

RECOVERY ACT
TAX CREDITS:
TAX RELIEF FOR
WORKING FAMILIES

A REPORT FROM
POLICY MATTERS OHIO

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Executive Summary

Thousands of low- and middle-income working Ohioans received larger tax credits in 2009 due to the American Recovery and Reinvestment Act, according to a new report from Policy Matters Ohio. Changes to the Earned Income Tax Credit (EITC) and Child Tax Credit (CTC) programs brought an additional \$400 million into Ohio. The report estimates that more than 640,000 children were directly assisted by the changes to these two programs.

The report comes out as Congress considers a series of tax reforms, including EITC and CTC expansions. The report details the changes including coverage of a third child and benefits up to a higher income level for married families under the EITC. The EITC program is the nation's largest poverty relief program for working families, bringing more than \$2.1 billion into Ohio for some 950,000 families. The maximum EITC credit was raised to \$5,657 from \$4,824 the previous year. Married filers with children received larger credits regardless of their income. The report also discusses changes to the CTC in which the credit, which is worth \$1,000 per child, became more widely available.

Changes to the EITC program increased refunds to 313,000 families, bringing Ohio more than \$121 million. Some 304,000 families benefited from the child tax credit with an average credit of \$833. The report discusses the household budget impact of these credits. Refund dollars are often spent in the community on housing, food, and education.

Policy recommendations include:

- 1. Make ARRA expansions to the EITC and CTC permanent.**

The EITC and CTC expansions help working families meet their own and their children's basic needs and move toward financial stability. Returning to pre-ARRA benefit levels would result in a loss of \$497 on average for the bottom 60 percent of working families. This is money that would not be spent by working families in their communities.

- 2. Enhance the childless worker portion of the EITC.**

Many childless workers support children through part-time custody, child care payments, alimony, and other indirect arrangements that do not qualify children as dependents on the tax return.

- 3. Increase support to free tax preparation programs.**

A broad method for increasing EITC and CTC claims has been a nation-wide effort to provide free or low-cost tax assistance for low-income families through an effort known as the Volunteer Income Tax Assistance (VITA) program. At the state-level, the Ohio Benefit Bank integrates public assistance and free tax preparation. Many eligible families do not claim credits and those who do, often pay high-costs to paid tax preparers. Methods to claim these credits needs improvement.

Recovery Act Tax Credits: Tax Relief for Working Families

Introduction

The American Recovery and Reinvestment Act of 2009 (Recovery Act or ARRA) provided tax cuts to households and businesses, expanded safety net services for the millions of jobless, and pumped business investment into the local economy. It has been estimated that the \$787 billion appropriation, to be allocated over two to three years, has created between 1.3 and 3.4 million jobs. The American economy was extremely troubled in late 2008 – a housing bubble had burst, leaving both the housing and the financial markets reeling. The federal stimulus was enacted to repair the damage. In this paper, we look at stimulus investment in a specific area of tax policy: tax credits for working families with children.

The Recovery Act provided relief to working families with children by expanding and strengthening two major federal tax credits: the Earned Income Tax Credit (EITC) and the Child Tax Credit (CTC). These two credits were originally slated to expire after the 2010 tax seasons but President Obama and legislators are considering making them permanent. This issue brief reviews the changes to the EITC and CTC in Ohio, considering whether their permanent expansion would better relieve need, assist communities and create a more equitable tax code.

The Earned Income Tax Credit

The Earned Income Tax Credit, available only to low- and moderate-income families who work and pay taxes, is the nation's largest program to help low-income families pay for basic needs. Under the Recovery Act, the maximum EITC for a family with three qualifying children and income between \$12,620 to \$24,000 is \$5,657. The average EITC in Ohio in the first year of the ARRA was \$2,210.

