

A REPORT FROM

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# POLICY MATTERS OHIO

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## AN OHIO EARNED INCOME TAX CREDIT: COSTS AND BENEFITS

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## EXECUTIVE SUMMARY

The federal Earned Income Tax Credit (EITC) provides up to \$4204 to working families who earn less than \$33,000. The credit enjoys wide bipartisan support because of its proven record in helping to reduce poverty, reward work, provide tax relief, stimulate the economy and meet basic expenses for working families. The federal EITC lifted 4.8 million people above the federally defined poverty line in 2001, more than any other government program.

An Ohio EITC, set at 20 percent of the federal benefit amount, would provide an estimated 676,466 working families in Ohio with an average annual credit of \$328 for an estimated total cost to the state of \$222 million dollars for the Tax Year 2004.<sup>1</sup> This is less than one percent of Ohio's projected General Revenue Fund expenditures for Fiscal Year 2004.<sup>2</sup> As Ohio debates changes to its tax system, many of which would fall more heavily on low and middle-income families, lawmakers should consider incorporating a state EITC into the changes. This would ensure that relief is provided to low- and moderate-income working families.

Other EITC-related findings include:

- ◆ Seventeen states offer EITCs based on the federal credit. In the last few legislative sessions, nine states and the District of Columbia enacted new EITCs or expanded existing state EITCs.
- ◆ A state EITC would help Ohio families escape poverty or meet basic expenses. In 2001, about one in six Ohio children lived below the official poverty line. A state EITC would lift more than 8000 of these children above that threshold.
- ◆ A state EITC would make Ohio's state and local tax distribution less regressive. In 2002, the poorest fifth of Ohio families (earning less than \$15,000 annually) paid 10.9 percent of their income in state taxes, while the top one percent of families (earning an average \$660,200) paid just 6.7 percent of their income toward such taxes, after the federal deduction offset.
- ◆ Every Ohio county has working families who claimed the federal EITC in 2000 and would qualify for a state EITC. In the average Ohio county, 12 percent of taxpayers filed for the federal credit. In six counties, more than 20 percent of taxpayers qualify.

In Tax Year 2000, the federal EITC credited 676,466 Ohio taxpayers with an average \$1587 each, for a total of \$1,074 million in federal credits to Ohio families. Only seven states saw more families claim the credit than Ohio. Ohio could build on this commitment by the federal government to Ohio's working families. The result would be less poverty, more ability to work and a more just tax system for employed Ohioans.

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<sup>1</sup> Estimates of cost are for 2004, but the estimate for the number of claimants is for 2001 (the most recent data available at <http://www.irs.gov/pub/irs-soi/00in36oh.xls>).

<sup>2</sup> OH Office of Budget and Management 2004-05 Blue Book, at <http://www.state.oh.us/obm/information/budget/Bluebook0405/tax.asp>

## INTRODUCTION

Ohio Governor Bob Taft recently released a proposal to reform and strengthen Ohio's tax system and raise substantial additional revenue to begin filling what is nearly a \$4 billion shortfall for the biennial budget. Some legislative leaders have responded with alternate proposals.

Raising additional revenue is a necessity in Ohio. Although the plans differ, none would make the entire tax system more progressive. A progressive system bases taxes on ability to pay, with higher income families bearing a higher proportion of the burden. One proposal – to have a flat tax – would make the income tax system less progressive. Other plans, including Taft's, expand the sales tax, which falls more heavily on low- and middle-income taxpayers. Any plan that makes the system more regressive should be accompanied by measures to increase fairness in the tax code.

The federal Earned Income Tax Credit (EITC), which provides tax refunds up to \$4204 to working families earning less than \$33,692, is a proven method for using the tax code to do just that – relieve the burden on low-income working families, support work effort, make the tax system more progressive, and stimulate the economy at the same time.

Between 1998 and 2001, 15 to 18 percent of Ohio's children lived below the official poverty line. During the same years, between 64 and 70 percent of these young people lived in a home with a working adult<sup>3</sup>. In 2001, 476,000 Ohio children were being raised in poverty<sup>4</sup>. Work is often not enough to bring Ohio families out of poverty.

The recent recession has turned some middle-income families into low income ones, and driven some low-income families into poverty. Some have lost jobs, others have had

### CREDIT PROFILE

NAME: Chawntilly Krier and daughters Seaira (age 7) and Keaira (age 2)

JOB: Administrative Assistant at Muskingum Area Technical College.

INCOME: \$26,000, including child support.

FEDERAL EITC: \$1605

CREDIT IF WE HAD AN OHIO EITC: \$320

MEETING MONTHLY EXPENSES: "Sometimes I have trouble – the mortgage, the day care the groceries. I can't afford full-time day care at a center for the baby."

THINGS THEY'VE DONE WITHOUT: "Well the kids have so many needs. My youngest needs a new coat, but finding the time to go buy it and the extra money in the budget is hard. You're always hoping for a sale."

WHAT SHE'D SPEND CREDIT ON: "On the kids and on visits to the doctor. I have health insurance but my youngest has to see a foot specialist and the shoes are not covered by insurance. They cost \$140."

FAVORITE THING: "I love just to be with my kids."

GOALS: "I have an associate's degree and I'm working on my Bachelor's Degree. My job provides me with a good stable environment and income until I meet that goal."

QUICK QUOTE ON EITC EXPANSION: "This is an opportunity for those who make too much to get any kind of financial assistance program. I can't get child care assistance, but we're still at a struggling point. People who are working are not always financially independent and this provides a financial cushion not so much for ourselves, but for our children."

<sup>3</sup> Economic Policy Institute analysis of Current Population Survey data.

<sup>4</sup> Zeller, George, "The State of Poverty in Ohio, 2002", Ohio Association of Community Action Agencies.

hours or wages reduced, still others have taken on lower-paying positions. Between June 2000 and June 2002, 203,000 Ohio workers and 55,000 Cuyahoga County workers lost their jobs<sup>5</sup>. The result for many employees and their children is less income, more poverty, and greater need.

