

The EITC's impact in the Promise Neighborhood

An opportunity to boost stability, planning and savings

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What is the EITC?

The Earned Income Tax Credit is a tax credit for working families. Tax credits reduce tax liability. They can be refundable or nonrefundable and that decision has a big impact on who benefits.

The federal EITC is refundable, meaning that if the tax owed is less than the amount of the credit, the balance is returned to the taxpayer in the form of a tax refund check. Families use this refund for childcare, transportation, school or work supplies, or just making ends meet. The refunded EITC raises family income, keeps children out of poverty, supports work, and also helps to make up for the fact that low-income families pay a higher share of their income in state and local taxes.

Last spring Ohio enacted a state EITC, a great first step. It is nonrefundable, capped for those with taxable income over \$20,000, and set at 5 percent of the federal credit. These features make the Ohio credit less effective at helping working families. The 5 percent credit is tiny compared to the national refundable-credit average of 16 percent. Ohio's cap means that the credit phases out at lower income levels. But the impact of the credit is reduced most because it is not refundable. As Ohio's EITC is structured, the majority of the poorest workers in the state will receive no benefit.

The EITC matters to Central

The federal EITC boosts the bottom line of working poor families and helps insulate kids against some of the damaging impacts of poverty. It already brings benefits to Ohio and Central's Promise Neighborhood. An estimated 191,000 Ohioans, including 99,000 children, were kept out of poverty by the EITC each year from 2010 to 2012. The federal EITC brings an estimated \$5.7 million to the Promise Neighborhood each year. Some 1,900 Promise Neighborhood tax returns – 56 percent of all returns – claimed it. The average refund in the neighborhood was \$3,001.

Unlike the federal EITC, Ohio's nonrefundable credit is not likely to produce significant gains for the community. The median gross income of the Promise Neighborhood is barely above the threshold for Ohio's existing low-income tax credit, which eliminates tax liability for those with taxable income less than \$10,000. Tax data show that nearly 40 percent of neighborhood returns that claim the federal EITC earned less than \$9,999. Those filers will receive no benefit from the state EITC as it is structured. The table below estimates the federal and Ohio credit for hypothetical families earning the Central neighborhood median income of \$10,239.

The EITC's modest income boost helps children and sets a foundation for future success. Kids in EITC families that receive larger credits tend to have higher test scores, particularly in math, higher graduation rates, and higher college attendance rates. A credit worth about \$3,000 claimed by a working parent during a child's early life may boost achievement as much as two additional months of schooling.

Making the Ohio EITC a credit that counts for Central				
Estimated EITC amounts based on Central median income of \$10,239, tax year 2013				
Family Composition	Maximum federal EITC	Maximum Ohio EITC with current non-refundable, capped credit	Estimated Ohio EITC, refundable, non-capped, 5 percent	Estimated Ohio EITC, refundable, non-capped, 16 percent
Single, Three or more qualifying children	\$ 4,601	\$0	\$230	\$736
Single, Two qualifying children	\$ 4,090		\$205	\$654
Single, One qualifying child	\$ 3,250		\$163	\$520
Single, No qualifying children	\$ 314		\$16	\$50

Source: Policy Matters Ohio, author's calculation based using EITC calculator at <http://eitcoutreach.org/home/outreach-tools/the-eic-estimator/>. Median income for the Promise Neighborhood is \$10,239. State credit based on likely interaction between the EITC, the current personal exemption rules, and the low income tax credit. These are estimates only, tax returns are highly individualistic and may differ.

These benefits continue into adulthood. Research has found that in low-income families a \$3,000 increase in family income between a child's first and fifth birthday is associated with an average 17 percent increase in annual earnings and an additional 135 hours of work each year when the child becomes an adult. It is clear that policies that make work pay also help make school work for kids.

A credit that counts for Central

The EITC offers an annual opportunity to help residents with financial literacy, savings, and programs that build stability, encourage planning, and even help families save a little for college. As it is, many Central families are not receiving the full return from their federal EITC. A slightly larger share of filers in the neighborhood use paid preparers and purchase refund anticipation products than filers in Cleveland and the state at large. Helping families create a tax-filing plan can greatly reduce the use of these services, so less of a family's return is lost to fees. No free tax preparation sites are located in the promise neighborhood, although some are nearby. Placing a tax-preparation site in the neighborhood, increasing outreach, and providing information about the EITC and tax assistance services would help families make informed decisions about their taxes.

Building partnerships with the county, nearby credit unions and traditional financial institutions could expand access to banking and savings services, which are currently missing in the Promise neighborhood. These partnerships could create matching savings programs targeted for education, child savings accounts, and resources to bank the unbanked.

The pro-family benefits that come from the EITC could be strengthened to help more kids succeed. The Ohio EITC should be fixed so the credit reaches the poorest working Ohioans. This means the credit should be refundable, non-capped, and increased. These changes would bring the credit in line with most state EITCs and increase the reach of the credit to many more families in the Promise neighborhood. Ohio's EITC should be made stronger and the community can take action to make this policy work for Central's kids.