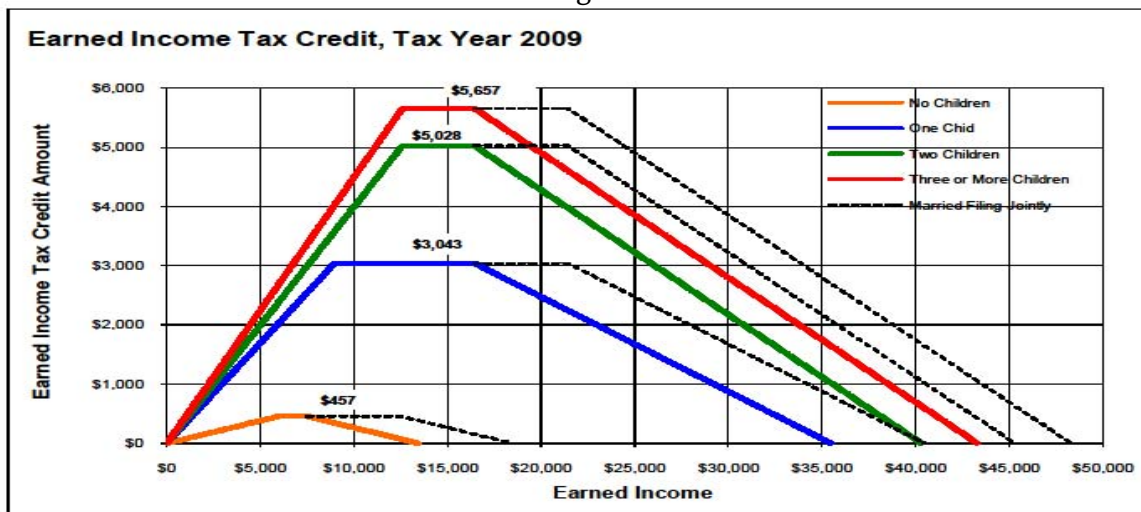
Enacted in 1975 under President Ford, the EITC has received support under Democratic and Republican leadership. Its popularity stems from its emphasis on work, its simplicity, and its fairness. Because the lowest-income families pay the highest share of their earnings in sales taxes, they are among the bigger beneficiaries of these tax credits. Because the size of the credit is related to number of children, it is a support for families with children. The EITC is a refundable tax credit: if the credit exceeds the amount owed, the government sends a refund check in the amount of the difference. In 2009, the EITC provided more than 950,000 Ohio families with total refunds of \$2.1 billion.¹

¹ Internal Revenue Service, "EITC State Statistics at-a-Glance for Tax Year 2009."
<http://www.eitc.irs.gov/central/eitcstats/> (updated 10/21/2010).

The EITC program is an extremely helpful program for those who qualify, but it has limits. First, only employed families or individuals qualify for assistance. This provision excludes unemployed people, whether they've lost a job, have a disability that prevents work, or live in a time (like now) or place of high unemployment. Second, the EITC is a wage supplement so it is most helpful during periods of higher employment and wages. The largest credit values are above the minimum wage levels of qualifying income, meaning the credit does not help the "poorest of poor" families most. Finally, the actual delivery of the EITC program continues to come under scrutiny. To receive the credit, families often turn to paid tax preparers who charge high preparation fees and often sell costly tax loans to families. While steps have been taken to curtail these practices, paid tax preparation siphons substantial money intended for families into the coffers of paid preparers.²

For 2009 and 2010, the American Recovery and Reinvestment Act (Recovery Act or ARRA) provides a new category of EITC eligibility for families with three or more children and expands benefits for married families. Figure 1 shows that families with 3 children and earnings between about \$12,000 and \$17,000 get the largest benefit. For families with three children, the ARRA increased the maximum EITC from \$5,028 to \$5,657 for tax year 2009 and 2010. At each income level, families with three or more children will receive a larger EITC than they would have without the change. In tax year 2009 and 2010, families earning as much as \$48,250 will receive the credit, which is an increase of more than \$6,000 in eligible income from the previous year.

Figure 1



For married couples, the ARRA will allow families with slightly higher incomes to qualify for the EITC regardless of the number of children (see Table 1, next page). The income threshold at which the EITC begins to phase-out for married couples increased to \$5,000 above the amount for unmarried filers (an increase of \$1,880 over tax year 2008 law). For example, the

² See Chi Chi Wu and Jean Ann Fox. "Major Changes in the Quick Tax Refund Loan Industry." National Consumer Law Center and Consumer Federation of America (February, 2010).

maximum credit in tax year 2008 for a married couple with one child (\$3,043) would have been available up to earnings of \$19,540. Due to the change, the maximum EITC will be available up to earnings of \$21,420 and the credit will not phase out completely until earnings of \$40,500.

	Income Eligibility		Maximum EITC Value	
	Pre-ARRA, 2008	ARRA	Pre-ARRA, 2008	ARRA
Married - One Child	\$36,950	\$40,500	\$2,917	\$3,043
Married - Two Children	\$41,646	\$45,300	\$4,824	\$5,028
Married-Three Children	\$41,646	\$48,250	\$4,824	\$5,657

The two major expansions to the EITC (coverage of a third child and extending the phase-out income range for married families) brought millions of dollars into Ohio communities, helping thousands of families pay for basic needs and save money. The average EITC of \$2,210 represents 10 percent of a family's income at \$22,000 a year. Families receiving larger benefits can see upward of three months of income from the EITC, reinforcing the economic power of the Recovery Act in a household budget. Policy Matters' survey research of EITC clients continues to find that recipients use refunds to pay for food, housing, transportation, and to catch up on bills (see Figure 2).³ In a yearly evaluation of free tax preparation programs for thousands of low-income families in 2009, Policy Matters found that basic needs and catching up on bills are the primary use of the EITC.⁴ An increasing portion of EITC recipients report saving portions of their refunds providing increased economic security for their family.