### OHIO'S REGRESSIVE TAX SYSTEM

It is widely accepted that taxes should be progressive – those who earn more should shoulder a larger portion of the burden. Like most states, Ohio relies on a regressive tax system, when all taxes are included. The state income tax is progressive, but Ohio is one of few states that currently imposes income taxes even on families earning less than the federal poverty line.

Sales and excise taxes are regressive: low- and middle-income workers typically pay a higher percentage of their income toward such taxes than higher income families. Proposals to temporarily raise current sales taxes or to expand the sales tax to cover services, while laudable for raising needed revenue, will hit the poor and middle harder than the top. Taxes on items like cigarettes, gasoline, clothing and some food\* already often comprise a significant portion of a poor household's income. This is compounded by federal social security and payroll taxes, which are also regressive.

\* Most groceries (sold for off-site consumption) are tax exempt in Ohio, as are prescription drugs. Restaurant, cafeteria, or vending machine food is taxable, as are certain groceries, such as carbonated beverages.

The federal EITC provides tax refunds to employed families with an adjusted gross income of less than \$33,692. Many states now have state EITCs, set at a percentage of the federal credit. This is an appealing bipartisan solution because it is easy to administer, imposes no costs on those who employ low-wage workers, encourages work, reduces poverty, and reduces the regressive nature of our tax system (see box). This research brief reviews the history of the federal EITC, describes EITC plans in other states, calculates the cost of an Ohio EITC, estimates the number of potential beneficiaries, and makes recommendations. Throughout this paper are short "credit profiles" – profiles of real Ohio families who would benefit from this modest assistance.

### THE FEDERAL EITC

The federal EITC enjoys bipartisan support because of its efficient achievement of several policy goals. For low- and moderate-income workers, primarily those with children, the credit rewards work, assists with expenses, reduces poverty, and helps families transition from welfare to work. First introduced by Democratic Senator Russell Long, it was signed into law by Republican President Gerald Ford in 1975. The credit, originally set at a maximum of \$400 in actual 1975 dollars or \$1337 in inflation adjusted 2002 dollars, was not initially indexed to inflation, so it eroded in value during the first several years. Under Republican President Ronald Reagan, the EITC was restored to its initial real value, indexed to inflation, and expanded slightly. Under Republican President George Bush, the credit was expanded more dramatically. And under Democrat Bill

<sup>5</sup> *Cleveland Plain Dealer*, February 1, 2003, "Thousands of Jobs Were Lost, This Year Expected to be Better", Allison Grant.

Clinton, the EITC was again expanded, and eligibility was widened to include a small credit for childless workers. Appendix A at the end of this paper depicts changes in the value of the credit and in eligibility for the credit between 1975 and 1999.

The maximum federal EITC benefit for the 2003 tax year is \$4,204 for families with two or more children and \$2,547 for families with one child. Workers without a qualifying child were eligible for a maximum credit of \$382 in 2003. This structure recognizes that larger families face higher living expenses than smaller ones. Initially, the EITC increases as the earnings of a household rise, to reward low-income families who choose to work more hours or who succeed in advancing to slightly higher-wage employment. For a family with two or more children, the EITC equals 40 cents of each dollar up to \$10,510 earned in 2003. The credit plateaus at this maximum amount until the family's income reaches \$13,730. The EITC begins to phase out as earnings rise above \$13,730 until earnings reach \$33,692

at which amount the credit disappears.<sup>6</sup> The gradual phase-out is designed to ensure that workers who advance won't be punished by having the decline in their credit exceed a raise received.

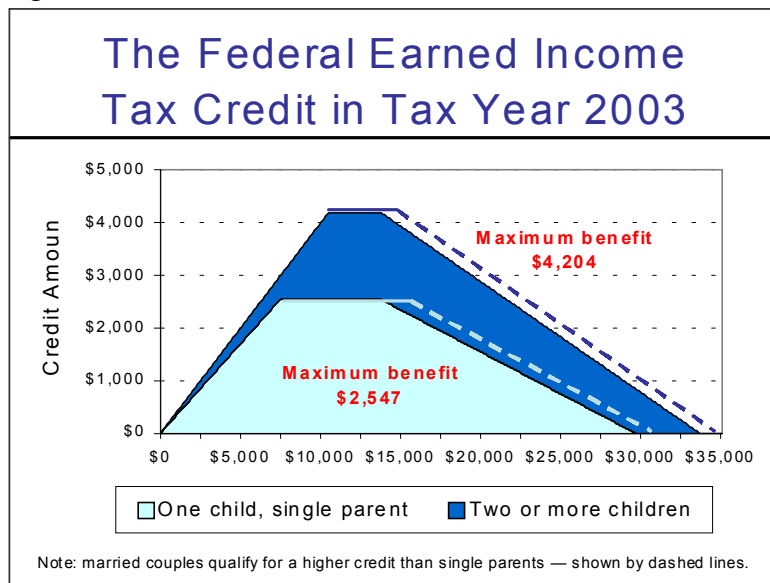
For families with one child, the credit equals 34 cents for every dollar earned up to \$7,490 for a maximum benefit of \$2,547. The EITC plateaus at this amount and begins to phase out once

household income reaches \$13,730. The credit disappears at an income of \$29,666 for a family of this size. Taxpayers with no children can receive up to \$382 if they earn less than \$11,230. Figure 1 illustrates the way in which the credit phases in and out.

The federal EITC is refundable, which means that a family is eligible for the credit as a refund even if the credit amount exceeds income tax liability. A non-refundable credit would exclude tax-exempt poor households who most need assistance.

Unlike other tax benefits for employed families such as the dependent care credit, the federal EITC does not disqualify claimants on the basis of the number of working parents. The determinant for eligibility is the family's income. This makes the EITC available to working families with children regardless of the number of employed parents

Figure 1



Source: Center on Budget and Policy Priorities.

