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

March 2020

The Earned Income Tax Credit (EITC) is a common-sense tax break that reduces the income tax owed by lower-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 $10.50, earn $43,680 a year—$24,630 less than what a two-parent family needs to earn in order to make ends meet.[1] The federal EITC helps working families close that gap, providing a refundable tax credit based on their income and family size.

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.[2]

In 2015 and 2016, Governor Raimondo and the Rhode Island General Assembly approved increases to the state credit: 12.5% of the federal credit in tax year 2016 and an increase to 15% for tax year 2017. This year the Governor's budget (H7171) proposes raising the state credit to 20% over five years. In the General Assembly, bills submitted by Senator Conley (S2xxx) and Representative Slater (H7623) would increase the state credit to 20% in one year; Senator Felag's bill (S2049) seeks an increase to 18%. Each increase of

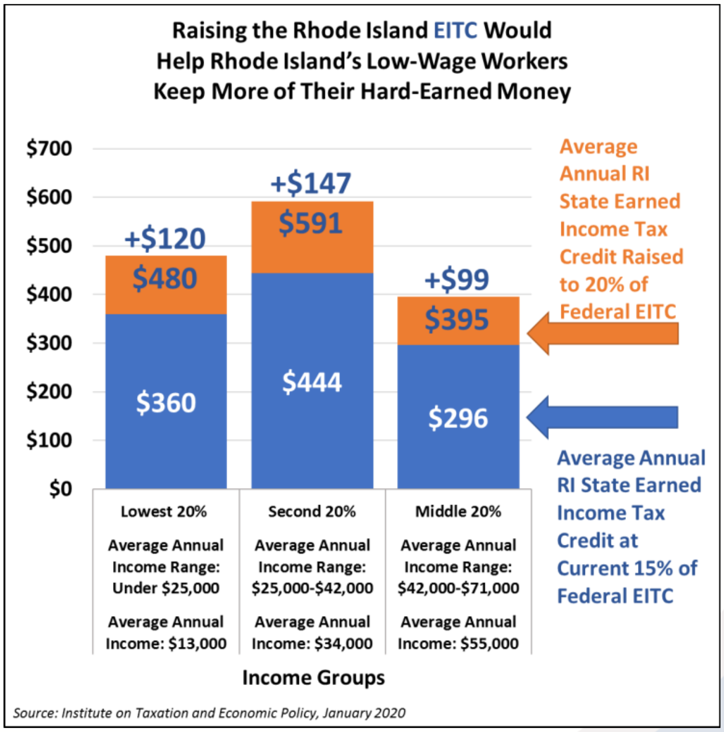

Chart 1

1% would bring approximately $22 per year to those eligible for the credit.[3] Chart 1 shows the positive impact of raising the EITC to 20%.

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 effects that reverberate through the local economy and become income for local businesses, employees, and governments. For refundable tax credits to low-income earners, Mark Zandi, a renowned national economic forecaster and chief economist at Moody's Analytics, identifies a "multiplier effect" in the range of 1.22 to 1.26, meaning that every dollar spent generates an additional $1.24 in economic activity.[4] Applying this multiplier to a state EITC set at 20% of the federal credit would add $46.3 million to the Rhode Island economy, $11.3 million more than added with the current 15% 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, 12.1% vs 7.9% (see Chart 2).[5] 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.

