Building a Stronger Economy by Increasing the Rhode Island Earned Income Tax Credit

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The Earned Income Tax Credit (EITC) is a common sense tax break that reduces the income tax owed by low-wage working families, allowing them to contribute more to vibrant local economies.

Many hard-working Ocean State families are struggling to pay for housing, heat, food, and health care. A two-parent family, both earning the current minimum wage of $10.10, earn $42,000 a year--$26,000 less than what a two-parent family needs to earn in order to make ends meet.[i] The federal EITC helps working families close that gap, providing a refundable tax credit based on their income and family size.

Impact of Increasing RI EITC

Income group	Lowest 20%	Second 20%	Middle 20%
Average Income	$12,000	$29,000	$52,000
Avg. state EITC at 15% of federal credit*	**$340**	**$574**	**$145**
Avg. annual EITC increase at 18%	**+$68**	**+$115**	**+$29**
Avg. annual EITC increase at 20%	**+$113**	**+$191**	**+$48**
Avg. annual EITC increase at 25%	**+$226**	**+$383**	**+$97**

Source: Based on Institute on Taxation and Economic Policy, February 2018

*These amounts are the average for those receiving the RI EITC, not average for everyone in this income category.

Twenty-nine states and the District of Columbia have enacted earned income tax credits (EITCs) to supplement the federal EITC, one of the nation's most effective tools for boosting the incomes of low-paid working families.[ii]

In 2015 and 2016, Governor Raimondo and the Rhode Island General Assembly approved increases to the state credit: 12.5 percent of the federal credit in tax year 2016 and an increase to 15 percent for tax year 2017. This year, there are bills pending in the General Assembly to increase the state credit to 15.5, 18, 20, and 25 percent (H7558 (Barros), S2071 (Felag), H7315 (Slater) / S2217 (Goldin), and S2191 (Metts)).

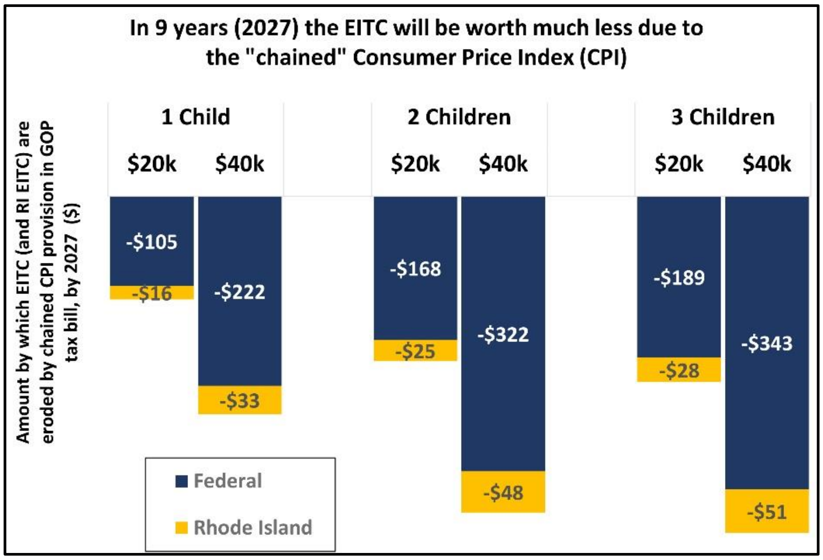
Rhode Island policymakers can help build an economy that works for everyone by strengthening the state's earned income tax credit. Below are a few reasons why Rhode Island should consider increasing the state EITC.

Good for local businesses and our state's economy

The EITC generates "multiplier" effects that reverberate through the local economy and become income for local businesses, employees and governments. Mark Zandi, a renowned national economic forecaster from Moody's Analytics, assumes a "multiplier effect" for refundable tax credits to low income earners in the range of 1.22 to 1.26, meaning that every dollar spent generates an additional $1.24 (approximately) in economic activity.[iii] Applying that multiplier to a state EITC set at 20 percent of the federal credit would add $46.4 million to the economy, $11.6 million more than added with the current 15 percent EITC.

Improving tax fairness

Like all residents, workers who receive the EITC pay payroll taxes, sales and property taxes, and other taxes and fees. Rhode Island's lowest income families pay one and a half times as much of their income towards state and local taxes as the wealthiest Rhode Islanders.[iv] This imbalance reflects our state's heavy reliance on sales, excise, and property taxes, all of which fall more heavily on families with lower incomes. Increasing the state EITC helps improve tax fairness.



