are built around their federal counterparts, and changes at the federal level would affect the state credits, unless a state acted to break the link between state credits and federal credits.

TABLE 4

Benefits of Various Tax Credits for a Single Parent of Two Children, 2008

	Federal tax credit	Range of State-Level Credit Value among States with Credit(s)		Number of states with state-level credit
		Minimum ^a	Maximum ^a	
Poverty-level wages (\$17,346)				
<i>EITC</i>	\$4,490	\$157	\$1,796	24
<i>Child credit</i>	\$1,327	\$66	\$660	3
<i>Child care credit</i>	\$0	\$12	\$2,760	28
<i>Combined benefit</i>	\$5,817	\$96	\$3,530	
Full-time minimum wage (\$15,080)				
<i>EITC</i>	\$4,824	\$169	\$1,930	24
<i>Child credit</i>	\$987	\$49	\$600	3
<i>Child care credit</i>	\$0	\$36	\$2,628	28
<i>Combined benefit</i>	\$5,811	\$48	\$3,690	

Notes: Assumes all income is from wages. Annual childcare costs equal \$6,000. Both children are under age 13 and qualify for the federal EITC, CTC, and CDCTC. Combined state-level benefit includes states with any of the identified credits and is the sum of the CTC, CDCTC, and EITC. Child care credit values in states count only those worth more than \$0 for families at the described income levels. Full-time minimum wage is calculated as 2,080 hours x \$7.25 per hour.

^a Only includes states that have a refundable version of the credit. Eligible individuals could also receive a recovery rebate credit or stimulus payment in 2008 on their federal tax return. Combined benefit includes states with at least one of the EITC, CDCTC, and CTC.

The Importance of Federal and State Income Taxes in the Social Safety Net

A substantial amount of assistance available to low-income families is delivered through federal and state income tax systems, which has some advantages over traditional transfer programs. For example, tax credits for working families often lack the stigma that can accompany transfer programs, and one need not apply for tax credits during limited operating hours of a welfare office that may be located inconveniently. For working families, this may remove a substantial barrier to getting assistance. Tax credits are also not subject to annual appropriations, making them a more stable source of support than transfer programs.

Administrative costs associated with delivering tax credits are typically low, particularly for states that piggy-back off of federal rules. On the other hand, benefit receipt may be poorly timed. Eligible individuals typically receive the bulk of their tax credits when they file their tax returns in the spring, unlike transfer benefits which are delivered monthly.

In many states, federal income tax credits—namely the earned income tax credit and the child tax credit—provide more cash assistance to working families than any other government transfer (this excludes

Social Security, which directs most benefits at the elderly and disabled).⁸ States vary dramatically in the design of their tax and transfer systems and as a result, people can fare quite differently, depending on where they live. Some states offer no subsidies via the income tax, and others offer substantial subsidies.

The Urban Institute's Net Income Change Calculator (NICC) allows analysts to calculate income taxes and transfers for representative families. By inputting data on items such as wages, hours worked, family structure, and child care costs and which transfer programs a family participates in it is possible to see how income support varies for similar families across the states.

The analysis in this paper is restricted to a single parent with two children (ages 6 and 8) working full time (2,080 hours a year) at the federal minimum wage (\$15,080). Child care expenses are either set at \$0, under the assumption that many low-income families will use informal care or \$500 per month, which allows them to qualify for the maximum child care credit, providing estimates that bound the possible tax benefits a family could receive. The family participates in Temporary Assistance for Needy Families (TANF) and has been combining TANF and wages for 12 months. This provides a calculation of the longer-term safety net rather than the more generous one often in place immediately after returning to work. Notably, few families actually receive TANF—only one-third of eligible families participated in TANF in 2008. The estimates also include Supplemental Nutrition Assistance Program (SNAP) benefits. About 68 percent of eligible SNAP families participated in 2008 (US Department of Health and Human Services, n.d.). Analysts estimate that not all families eligible for the EITC receive the credit, but it is generally accepted that EITC participation rates for families with children are high—close to 90 percent (Scholz 1994).