³ See David Rothstein, "Who Takes Credit?" series of EITC report evaluations. www.policymattersohio.org

⁴ Cite - if it's the same one, cite Rothstein, see Fn #3 - or something

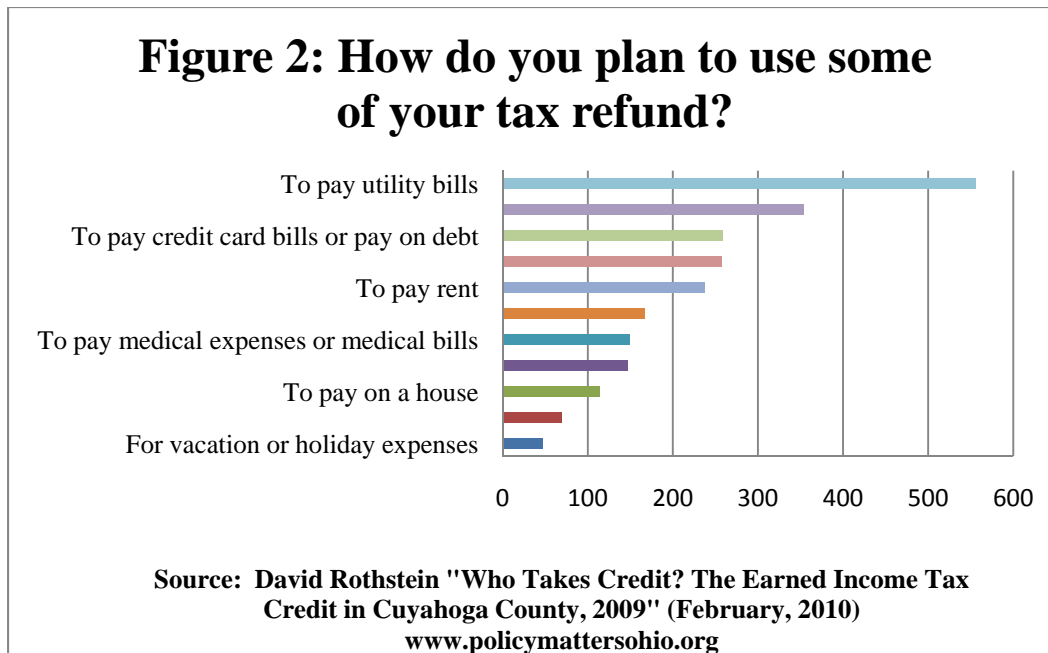


Table 2, below, displays how the two new provisions of the ARRA affected the EITC program in Ohio. By extending the phase-out range for married families and adding coverage of a third child, 286,427 families received more coverage and a larger EITC payment. More than 33,000 families received completely new benefits under the two additional EITC programs. The EITC’s effect on families with children was particularly noteworthy. More than 640,000 children in Ohio benefited from larger EITC amounts or new coverage. In total, Ohio communities received more than \$121 million in *new* EITC dollars.⁵

Program	Existing Filers Receiving Additional Benefits	New Filers Receiving Benefits	Additional Money to Ohio
Extended phase-out income range for married families	142,358	24,206	\$50.3 million
Coverage of a third child, also known as the “third tier” benefit	144,069	9,145	\$71 million
Total	286,427	33,351	\$121.3 million

Source: The Brookings MetroTax model, 2008 American Community Survey microdata.

⁵ Bob McIntyre, “Refundable Credits Expanded in the Economic Recovery Act.” Citizens for Tax Justice (October 19, 2010).

Child Tax Credit

The Child Tax Credit (CTC) is a federal tax credit that helps reduce taxes owed by working families by providing up to \$1,000 per qualifying child. Similar to the EITC, the CTC reduces or eliminates federal income tax liability and then provides a refund with the remaining credit. The CTC provides only modest support, but it has less stringent income barriers than the EITC, allowing thousands of children to be covered, particularly in middle and upper-middle class families. For married filers, the phase-out begins at \$110,000 and for single filers at \$75,000. The refundable portion of the credit varies by family earnings and the amount of credit leftover from taxes owed. With the ARRA changes, the CTC refund is based on the amount by which the earned income of a worker (and spouse, if married) exceeds \$3,000. Families with any CTC remaining after their income tax liability has been eliminated may receive a refund of up to 15 percent of their earnings more than \$3,000.