<sup>6</sup> Married couples qualify if they earn up to \$1000 more than single individuals with the same number of children.

in the household, eliminating concerns about the credit either rewarding or punishing stay-at-home parents in two-parent families.

The results of the federal EITC have been impressive. In 2001 alone 19.1 million US families claimed the EITC. The program lifted 4.8 million people, 2.6 million of whom were children, above the official poverty line. The EITC lifts more working families out of poverty than any other government program.<sup>7</sup>

### CREDIT PROFILE

**NAME:** Patricia Gorman, husband Joseph, and 9-month old daughter Emily

**JOB:** Patti just started a new full-time job as a Clinical Service Provider at a non-profit mental health agency. Joe is an independent contractor, doing general labor and piano repair.

**LAST YEAR'S INCOME:** \$22,000 combined – Patti was home with Emily for part of the year.

**FEDERAL EITC:** \$1004

**CREDIT IF WE HAD AN OHIO EITC:** \$200

**CHILD CARE:** Right now, Joe is with the baby while Patti works days, and Patti is with Emily while Joe works at night.

**GOALS:** Patti is trying to complete a Bachelor's degree in social work, while working full time. Joe is trying to become a carpenter.

**ECONOMIZING:** After deciding that their apartment was too dangerous for the baby (gunshots, a break-in and roaches were among the worries), the Gormans moved in with Joe's parents. Joe's parents have been flexible about rent when Joe and Patti have been unemployed.

**THINGS THEY'VE GONE WITHOUT:** The Gormans haven't had health insurance as a family for most of the last two years and have to wait until payday to buy groceries. They ration their car trips carefully, because they can't always afford gas. In general, they stick to a tight budget.

**WHAT SHE'D SPEND HER CREDIT ON:** “A college account for Emily.”



<sup>7</sup> Center on Budget and Policy Priorities, “A Hand Up: How State EITCs Helped Working Families Escape Poverty in 2001”, Nick Johnson, p. 1. <http://www.cbpp.org/12-27-01sfp.pdf>.

## STATES WITH EITCS

Currently, seventeen states offer Earned Income Tax Credits based on the federal credit. In the last few legislative sessions, eleven states including the District of Columbia enacted new EITCs or expanded existing state EITCs. Two local governments –

Montgomery County, MD and Denver, CO – offer local EITCs.<sup>8</sup>

These credits have found support across party lines in many of these states and have been enacted in states with both Democratic and Republican administrations and legislatures. Table 1 depicts state EITCs and their characteristics.

The credit in twelve of the seventeen states is refundable. Families in these states receive the full credit amount even if it exceeds their income tax liability. The remaining five offer a non-refundable credit. The level of the state credit as a percentage of the federal credit varies from five percent in states such as Illinois and Maine to as high as 45 percent in Minnesota. The annual cost of refundable state EITCs in recent years has ranged from about \$11 million in Vermont to \$361 million in New York. A state EITC can be administered and claimed without large administrative burdens. The amount of a family's state EITC is easily determined by multiplying the federal credit by the state percentage.

Table 1

STATES EITCS TAX YEAR 2003	
State	Percentage of Federal Credit
<u>Refundable Credits</u>	
Colorado*	10%
D.C.	25%
Indiana	6%
Kansas	15%
Maryland	20%
Massachusetts	15%
Minnesota	25% to 45% (depending on earnings)
New Jersey	20% (if income < \$20,000)
New York	30%
Oklahoma	5%
Vermont	32%
Wisconsin	4% - 1 child 14% - 2 children 43% - 3 or more children
<u>Non-Refundable Credits</u>	
Illinois*	5%
Iowa	6.5%
Maine	5%
Oregon	5%
Rhode Island	25%
*Colorado's credit was suspended in 2002 and may be suspended in 2003; Illinois' credit will expire this year if not extended by legislature.	
Source: Center on Budget and Policy Priorities, "A Hand Up: How State EITCs Help Working Families Escape Poverty in 2003", Washington D.C., forthcoming.	

<sup>8</sup> CBPP, "A Hand Up", 2001.

## POLICY OBJECTIVES

The federal EITC has been lauded by researchers and policymakers from both parties for accomplishing a number of related policy goals, including reducing poverty, assisting in meeting basic needs, reducing the regressive nature of the state tax system, assisting as families leave welfare, supporting work, and stimulating the economy.

### Paring poverty

In 2001, more than 16.5 percent of Ohio's children lived below the official poverty line<sup>9</sup>. More than half of the state's poor children (54%) were younger than age six; and more

#### CREDIT PROFILE

**NAME:** Anquette Nelson and four-year-old son Antonio  
**JOB:** Certified Nursing Assistant with Visiting Nurse Association  
**LAST YEAR'S INCOME:** \$14,000  
**FEDERAL EITC:** \$2282  
**CREDIT IF WE HAD AN OHIO EITC:** \$456  
**HOURS OF WORK:** Second shift, 2:30-9:30 p.m.  
**CHILD CARE:** "My parents work morning shift, so I chose second shift so that they could be with Antonio in the evening. They feed him, give him a bath and put him in pajamas. He's usually asleep when I pick him up and bring him home."  
**AMBITION:** "I like my job. I'm going back to school in January to get my RN degree, so that I can advance in nursing."  
**BIGGEST EXPENSES:** groceries, rent on two-bedroom apartment  
**MEETING MONTHLY EXPENSES:** "It's hard, but I do it. I could use new living room furniture, extra groceries, and household things, but I get by."  
**WHAT SHE'D SPEND HER CREDIT ON:** "I'd start saving my son's tuition for school next year."  
**QUICK QUOTE ON EITC EXPANSION:** "It would help out a whole lot. It's a brilliant idea that would help out a lot of families."

than half, approximately 231,200, lived in extreme poverty, in families with incomes less than 50 percent of the poverty level<sup>10</sup>. Poverty is a very real problem for far too many in Ohio.