All calculations are for 2008, the most recent year for which data on taxes and transfers are available in NICC. Although health programs certainly form the backbone of much assistance, these programs are not included in NICC, and thus they are not included in these calculations. This analysis is limited to providing a good representation of cash and near-cash benefits, which consists of wages, TANF, SNAP, and federal and state income taxes.

TABLE 5

Effect of State Taxes, TANF, and SNAP on Income for a Single Parent with Two Children

Parent pays \$6,000 annual child care expenses and works full time at the minimum wage, 2008

State	TANF and SNAP	State taxes	Total income
State income taxes increase after-tax income			
New York	3,936	3,996	29,723
Oregon	3,228	2,688	27,707
Minnesota	3,228	2,640	27,659
Vermont	4,104	2,556	28,451
Nebraska	4,692	2,520	29,003
District of Columbia	5,712	1,920	29,423
Iowa	3,228	1,656	26,675
New Mexico	3,228	1,512	26,531
Maryland	3,876	1,200	26,867
Louisiana	3,228	1,104	26,123
Hawaii	9,408	1,092	32,291
New Jersey	3,228	1,080	26,099
California	4,968	1,020	27,779
Kansas	4,644	960	27,395
Massachusetts	3,228	720	25,739
Wisconsin	3,228	588	25,607
Maine	3,228	504	25,523
Michigan	3,228	324	25,343
Oklahoma	3,228	240	25,259
Rhode Island	5,280	180	27,251
North Carolina	3,228	168	25,187
Georgia	3,228	12	25,031
State income taxes do not affect after-tax income			
Alaska	9,000	0	30,791
Arizona	3,228	0	25,019
Colorado	3,228	0	25,019
Connecticut	7,932	0	29,723
Delaware	3,804	0	25,595
Florida	3,228	0	25,019
Idaho	3,228	0	25,019
Kentucky	3,228	0	25,019
Nevada	3,228	0	25,019
New Hampshire	5,160	0	26,951
North Dakota	7,236	0	29,027
Ohio	4,404	0	26,195
Pennsylvania	3,228	0	25,019
South Carolina	3,228	0	25,019
South Dakota	3,228	0	25,019
Tennessee	4,788	0	26,579
Texas	3,228	0	25,019

TABLE 5 CONTINUED

State	TANF and SNAP	State taxes	Total income
Utah	3,228	0	25,019
Virginia	6,492	0	28,283
Washington	3,228	0	25,019
West Virginia	3,228	0	25,019
Wyoming	3,228	0	25,019
State income taxes decrease after-tax income			
Arkansas	3,228	-12	25,007
Indiana	4,968	-12	26,747
Mississippi	3,228	-12	25,007
Missouri	3,228	-12	25,007
Illinois	3,336	-24	25,103
Montana	3,228	-72	24,947
Alabama	3,228	-228	24,791

Source: Urban Institute Net Income Change Calculator.

Notes: Earnings = \$15,080; federal tax credits = \$6,711. All income comes from earnings. The two children are ages 6 and 8. The family participates in both SNAP and TANF if eligible and has combined earnings and TANF for 12 months. The parent works 2,080 hours per year at the fully phase-in minimum wage of \$7.25.