Source: CBPP federal tax mode, based on Congressional Budget Office inflation projections.

Figure 1

The newly enacted Tax Cuts and Jobs Act (the Act) erodes the value of the EITC over time by using a different measure of inflation, the 'chained' Consumer Price Index (CPI). This means that the maximum value of the federal credit will rise more slowly over time than under the current law. This change also reduces the value of most state EITCs that are linked to the federal EITC. For example, a family with two children earning $40,000/year would see the annual value of their federal EITC eroded by $322 and their Rhode Island EITC eroded by $48 under the Act (Figure 1). States can mitigate this effect by increasing their credits.[v]

Keeps families working and reduce poverty

EITCs help low-wage working families pay for expenses that allow them to work, like child care and transportation. They are also structured to encourage the lowest-earning families to work more hours. Extra time and experience in the working world translates into better opportunities and higher pay over time. Three of every five recipients of the federal credit use it temporarily —for just one or two years at a time—while they get on their feet.[vi]

Important to workers of color

Low wages make it hard for working families to afford basics like decent housing in safe neighborhoods, nutritious food, reliable transportation, and quality child care, as well as educational opportunities that can move working families toward the middle class—especially working families of color. The median income for Black ($42,425) and Latino ($36,877) households is well below White households ($65,485), making it more likely that these workers will benefit from an increased state EITC.[vii] Latinos in particular are over-represented among EITC filers. More than one in nine of Rhode Island's labor force is Latino, but nearly one in four of the EITC-eligible population in the state is Latino.[viii]

Easy to administer, less expensive than many other tax cuts

States incur virtually no costs for determining eligibility for their credit because in most cases, families eligible for the federal credit also are eligible for the state credit. And because state credits like Rhode Island typically are set at a fixed percentage of the federal credit, revenue departments need only add one line to a state's income tax form.

State EITCs also offer a good value to states. Existing refundable EITCs in states with income taxes cost less than 1 percent of state tax revenues each year.[ix] Though low-income households comprise a substantial share of all taxpayers, they account for a smaller share of tax revenue. A few hundred dollars for each family makes a big difference to the family's ability to make ends meet without making a major dent in a state's treasury.

Neighboring states recognize the importance of strong state EITCs

Connecticut and Massachusetts currently offer refundable state EITCs at 23 percent of the federal credit—8 points higher than Rhode Island's.

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[i] The Economic Progress Institute, 2016. *The 2016 Rhode Island Standard of Need*. http://www.economicprogressri.org/index.php/rhode-island-standard-of-need-8/

[ii] Erica Williams and Samantha Waxman, February 7, 2018. *States Can Adopt or Expand Earned Income Tax Credits to Build a Stronger Future Economy*. Center on Budget and Policy Priorities. https://www.cbpp.org/research/state-budget-and-tax/states-can-adopt-or-expand-earned-income-tax-credits-to-build-a

[iii] Mark Zandi, February 7, 2012, Moody's Analytics *Bolstering the Economy: Helping American Families by Reauthorizing the Payroll Tax Cut and UI Benefits*. Written Testimony before the Joint Economic Committee. https://www.economy.com/mark-zandi/documents/2012-02-07-JEC-Payroll-Tax.pdf

[iv] Institute on Taxation and Economic Policy, January 2015, *Who Pays? 5th Edition A distributional analysis of the tax systems in all 50 states*. https://itep.org/whopays/

[v] Chuck Marr, December 21 2017*, Instead of Boosting Working-Family Tax Credit, GOP Tax Bill Erodes It Over Time*. Center on Budget and Policy Priorities, https://www.cbpp.org/blog/instead-of-boosting-working-family-tax-credit-gop-tax-bill-erodes-it-over-time.

[vi] Erica Williams and Samantha Waxman, February 7, 2018, *State Earned Income Tax Credits and Minimum Wages Work Best Together* Center on budget and Policy Priorities. https://www.cbpp.org/research/state-budget-and-tax/state-earned-income-tax-credits-and-minimum-wages-work-best-together

[vii] Economic Progress Institute analysis of US Census Bureau, 2016 American Community Survey data

[viii] Brookings' MetroTax model using 2015 American Community Survey public use microdata (PUMS)

[ix] Erica Williams and Samantha Waxman, February 7, 2018. *State Earned Income Tax Credits and Minimum Wages Work Best Together* Center on budget and Policy Priorities. https://www.cbpp.org/research/state-budget-and-tax/state-earned-income-tax-credits-and-minimum-wages-work-best-together