Poverty persists even among working families. From 1998 to 2001 between 64 and 70 percent of poor children lived in homes with an employed adult. Implementing an

Ohio EITC would help struggling workers – from those in deep poverty to those in moderate-income families. For those living deeper in poverty, the EITC would reduce the poverty gap – the difference between earnings and the poverty threshold. An Ohio EITC at the 20% level would lift approximately 8,000 children above the official poverty line, and would lower the poverty gap for many other children.

The contribution of a state EITC in combating poverty can be illustrated with a few examples.

- A family of four in Ohio with one full-timer worker earning \$7.00 an hour has an annual income of \$14,600. After paying taxes and claiming existing credits (including the federal EITC), net income is \$17,633, or \$500 below the poverty line. A 20 percent Ohio EITC of \$738 would lift this family out of poverty.

<sup>9</sup> Zeller, "State of Poverty in Ohio".

<sup>10</sup> Children's Defense Fund-Ohio, "Ohio Children's: Factsheet—Ohio".  
[http://www.cdfohio.org/reports/2002\\_Factsheets/index/pdf/ohio02fs.pdf](http://www.cdfohio.org/reports/2002_Factsheets/index/pdf/ohio02fs.pdf)



- A minimum wage (\$5.15/hour) earning single parent of one child working 40 hours per week for 48 weeks in the year has an annual income of \$9,888. After taxes and credits, the family’s net income is about \$11,843, or about \$364 less than the federal poverty threshold of \$12,207. A 20% Ohio EITC of \$485 will lift this family above the poverty line.
- For a family of four with one full-time minimum-wage worker and one stay-at-home parent, a state EITC would lower the poverty gap, raising income from \$14,720 (with the federal EITC) to \$15,520, about \$800 closer to the federal poverty threshold of \$17,960 for a family this size.

**Buying Basics**

Unlike wealthier households, families in modest circumstances pay a relatively high percentage of their income toward essentials. The money that families receive from a refundable Ohio EITC is likely to be used for food, transportation, rent, childcare, taxes, and other basic expenses. Surveys have found that 80 percent of EITC recipients plan to use their payment for immediate bills, such as rent and utilities, or to pay for better

housing, transportation, or education.<sup>11</sup> The Economic Policy Institute's comprehensive 1999 study on family budgets estimated the basic costs faced by six different family types in sixteen different communities throughout Ohio. Many Ohio families do live on far less than the amounts depicted here, but they do so either by living in substandard housing, having unreliable transportation, purchasing low-cost child care, getting help from extended family, or in other ways scrimping.

Table 2

<b>MONTHLY EXPENSES, VARIOUS OHIO COMMUNITIES, VARIOUS FAMILIES, 1999</b>			
	Rural Ohio 1 parent 1 child	Cleveland 1 parent 2 children	Columbus 2 parents 2 children
Housing	\$428	\$594	\$553
Food	\$230	\$351	\$510
Childcare <sup>1</sup>	\$358	\$692	\$692
Transportation	\$197	\$170	\$240
Health care	\$179	\$189	\$204
Other necessities	\$204	\$293	\$329
Taxes	\$30	\$273	\$277
Monthly total	\$1626	\$2562	\$2805
Annual total	\$19,513	\$30,746	\$33,655
Annual income at \$6.80/hr, full-time*	\$13,700	\$13,700	\$27,300
State EITC at 20% of federal	\$468	\$778	\$203

\*Ten percent of Ohio workers earn less than this hourly wage.

Source: Economic Policy Institute, Policy Matters Ohio.

The budgets calculated costs for housing, food, transportation, health care, childcare, other necessities<sup>12</sup> and taxes, but left no room for savings, restaurant meals, entertainment, or even emergency expenses like rental insurance. Table 2 illustrates basic

<sup>11</sup> CBPP, “Facts about the Earned Income Credit”, 2003, p. 20.

<sup>12</sup> Other necessities include clothing, a telephone, personal care expenses, household supplies, school supplies, reading materials, bank fees and some toys. These were derived by EPI from the Consumer Expenditure Survey. For more on methodology in calculating the family budget, see Appendix A of *Hardships in America: The Real Story of Working Families*, by Heather Boushey, Chauna Brocht, Bethney Gunderson and Jared Bernstein, Economic Policy Institute, 2001.

estimated expenses for three family types in three Ohio communities, and lists the EITC for which each family would be eligible if Ohio enacted the credit at 20 percent of the federal level. To calculate family budgets for different family types in other regions of Ohio, go to [www.epinet.org](http://www.epinet.org).

### Reducing Regressiveness

State taxes are regressive in that lower-income households pay a higher percentage of their income toward these taxes than do higher-income households. In 2002, the poorest fifth of non-elderly Ohio families (earning less than \$15,000 annually) paid 10.9 percent of their income in state taxes, while the wealthiest one percent of families (earning more than \$261,000 or an average of \$660,200) paid just 6.7 percent of their income toward such taxes (after the federal deduction offset).<sup>13</sup>

Sales and excise taxes are particularly regressive. The poorest fifth of non-elderly Ohio families paid 6.3 percent of their income in sales and excise taxes in 2002, while those in the top one percent paid just 1.0 percent.

Ohio property taxes are also regressive – families in the lowest-earning 20 percent pay 2.9 percent of their income toward such taxes while those in the top one percent pay just 1.6 percent.

By contrast, the state's personal income tax is progressive – graduated so that those with higher incomes pay at higher rates. As a result, the poorest fifth of non-elderly Ohio families paid 1.7 percent of their

income in personal income taxes, compared to 3.9 percent for the middle fifth of families and 6.9 percent for the top 1 percent. Although Ohio's income tax is progressive, the regressive nature of most other state taxes makes the system as a whole regressive. Further, Ohio is one of only 19 states that levy income taxes on working families with incomes below the federal poverty level.