TABLE 6

Effect of State Taxes, TANF, and SNAP on Income for a Single Parent with Two Children

Parent has no child care expenses and works full time at the minimum wage, 2008

State	TANF and SNAP	State Taxes	Total Income
States with income taxes that increase income			
District of Columbia	2,484	1,752	26,027
New York	2,676	1,752	26,219
Vermont	1,968	1,536	25,295
Maryland	1,968	1,200	24,959
Minnesota	1,968	1,200	24,959
New Jersey	1,968	1,080	24,839
Kansas	1,968	912	24,671
Massachusetts	1,968	720	24,479
Wisconsin	1,968	588	24,347
New Mexico	1,968	552	24,311
Nebraska	1,968	480	24,239
Iowa	1,968	336	24,095
Michigan	1,968	324	24,083
Oklahoma	1,968	204	23,963
Rhode Island	2,052	180	24,023
North Carolina	1,968	168	23,927
Louisiana	1,968	60	23,843
Oregon	1,968	60	23,819

TABLE 6 CONTINUED

State	TANF and SNAP	State taxes	Total income
States with income taxes that have no effect on income			
<i>Alaska</i>	6,420	0	28,211
<i>Arizona</i>	1,968	0	23,759
<i>California</i>	3,708	0	25,499
<i>Colorado</i>	1,968	0	23,759
<i>Connecticut</i>	6,720	0	28,511
<i>Delaware</i>	1,968	0	23,759
<i>Florida</i>	1,968	0	23,759
<i>Idaho</i>	1,968	0	23,759
<i>Kentucky</i>	1,968	0	23,759
<i>Maine</i>	1,968	0	23,759
<i>Nevada</i>	1,968	0	23,759
<i>New Hampshire</i>	1,968	0	23,759
<i>North Dakota</i>	1,968	0	23,759
<i>Pennsylvania</i>	1,968	0	23,759
<i>South Carolina</i>	1,968	0	23,759
<i>South Dakota</i>	1,968	0	23,759
<i>Tennessee</i>	2,460	0	24,251
<i>Texas</i>	1,968	0	23,759
<i>Utah</i>	1,968	0	23,759
<i>Virginia</i>	5,232	0	27,023
<i>Washington</i>	1,968	0	23,759
<i>West Virginia</i>	1,968	0	23,759
<i>Wyoming</i>	1,968	0	23,759
States with income taxes that increase income			
<i>Arkansas</i>	1,968	-12	23,747
<i>Indiana</i>	1,968	-12	23,747
<i>Mississippi</i>	1,968	-12	23,747
<i>Missouri</i>	1,968	-12	23,747
<i>Illinois</i>	2,076	-24	23,843
<i>Ohio</i>	1,968	-48	23,711
<i>Georgia</i>	1,968	-60	23,699
<i>Montana</i>	1,968	-72	23,687
<i>Hawaii</i>	6,192	-96	27,887
<i>Alabama</i>	1,968	-228	23,531

Source: Urban Institute Net Income Change Calculator.

Notes: Earnings = \$15,080; federal tax credits = \$6,711. All income comes from earnings. The two children are ages 6 and 8. The family participates in both SNAP and TANF if eligible and has combined earnings and TANF for 12 months. Works 2,080 hours per year at the fully phase-in minimum wage of \$7.25.

The social safety net can vary dramatically between states. For a single parent of two children who works full time at the minimum wage all year long (\$15,080 annual earnings), TANF, SNAP, and state income tax credits can add between almost \$3,000 and \$10,500 if this family participates in SNAP and TANF and has childcare expenses of at least \$500 per month (table 5). If the same family does not have childcare expenses, benefits from TANF, SNAP, and state tax credits can vary from just over \$1,700 to \$6,700 (table 6). In both scenarios, federal tax credits will add an additional \$6,700 in benefits. Adding together benefits available to this sample family from TANF, SNAP, and state tax systems shows a wide range on a state's reliance on its income tax system for providing assistance. State tax credits can account for about one-third of the state safety net if the sample family has child care costs and up to 44 percent of the combined subsidy if the family has no childcare costs. Ignoring TANF, since so few families actually receive TANF benefits, the proportion of the state safety net coming from state tax credits rises to 50 and 51 percent. Including federal credits in the calculation tilts the scale even more toward the importance of tax policy for low-income families.