The expansion to the CTC primarily benefited the lowest-income families with children (see Table 3). The income threshold at which a worker can get the refundable CTC was reduced to \$3,000 (Scenario 2) in 2009 and 2010 from \$8,500 (Scenario 1) in 2008. Prior to ARRA, the CTC threshold was scheduled to increase to \$12,550 (Scenario 3) in 2009.⁶ The CTC is only a partially refundable tax credit, which means that very low-income families with children are unable to take full advantage of credit. Lowering the threshold amount to \$3,000 has two effects: more families become eligible for the refundable portion and families already eligible for the credit may receive a larger amount.

	Pre-ARRA Child Tax Credit Level	ARRA Child Tax Credit	Post-ARRA Child Tax Credit (Scheduled in 2012)
	Scenario 1 \$8,500 Threshold	Scenario 2 \$3,000 Threshold	Scenario 3 \$12,500 Threshold
Earned Income	\$10,000	\$10,000	\$10,000
• Standard Deduction	-\$8,350	-\$8,350	-\$8,350
• Exemptions	-\$7,300	-\$7,300	-\$7,300
• Taxable Income	\$0	\$0	\$0
• Tax Liability	\$0	\$0	\$0
Nonrefundable Child Tax Credit	\$0	\$0	\$0
*Refundable Child Tax Credit	\$225	\$1,000	\$0
Total Child Tax Credit	\$225	\$1,000	\$0

*The refundable Child Tax Credit equals [15 percent x (Earned Income – Threshold)]

Source: Policy Matters Ohio

⁶ If no legislative action is taken, Scenario 3 will take effect following the ARRA in 2012.

The threshold change to \$3,000 provided larger credits to more than 170,000 families and provided 134,000 families with a credit they did not already receive (see Table 4). The average credit increase for families with incomes between \$10,000 and \$20,000 (the largest income group affected) was \$749.

If the changes embodied in the Recovery Act are not made permanent the largest impact (93 percent of the reduction) is on families with incomes of \$30,000 or less. Specifically, families between \$3,000 and \$12,750 would lose their entire refundable credit.⁷ Additionally, the CTC maximum credit amount of \$1,000 was the result of an increase from the larger Bush Administration tax cut package in 2001. If policymakers do not change the revision schedule, the CTC maximum credit is scheduled to drop back to \$500 maximum per child.

Total Number of Families Impacted	Existing Filers Receiving Additional Benefits	New Filers Receiving Benefits	Average Credit Increased for Families with Incomes between \$10k & \$20k
304,182	170,148	134,034	\$749

Source: The Brookings MetroTax model, 2008 American Community Survey microdata.

Credits for Working Families: EITC and CTC Together

Together, the EITC and CTC expansions provided major tax relief for working families with a wide range of incomes. Together, the two programs brought millions of dollars into Ohio's economy. When income is factored into the ARRA tax credits and broken down into seven income categories, the primary beneficiaries are families with incomes in the second and middle twenty percent of income earners (see Table 5). The average incomes in those income quartiles, from \$25,099 to \$41,749, experienced the largest EITC benefits (80 percent) while those with average incomes ranging from \$10,883 to \$25,099 saw the largest share of CTC benefits (93 percent). The bottom 60 percent of earners, with an average income of \$25,926, received 88 percent of the EITC increases and 96 percent of the CTC increases.

⁷ Elizabeth Kneebone, "The Child Tax Credit after ARRA: How Would Expiration Affect Metropolitan Families?" Metropolitan Policy Program at the Brookings Institution. (7/8/2010). http://www.brookings.edu/papers/2010/0708_child_tax_credit_kneebone.aspx

Ohio Taxpayers		Share of Recovery Act Tax Credits		Average Recovery Act Tax Credits for Beneficiaries	
Income Level	Average Income	EITC	CTC	EITC	CTC
Lowest 20%	\$10,883	7.5%	52%	\$384	\$871
Second 20%	\$25,099	36.9%	40.7%	\$511	\$850
Middle 20%	\$41,740	43.7%	3.5%	\$510	\$642
Fourth 20%	\$63,192	11.9%	3.8%	\$455	\$544
Next 15%	\$100,334	0	0	0	0
Next 4%	\$203,142	0	0	0	0
Top 1%	\$902,3356	0	0	0	0
All	\$59,622	100%	100%	\$491	\$833
<i>Bottom 60%</i>	<i>\$25,926</i>	<i>88.1%</i>	<i>96.2%</i>	<i>\$497</i>	<i>\$851</i>

Source: ITEP Tax Model, October 2010 from Bob McIntyre, "Refundable Credits Expanded in the Economic Recovery Act."