#### CREDIT PROFILE

**NAME:** Donna, husband Jimmy and 8-month old son Samuel Workman

**JOB:** Jimmy works as an RV detailer for Sherwood RV in Hillsboro. Donna had worked as a home health care aide but now stays home with Samuel

**LAST YEAR'S INCOME:** \$20,000

**FEDERAL EITC:** \$1324

**CREDIT IF WE HAD AN OHIO EITC:** \$264

**MEETING MONTHLY EXPENSES:** "Lately, it's been hard. We've got car insurance, house insurance, house taxes ... it all comes due at the same time, and you've got your fuel bills on top of that. We heat with oil and it's very expensive."

**THINGS THEY'VE DONE WITHOUT:** "Yeah, there are lots of things. Extra things for the baby. Clothes, money to go to the doctor when we need to go. We don't go a lot of the time. We've got insurance for the baby through Healthy Start – but it doesn't cover us. Jimmy doesn't get insurance through work."

**WHAT SHE'LL SPEND HER CREDIT ON:** "I'd probably put it in savings. We don't get to put away much money now."

**FAVORITE THING TO DO WITH THE BABY:** "He likes to have me read to him."

**QUICK QUOTE ON EITC EXPANSION:** "If we go to war and the fuel doubles, how are people gonna make it? We'll freeze to death. We barely pay the bills now. This is definitely needed."

<sup>13</sup> This entire sub-section of the paper draws heavily from the Institute on Taxation and Economic Policy's January 2003 report, "Who Pays: A Distributional Analysis of the Tax System in all 50 States".

Ohio families begin to owe state income taxes at very low levels. In 2001, Ohio began taxing married families with two children when they earned just \$12,500, well below the poverty line. Only six states taxed families below that level. Governor Taft's recent tax proposal would reduce the burden on the lowest-paid families, by eliminating income taxes on couples earning less than \$13,750. This would help the lowest-income families, but would not assist those earning between \$13,750 and \$34,000. If a refundable EITC at 20 percent of the federal credit had been in effect in 2001, a two-parent family of four would not have owed income tax until income reached \$24,000.<sup>14</sup>

States typically raise a variety of taxes during recessions. States raised progressive taxes like income and corporate taxes as well as regressive taxes like sales and excise taxes during the recession of the early 1990s to balance budgets and to compensate for dwindling surpluses. However, when the economy revived and began expanding, many states repealed progressive taxes but reduced regressive taxes little or not at all. As a result, low-income families are still burdened with regressive taxes while higher-income families have reduced tax liabilities. Ohio followed this pattern to some extent. Between the sluggish years of 1990 and 1992, Ohio raised personal income, corporate, and gasoline taxes and expanded the sales tax base. Many Ohio municipalities also raised regressive sales taxes in these years. During the economy's expansionary phase from 1994-2001, Ohio reduced corporate and estate taxes multiple times, and temporarily reduced personal income taxes, but left sales taxes virtually unchanged. In part because of this approach, between 1989 and 2002, the state and local tax burden as a share of income on the top one percent declined by .5 percent, while the burden on the bottom fifth increased by 2.3 percent, after the federal offset deduction<sup>15</sup>.

The Governor's proposal to raise needed revenue in Ohio relies partly on expanding the base for the sales tax. This is needed because of the current shortfall, but it will make Ohio's tax code more regressive. Other current proposals, some of which don't raise additional revenue, would also fall more heavily on low and moderate earners. Incorporating a state EITC into any of these proposals would ease the burden on families of modest means.

### **Transitioning from TANF**

An Ohio EITC would assist those moving out of Temporary Assistance to Needy Families (TANF) and into work. The EITC would make that transition more affordable. Many former TANF participants don't escape poverty when they enter the workforce. A recent report focusing on Cuyahoga County found that 59 percent of those leaving the Ohio Works First program (Ohio's name for TANF) had a household income below the poverty line six months later.<sup>16</sup> This is consistent with evidence from other states.<sup>17</sup> For such families, the federal EITC combined with a refundable Ohio EITC could make the

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<sup>14</sup> CBPP, "State Income Tax Burdens on Low-Income Families in 2001: Assessing the Burden and Opportunities for Relief", February 2002, pp. 9-10.

<sup>15</sup> ITEP, "Who Pays?".

<sup>16</sup> Center on Urban Poverty and Social Change, "How are they managing?", April 2002.

<sup>17</sup> CBPP, "A Hand Up", p. 13, found that welfare recipients who found jobs earned between \$8,000 and \$12,000 per year in 2000.

difference between being able to afford childcare and other basic expenses of working, or being forced to return to public assistance.

Recent academic research on the EITC indicates that the federal credit reduces the number of welfare recipients by making work a more affordable choice for single parents. In a series of studies on the EITC, Harvard economist Jeffrey Liebman noted a dramatic increase (from 72.7 percent in 1984 to 82.1 percent in 1996) in work participation by single mothers, but not by single women without children. He and University of California economist Nada Eissa concluded that there was a sizable EITC-created effect in inducing single women with children to work. Northwestern University economists Bruce Meyer and Dan Rosenbaum found that “a large share of the increase in employment of single mothers in recent years can be attributed to the (federal) EITC.”<sup>18</sup> The federal EITC encourages employment and supports welfare reform by aiding the transition from welfare to work. A state EITC would add to this positive effect.

### Working for Workers

In addition to strengthening parents' ability to leave TANF and enter the work force, a state EITC would reward those who are employed, by providing a subsidy to modest or

#### CREDIT PROFILE

**NAME:** Isabel, husband Mauricio and 18-month old son Noa Wong.

**JOB:** Isabel is home with the baby. Mauricio is a teaching assistant at Case Western Reserve University, working toward his doctorate.