In 2008, there were 22 states (including the District of Columbia) that used their state income tax systems to provide subsidies—beyond simply eliminating tax liability—for a single parent with two children working full time at the minimum wage (\$15,080) and paying for child care (\$6,000 per year). Six states would have collected income taxes from this family, typically a very small amount, with the exception of Alabama. If the family did not have child care expenses to offset with tax credits, the number of states providing subsidies through the state income tax dropped to 18 and the number of states collecting taxes from this family increased to 10. Still, families may have been better off paying less in child care and more in taxes.

Conclusion

Federal and state income tax systems have become an important part of the safety net for low-income working families. In large part, states copy elements of the federal income tax system to deliver similar benefits. The two most common state tax credits that mimic credits from the federal income tax system are state-level EITCs and child care credits. In some cases, the state child care credits are much more progressive than the federal credit because they are refundable—so unlike the federal child care credit, very low income families can benefit from the state level credit.

In 2001, federal tax assistance for low-income families was expanded as part of the Economic Growth and Tax Relief Reconciliation Act of 2001. Following that, the 2009 American Recovery and Reinvestment Act made further expansions. Both of these laws increased the generosity of the federal EITC—the first for some married couples, the second for families with more than two children. The Economic Growth and Tax

Relief Reconciliation Act also increased the amount of expenses eligible for the federal Child and Dependent Care Tax Credit, effective for tax year 2003. Only one state with a CDCTC, Hawaii, opted to only provide a state credit for the lower level of expenses available before 2003. State policymakers may accept federal changes to tax credits as a matter of practicality, not because they believe changes are necessary. Credit enforcement can be difficult. The more similar state credits are to federal credits, the more states are able to piggyback on federal enforcement efforts for their own enforcement.

In light of this, and in light of the significant role that state income taxes play in the total state-level safety net, federal policymakers need to be aware of how reliant states are on the federal tax system to deliver benefits to low-income working families. State policymakers continue to rely on federal tax policy to provide a substantial source of support to low-income working families. As NICC program rules are updated, we will use future reports to document changes to the state tax system resulting from changes in the federal tax system. Cuts at the federal level could trickle down to the state level, leaving working families worse off not just because they will receive lower federal credits, but also because their state credits would fall. Given the large role taxes play in the total safety net, policymakers should exercise caution when making changes.

Notes

1. For ease of exposition, I will be considering Washington DC a state in this paper.
2. The recovery rebate credit was enacted in 2008 for one year. It provided a maximum credit equal to \$600 per taxpayer, \$1,200 if married filing jointly plus \$300 for each child under age 17 for taxpayers with income of at least \$3,000. The credit began to phase out for single filers once their income reached \$75,000 (\$150,000 for joint filers) at a rate of 5 percent.
3. Total rebates in 2008 at these income levels are slightly higher than \$6,700 because of the temporary recovery rebate credit that was available that year.
4. This calculation treats the EITC the same as if it were wages. The official poverty rate is unchanged with the addition of an EITC because the official poverty measure does not account for taxes or tax credits in its measure of income.
5. Colorado has an EITC in its tax code, but suspended payments in 2008 because of budget constraints. Washington has a state EITC on the books that has never been funded.
6. Tax Credits for Working Families, "States with EITCs," accessed January 15, 2012, <http://www.taxcreditsforworkingfamilies.org/earned-income-tax-credit/states-with-eitcs/>.
7. The refundability threshold for the federal CTC was reduced from \$8,500 in 2008 to \$3,000 after 2008. As a result, the CTC is now worth \$2,000 to a single parent with two children working at poverty-level wages. The CTC for this same family working full time at the minimum wage is \$1800. That reduced refundability threshold expires after 2017, at which point the refundability threshold will increase to around \$15,000. Then, the full-time minimum wage worker will not receive any benefit and the poverty-level worker will receive very little benefit for the CTC.
8. Benefits from disability and housing programs could certainly be larger, but relatively few working families benefit from these programs.

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