

Common sense reform for working Ohio: Refundable EITC would help clean up unfair tax code

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What is the Ohio EITC and why does it need reform?

Ohio struggles with declining labor force participation. A significant portion of families living in poverty are working families, and statewide, poverty remains above pre-recession levels. Our out-of-balance state tax system has been made worse by years of tax cuts that have gone primarily to the affluent. The Earned Income Tax Credit (EITC) is a tax policy designed to help address each of these problems. Yet, Ohio's credit remains one of the weakest in the nation.

The federal government, 26 states and Washington D.C. have EITCs. The credits can be refundable or nonrefundable. Refundability allows workers to get the full value of their credit regardless of their income tax liability. In refundable states, the amount of the credit that exceeds the taxpayer's state income tax liability is returned to the claimant as a tax refund. For example, the average Ohio EITC for workers earning between \$21,000 and \$39,000 is \$142. If the claimant has \$100 in tax liability, then the remaining \$42 of EITC is simply lost. In a refundable state, the \$42 would be returned to the claimant in the form of a tax refund check. Ohio's credit is one of only four nonrefundable state EITCs.

Ohio's EITC has other flaws. It is also capped. The maximum EITC a filer with taxable income over \$20,000 can claim is only half their tax liability, even if they are otherwise eligible for more. The value of the credit is also below the average value of other state credits (17 percent of the U.S. credit).

These policy decisions add up to make Ohio's EITC one of the weakest in the nation. The current Ohio EITC does nothing for 92 percent of the poorest Ohioans. And for the 8 percent that do receive help from the credit, the average tax savings is only \$70.

How would a reformed EITC help working Ohioans?

Bringing Ohio's credit in line with other state EITCs would mean more money in the pockets of Ohio workers. It would help keep low-income workers in the labor market and offset some of the disproportionate tax load carried by these workers. A refundable, non-capped, EITC that is 20 percent of the federal credit would provide 38 percent of Ohio's poorest with a tax cut. The eligible workers in that income range would see an average cut of \$451. Many workers in this income category do not earn enough to pay Ohio income taxes, so most of this cut would be returned to these taxpayers in the form of a tax refund. The vast majority of this money would go into the local economy for essentials.

EITC Impact

Ohio's tax cuts have shorted the state budget. Low- and middle-income families pay more of their income in taxes than their wealthier counterparts do and many struggle to move up in our economy.

The EITC can help. The credit encourages work, helps keep families out of poverty and can help bring some balance to the tax code. But Ohio's credit is too weak to work.

Common sense reform is needed. Policymakers should fix Ohio's EITC and put it on par with other states' credits:

- Make the credit refundable;
- Eliminate the cap; and
- Raise the amount of the credit.

These changes would mean working poor families would get income support.

This table shows the estimated effect of a reformed EITC on different income groups.

| A well-targeted EITC could lift up Ohio workers: Effect of a 20 percent, non-capped, refundable EITC by income class | | | |
|---|-----------------------|----------------------|-----------------------|
| | Poorest Ohioans | Low-income Ohioans | Middle-income Ohioans |
| Income range | Less than \$21,000 | \$21,000-\$39,000 | \$39,000-\$60,000 |
| Average income | \$13,000 | \$29,000 | \$49,000 |
| Share receiving tax cut after reforms | 38% | 30% | 14% |
| Change from share of those getting existing credit | +30 percentage points | +8 percentage points | +3 percentage points |
| Average EITC tax savings after reforms | \$451 | \$620 | \$312 |
| Change from existing credit | +\$381 | +\$478 | +\$199 |

Source: Institute on Taxation and Economic Policy, December 2016. Covers Ohio residents only and is based on 2016 income. Percentages rounded.

The EITC is intended to do more than just reduce or eliminate income tax liability. The credit is designed to encourage work, insulate working families from poverty and help make up for the fact that low-income people pay more of their income in state and local taxes than wealthier people do.

The state EITC can only be effective at addressing these concerns if the credit is refundable. Existing income-tax credits and exemptions already eliminate state income tax liability for many. This makes the current nonrefundable EITC a redundant and ineffective credit for most of the lowest-income Ohioans. Without refundability, the EITC ignores all the other taxes these workers pay. These workers may not have high state income tax bills, but they pay a higher share of their income in state and local taxes than the wealthy do on average.

Other classes of Ohio taxpayers get refunds when their credits exceed their tax liability. Ohio already has refundable tax credits on the books for motion picture producers, historic building rehabilitators and venture capitalists. Ohio also rewards corporations with refundable credits.

Rebuild our economy from the middle out: Start with EITC reform.

Ohio’s recovery from the great recession worked for some, but for many working Ohioans the last decade has been a struggle. Poverty rates remain stubbornly high. Incomes haven’t risen in real terms. The state has been unable to fully invest in programs that help families move ahead, like the EITC, transportation, and childcare supports. The EITC is a straightforward policy reform that could start turning Ohio away from trickle-down economic policy toward policies that build our economy from the middle out. These reforms will put more money into the pockets of people who work for a living. Ultimately, that cash will support the businesses working people frequent and those who provide the services they purchase. Unlike giveaways at the top, supports to working families send cash to the places that need it most.