**LAST YEAR'S INCOME:** \$15,000

**FEDERAL EITC:** \$2120

**CREDIT IF WE HAD AN OHIO EITC:** \$424

**MEETING MONTHLY EXPENSES:** “It's hard to find enough money to cover health insurance, food and clothing.”

**THINGS THEY'VE DONE WITHOUT:** “We have only one car, and I'd like a better car.”

**WHAT THEY WOULD SPEND CREDIT ON:** Food.

**FAVORITE THING TO DO WITH THE BABY:** “I love taking him to the swimming pool in the summer.”



low wages. Because only workers qualify, it encourages people to work, and helps to make work a more viable option – helping people meet the increased expenses, like child care and transportation, that are associated with work. The credit supports work efforts of low- and moderate-income families whether or not they previously received public assistance. In a system that often seems to leave out lower-paid workers, the credit is a refreshing exception.

This is particularly important because changes in welfare policy have meant that we increasingly expect families to work, regardless of their circumstances. Yet over the last few decades in Ohio and the nation, we've seen a decline in real wages for middle- and

<sup>18</sup> CBPP, “A Hand Up”, 2001.

low-income workers. If work is to be the route out of poverty, then a state EITC can play a valuable role in helping workers who still aren't getting by.

**Energizing the Economy**

Ohio has been hit hard by the national recession. The state's official seasonally-adjusted unemployment rate rose from a low of 3.6% in March 2001 to 5.6% in December 2002.<sup>19</sup> Between June 2000 and June 2002, 203,000 Ohio workers and 55,000 Cuyahoga County workers lost their jobs.<sup>20</sup> Implementing a state EITC now could offset some of the hardships caused by the current recession and provide an added incentive to find work. The spending induced as a result of the credit could also contribute slightly towards economic recovery. Unlike tax breaks to the wealthy, tax credits to families of modest means are typically spent in the immediate community on essentials<sup>21</sup>.

**DESIGNING AN OHIO EITC**

A number of state EITC bills have been introduced in the past several legislative sessions, and each has varied slightly in its design. House Bill 17, introduced by Representative Miller in January 2003, is similar to the proposal in this paper – it provides a refundable state Earned Income Credit equal to 20% of the federal credit to all those who qualify for the federal EITC.<sup>22</sup>

Placing Ohio's credit at the 20% level puts Ohio slightly ahead of the average state offering such a credit. The District of Columbia, Minnesota, New York, Vermont, and Wisconsin offer credits that exceed this level, while other state credits fall below this percentage. Table 3 illustrates the earnings, federal credit, and state credit under this proposal, for families with different earnings in Ohio.

The federal EITC primarily helps families with

Table 3

<b>EITC AMOUNTS BY FAMILY INCOME LEVELS, 2003</b>			
	Gross Earnings	Federal EITC	20% Ohio EITC
<b>Family of four with two children</b>			
Half-time minimum wage	\$5,350	\$2,140	\$428
Full-time minimum wage	\$10,700	\$4,204	\$840
Wages equal federal poverty line	\$18,800	\$3,347	\$669
Wages equal 150% of poverty line	\$28,200	\$1,367	\$272
<b>Family of three with one child</b>			
Half-time minimum wage	\$5,350	\$1,819	\$364
Full-time minimum wage	\$10,700	\$2,547	\$508
Wages equal federal poverty line	\$14,600	\$2,547	\$508
Wages equal 150% of poverty line	\$21,900	\$1,401	\$280

Source: Center on Budget and Policy Priorities, and Policy Matters Ohio.

<sup>19</sup> Bureau of Labor Statistics website, local area unemployment statistics for Ohio at [www.bls.gov](http://www.bls.gov).

<sup>20</sup> *Cleveland Plain Dealer*, February 1, 2003, "Thousands of Jobs Were Lost, This Year Expected to be Better", Allison Grant.

<sup>21</sup> Reich, Robert B., "Quick Tax Relief for an Ailing Economy", *New York Times*, October 15, 2002. <http://www.prospect.org/webfeatures/2002/10/reich-r-10-15.html>

<sup>22</sup> Legislators who've introduced state EITC bills in the last several sessions include Senators Ryan, Fingerhut, Herington, Shoemaker, Hagan, and Furney, and Representative Britton. Those bills have differed slightly from the proposal described here. Cosponsors of HB 17 include Representatives Carano, Ujvagi, Domenick, Allen, Sferra, Skindell, Cirelli, and Harwood.

children. About 98% of overall EITC benefits go to families with children.<sup>23</sup> Single individuals and married couples without children are eligible for a small federal credit, capping out at a maximum of \$364 in 2001. We recommend that the modest state credit also be extended to these childless taxpayers. A state credit at 20 percent of the federal EITC would provide a maximum of \$73 to households without children. For very little cost, Ohio could provide a small amount of needed support to very low-income working individuals without children, many of whom are ineligible for most government programs.

## COST OF AN OHIO EITC

In 2001, the federal EITC credited 692,543 Ohio taxpayers with an average \$1608 each, for a total of \$1,114 million dollars. Ohio claimants made up 3.38 percent of claims nationwide. The most common family type claiming the credit in Ohio had two children (40.6 percent of claims), followed by families with one child (38.0 percent of claims). Only 17.2 percent of claimants were childless. More Ohioans benefit from the program than in most states: only seven states had a higher number of EITC claimants in 2000.

Other states that have implemented new state EITCs have found that between 10 and 15 percent of federal claimants in the state do not claim the state EITC in the first several years of implementation. This is primarily because workers are initially unaware of the state credit. Even after a few years, participation may remain at about 90 percent, because some taxpayers may not file claims for the small amount of the credit.

If an Ohio EITC were enacted at 20 percent of the level of the federal credit, we estimate a cost to Ohio of \$222 million in Fiscal Year 2004. Table 4 estimates the cost of a state EITC at 20 percent of the federal credit for the years 2004 through 2008. The annual percentage share of Ohio claims is assumed to be constant at 3.38 percent.