An Additional EITC Expansion: Workers Not Claiming Children

The Recovery Act expansions did not change eligibility criteria or refund amounts for workers without children. Currently, the childless worker's maximum credit value is \$457 for earners between \$6,000 and \$8,000. The original rationale for keeping this part of the EITC low was because the credit attempts to help working families *with* children. However, single-filing workers often support other family members even if they are not eligible to claim them on their tax return. Childless workers are an important segment of the economy. Table 6, below, provides information on how Ohio workers would benefit from doubling the EITC for workers without dependent children. More than 267,000 workers would be eligible for a larger EITC, bringing more than \$148 million to Ohio.

Total Filers Affected	Newly Eligible Filers	Filers Eligible for a Bigger Credit	Additional EITC Dollars Available
356,863	89,707	267,156	\$148.6 million

Source: The Brookings MetroTax model, 2008 American Community Survey microdata.

Based on the American Community Survey from the Census, we can predict demographic information about those who would benefit from doubling the childless worker portion of the EITC. The most common industries or occupations are manufacturing, retail, food service, health care, and construction. More than half of those benefiting are older than 45 and nearly 85

percent have incomes under \$15,000. Fewer than 10 percent of beneficiaries would be enrolled in any level of school, meaning they are low-wage, mostly adult workers.⁸

Policy Recommendations:

As December begins, there is much debate about extending tax credits for working families. As this report shows, the EITC and CTC expansions made sizable impacts in Ohio. The following recommendations would help working families and inject money into the economy.

Make Recovery Act expansions to the EITC and CTC permanent.

The EITC and CTC expansions help working families meet their own and their children's basic needs and move toward financial stability. Returning to pre-ARRA benefit levels would result in a loss of \$497 on average for the bottom 60 percent of working families. This is money that would not be spent by working families in their communities.

If the CTC resets to the 2001 level, the bottom 60 percent of families would lose an average of \$851 in benefits. For instance, last year a single mother with two children working full-time at minimum wage (\$14,500) received a CTC of \$1,750. The reset to the 2001 levels would provide the mother \$270.

Enhance the childless worker portion of the EITC.

Policymakers should double the childless worker portion of the EITC. Many childless workers support children through part-time custody, child care payments, alimony, and other indirect arrangements that do not qualify children as dependents on the tax return. Doubling the childless worker provision would bring more than \$148 million into Ohio and is an important supplement to the minimum wage.

Increase support to free tax preparation programs.

A broad method for increasing EITC and CTC claims has been a nation-wide effort to provide free or low-cost tax assistance for low-income families through an effort known as the Volunteer Income Tax Assistance (VITA) program. VITA is a volunteer-staffed and IRS-directed program, where local communities organize efforts to provide free tax assistance for working families who make \$56,000 or less. Ohio has several vibrant VITA coalitions that include partnerships between social service agencies, United Ways, nonprofit groups, city and county governments, and private businesses. Another free tax preparation program is the Ohio Benefit Bank (OBB), developed in partnership with the Ohio Association of Second Harvest Foodbanks and the Governor's Office of Faith-Based and Community Initiatives. The Benefit Bank, which continues to grow and includes some 400 private and nonprofit partners, also provides screening for and assistance claiming government benefits. The problem is that both VITA and Benefit

⁸ Elizabeth Kneebone presentation to the National Community Tax Coalition day of Action, "Economic Recovery and the Earned Income Tax Credit," Metropolitan Policy Program at the Brookings Institution (October 21, 2009).

Bank programs are nowhere near scale. A small percentage of eligible low-income families use these services (less than 4% of EITC recipients).

Federal and state policymakers have the opportunity to increase support for the IRS VITA program. As the tax code continues to be a way to disperse social and economic benefits, it is imperative that the method for tax preparation be fair and widely available. More assistance in the form of advertising, staff, and training would greatly benefit the free filing effort. Increased use of e-filing would also increase the speed of refunds to families. This type of investment could have tremendous ripple effects across the state, particularly in counties where VITA sites are not available. State support for these efforts, such as the Ohio Commission for the Earned Income Tax Credit, are crucial to the success of expanding free tax preparation and the EITC. Sen. Sherrod Brown recently introduced a bill that would increase VITA funding from \$12 million to \$35 million a year, a much needed step to meet the need for tax preparation services.⁹

⁹ S. 3865: The *VITA* Act of 2010

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