### Financing the Credit

While \$222 million is a substantial expense for the state of Ohio, in the context of other state expenditures it is relatively affordable. For fiscal year 2004, Ohio's total General Revenue Fund (GRF) expenditures are projected to be \$24,077,300,000.<sup>24</sup> The 2004 estimated EITC expense would constitute less than one percent (.92 percent) of these expenditures. Much of this could be funded with money raised from the

Table 4

ESTIMATED COST 20 PERCENT OHIO EITC	
Year	Cost
2004	\$222,000,000
2005	\$227,000,000
2006	\$237,000,000
2007	\$244,000,000
2008	\$251,000,000

Source: CBPP Priorities, Internal Revenue Service.

<sup>23</sup> CBPP, "Should the EITC for Workers Without Children Be Abolished, Maintained, or Expanded?", 2000.

<sup>24</sup> This is projected Ohio General Revenue Fund expenditure, from page b-11 of the Governor's proposed budget at [http://www.state.oh.us/obm/information/budget/Bluebook0405/PDF/b\\_comp.PDF](http://www.state.oh.us/obm/information/budget/Bluebook0405/PDF/b_comp.PDF). The projected state-only GRF expenditures are \$18,788,800,000, of which this would constitute just over one percent (.12 percent). The GRF is the largest fund of the state. It receives most of the revenue from the income tax, and is used to support the general operating budget.

proposed expansion of the sales tax. The refundable portion of the credit that goes to families defined as "needy" by the state of Ohio could be paid for with federal funds from the TANF block grant, or by counting funds expended on EITCs toward meeting the "maintenance of effort" (MOE) required under TANF.<sup>25</sup>

### **Statewide Impact**

Every Ohio county has working families who claimed the federal EITC in 2000 and would qualify for the state EITC. The percentage of taxpayers filing for the credit ranges from a low of 4.8 percent in Geauga County to a high of 21.5 percent in Meigs County. Six counties have more than twenty percent of taxpayers filing for the credit, and the statewide average is 12 percent. The largest actual number of taxpayers who qualify is in Cuyahoga County, where more than 96,000 families would see a refund under this proposal. Appendix B depicts the number and percentage of taxpayers in each county who filed for the federal credit in 2000.

## **CONCLUSION**

A refundable EITC for Ohio, set at 20 percent of the federal credit, would help Ohio's working families. EITCs have been shown to reduce poverty, increase income, reward work, make the tax system less regressive, stimulate the economy, and assist low- and moderate-income families in meeting basic needs. The state is considering several tax law changes, none of which would make the system more progressive. Incorporating a state EITC into these plans would increase the fairness of the proposals, and could increase popular support in every Ohio county. A state EITC is a reform that has worked in other states and that would work well in Ohio.

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<sup>25</sup> CBPP, "A Hand Up", p. 30, 2001.

Appendix A

Earned Income Tax Credit Parameters: 1975-1999							
Year	Phase-In Rate	Phase-In Range	Maximum Credit –		Phaseout Rate	Phaseout Range	
			Maximum Credit - Actual Dollars	Inflation-adjusted to 2002 Dollars			
1975-'78	10.0%	\$0-\$4,000	\$400	\$1,337	10.0%	\$4,000-\$8,000	
1979-'84	10.0%	\$0-\$5,000	\$500	\$1,239	12.5%	\$6,000-\$10,000	
1985-'86	14.0%	\$0-\$5,000	\$550	\$920	12.22%	\$6,500-\$11,000	
1987	14.0%	\$0-\$6,080	\$851	\$1,348	10.0%	\$6,920-\$15,432	
1988	14.0%	\$0-\$6,240	\$874	\$1,329	10.0%	\$9,840-\$18,576	
1989	14.0%	\$0-\$6,500	\$910	\$1,320	10.0%	\$10,240-\$19,340	
1990	14.0%	\$0-\$6,810	\$953	\$1,312	10.0%	\$10,730-\$20,264	
1991(a)	16.7%(b)	\$0-\$7,140	\$1,192	\$1,574	11.93%	\$11,250-\$21,250	
	17.3%(c)		\$1,235	\$1,631	12.36%		
1992(a)	17.6%(b)	\$0-\$7,520	\$1,324	\$1,697	12.57%	\$11,840-\$22,370	
	18.4%(c)		\$1,384	\$1,774	13.14%		
1993(a)	18.5%(b)	\$0-\$7,750	\$1,434	\$1,785	13.21%	\$12,200-\$23,050	
	19.5%(c)		\$1,511	\$1,881	13.93%		
1994	26.3%(b)	\$0-\$7,750	\$2,038	\$2,474	15.98%	\$11,000-\$23,755	
	30.0%(c)	\$0-\$8,425	\$2,528	\$3,069	17.68%	\$11,000-\$25,296	
	7.65%(d)	\$0-\$4,000	\$306	\$371	7.65%	\$5,000-\$9,000	
1995	34.0%(b)	\$0-\$6,160	\$2,094	\$2,472	15.98%	\$11,290-\$24,396	
	36.0%(c)	\$0-\$8,640	\$3,110	\$3,671	20.22%	\$11,290-\$26,673	
	7.65%(d)	\$0-\$4,100	\$314	\$371	7.65%	\$5,130-\$9,230	
1996	34.0%(b)	\$0-\$6,330	\$2,152	\$2,467	15.98%	\$11,610-\$25,078	
	40.0%(c)	\$0-\$8,890	\$3,556	\$4,077	21.06%	\$11,610-\$28,495	
	7.65%(d)	\$0-\$4,220	\$323	\$370	7.65%	\$5,280-\$9,500	
1997	34.0%(b)	\$0-\$6,500	\$2,210	\$2,477	15.98%	\$11,930-\$25,750	
	40.0%(c)	\$0-\$9,140	\$3,656	\$4,098	21.06%	\$11,930-\$29,290	
	7.65%(d)	\$0-\$4,340	\$332	\$372	7.65%	\$5,430-\$9,770	
1998	34.0%(b)	\$0-\$6,680	\$2,271	\$2,506	15.98%	\$12,260-\$26,473	
	40.0%(c)	\$0-\$9,390	\$3,756	\$4,145	21.06%	\$12,260-\$30,095	
	7.65%(d)	\$0-\$4,460	\$341	\$376	7.65%	\$5,570-\$10,030	
1999	34.0%(b)	\$0-\$6,800	\$2,312	\$2,497	15.98%	\$12,460-\$26,928	
	40.0%(c)	\$0-\$9,540	\$3,816	\$4,121	21.06%	\$12,460-\$30,580	
	7.65%(d)	\$0-\$4,530	\$347	\$375	7.65%	\$5,670-\$10,200	
2000	34.0%(b)	\$0-\$6,920	\$2,353	\$2,458	15.98%	\$12,690-\$27,413	
	40.0%(c)	\$0-\$9,720	\$3,888	\$4,062	21.06%	\$12,690-\$31,152	
	7.65%(d)	\$0-\$4,610	\$353	\$369	7.65%	\$5,770-\$10,380	
2001	34.0%(b)	\$0-\$7,140	\$2,428	\$2,466	15.98%	\$13,090-\$28,281	
	40.0%(c)	\$0-\$10,020	\$4,008	\$4,071	21.06%	\$13,090-\$32,121	
	7.65%(d)	\$0-\$4,760	\$364	\$369	7.65%	\$5,950-\$10,708	
2002	34.0%(b)	\$0-\$7,370	\$2,506	\$2,506	15.98%	\$14,520-\$30,201	
	40.0%(c)	\$0-\$10,350	\$4,140	\$4,140	21.06%	\$14,520-\$34,178	
	7.65%(d)	\$0-\$4,910	\$376	\$376	7.65%	\$7,150-\$12,060	
2003	34.0%(b)	\$0-\$7,490	\$2,547	N.A.	15.98%	\$14,730-\$30,666	
	40.0%(c)	\$0-\$10,510	\$4,202	N.A.	21.06%	\$14,730-\$34,692	
	7.65%(d)	\$0-\$4,990	\$382	N.A.	7.65%	\$7,240-\$12,230	

(a) Basic credit only. Does not include supplemental young child credit or health insurance credit.

(b) Families with one qualifying child.

(c) Families with two or more qualifying children.

(d) Taxpayers with no qualifying child.

Source: 1998 *Green Book* for 1975-1997 and Office of Tax Analysis for 1998-1999, and author's analysis.



Appendix B

<b>Federal EITC Claims, Ohio Counties: 2000</b>					
<b>County</b>	<b>Returns Claiming EITC</b>	<b>Percent Claiming EITC</b>	<b>County</b>	<b>Returns Claiming EITC</b>	<b>Percent Claiming EITC</b>
Adams	2,579	20.7	Licking	7,084	10.5
Allen	6,852	14.0	Logan	2,623	11.0
Ashland	2,372	9.9	Lorain	15,506	11.5
Ashtabula	7,237	14.9	Lucas	30,408	14.3
Athens	3,764	15.5	Madison	2,056	9.8
Auglaize	2,198	7.7	Mahoning	17,000	14.0
Belmont	4,905	15.9	Marion	4,140	13.8
Brown	2,616	14.8	Medina	4,443	5.7
Butler	15,342	10.0	Meigs	1,905	21.5
Carroll	1,169	12.0	Mercer	1,561	7.6
Champaign	1,957	10.9	Miami	5,056	9.9
Clark	9,180	13.5	Monroe	1,012	15.9
Clermont	8,227	9.1	Montgomery	34,828	12.3
Clinton	2,662	12.2	Morgan	957	17.9
Columbiana	7,422	14.4	Morrow	1,377	12.2
Coshocton	2,228	13.8	Muskingum	6,449	15.2
Crawford	3,035	12.9	Noble	628	15.3
Cuyahoga	96,395	14.2	Ottawa	1,856	8.1
Darke	2,307	9.5	Paulding	935	10.2
Defiance	1,889	9.6	Perry	2,654	16.1
Delaware	3,044	5.1	Pickaway	2,505	11.2
Erie	4,656	10.9	Pike	2,178	20.2
Fairfield	5,077	8.9	Portage	6,826	9.0
Fayette	1,861	14.7	Preble	2,061	10.6
Franklin	67,531	12.4	Putnam	1,060	5.8
Fulton	2,125	8.9	Richland	7,871	13.0
Gallia	2,432	18.5	Ross	4,768	14.4
Geauga	1,987	4.8	Sandusky	3,061	11.1
Greene	6,117	10.0	Scioto	6,643	21.0
Guernsey	3,339	17.9	Seneca	3,487	10.9
Hamilton	54,853	12.8	Shelby	2,283	9.8
Hancock	2,995	9.2	Stark	23,316	11.8
Hardin	1,735	12.1	Summit	29,642	11.5
Harrison	1,216	16.5	Trumbull	13,040	12.2
Henry	1,225	8.2	Tuscarawas	5,523	11.9
Highland	3,061	16.3	Union	1,442	8.7
Hocking	1,930	15.9	Van Wert	1,193	9.5
Holmes	1,325	10.5	Vinton	1,043	21.1
Huron	4,202	11.6	Warren	4,776	6.5
Jackson	2,628	19.7	Washington	4,236	14.1
Jefferson	4,977	14.3	Wayne	5,232	9.5
Knox	2,662	10.5	Williams	2,126	10.6
Lake	8,431	7.0	Wood	4,304	7.6
Lawrence	5,317	20.9	Wyandot	1,180	9.7
			<i>All Ohio</i>	<i>661,336</i>	<i>12.0</i>

Note: The actual number of EITC claims in 2000 in Ohio was 661,348 (not 661,336). The IRS removes the data from zip codes with fewer than 10 returns, resulting in the small discrepancy between the numbers.

Source: <http://ftp.irs.gov/pub/irs-eta/oh.xls>

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