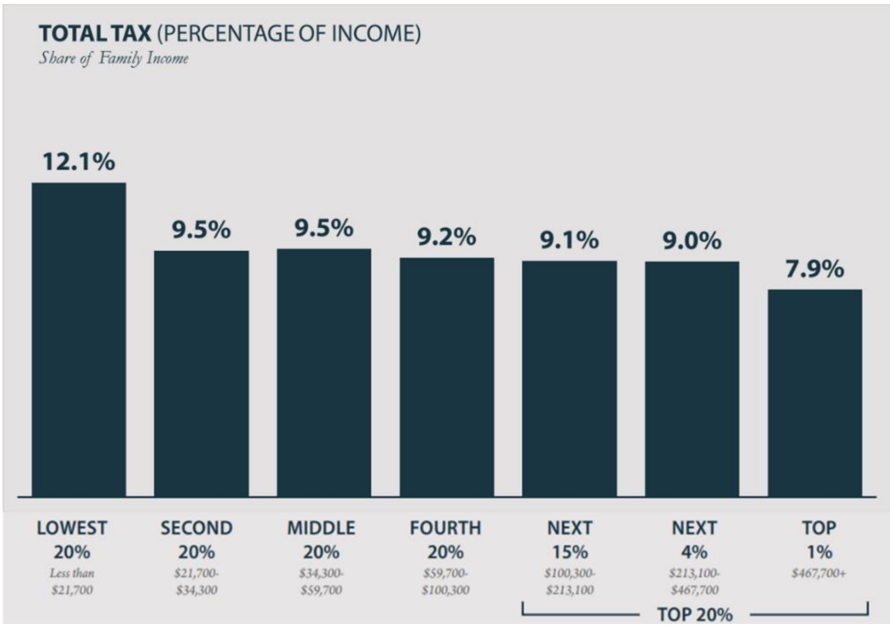

Chart 2

Mitigates loss of value of federal EITC

The December 2017 Tax Cuts and Jobs Act (TCJA) 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 previous standard. This change also reduces the value of state EITCs (like that of Rhode Island) linked to the federal EITC. With reduced federal and state credits combined, working families stand to lose hundreds of dollars per year. States can mitigate this effect by increasing their credits.[6]

Keeps families working and reduces poverty

EITCs help lower-wage working families pay for expenses that allow them to work, expenses such as child care and transportation. The credit is also structured to encourage the lowest-earning families to work more hours. Extra time and experience in the working world translate 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 back on their feet.[7]

Important to workers of color

Low wages make it hard for working families—especially working families of color—to afford basics like decent housing in safe neighborhoods, nutritious food, reliable transportation, quality child care, as well as educational opportunities that can move working families towards the middle class. The median household income for Black ($41,63) and Latino ($36,920) households is well below that of Non-Hispanic White households ($69,896), making it more likely that the former will benefit from an increased state EITC.[8] Latinos in particular are over-represented among EITC filers. More than one in nine workers in Rhode Island's labor force is Latino, but nearly one in four of the EITC-eligible population in the state is Latino.[9]

Easy to administer, less expensive than many other tax cuts

States incur virtually no costs for determining eligibility for this credit because in most cases, families eligible for the federal credit also are eligible for the state credit. And because state credits like that in Rhode Island typically are set at a fixed percentage of the federal credit, revenue departments need only add or modify one line in 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 one percent of state tax revenues each year.[10] 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 ability of families to make ends meet without making a major dent in a state's treasury. 3

Neighboring states recognize the importance of strong state EITCs

For Tax Year 2020, Vermont offers a refundable state EITC at 36% of the federal credit, with Massachusetts offering 30% and Connecticut 23%—from 8 to 21 points higher than Rhode Island's EITC. Chart 3 shows what the Rhode Island EITC would look like if the state adopts one of these rates or the 20% proposed in current legislation.

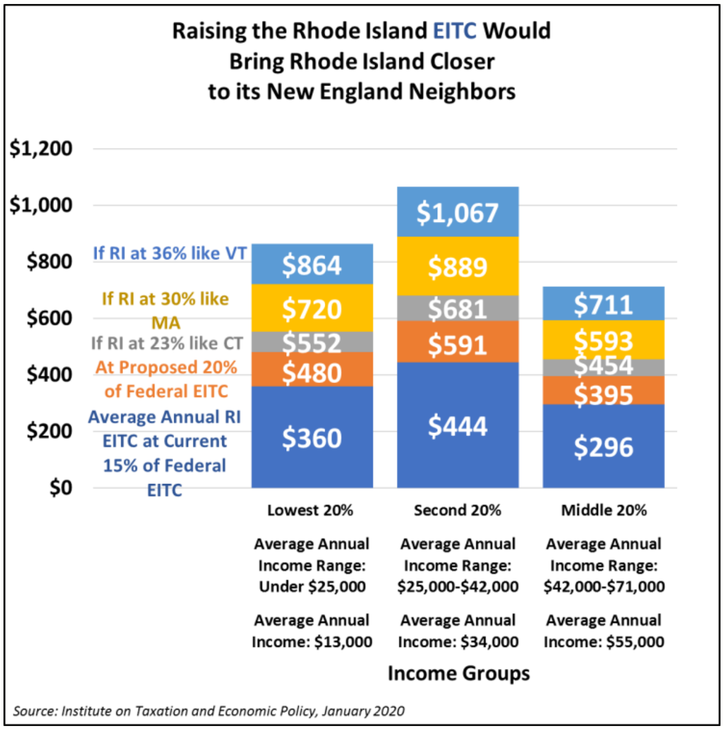

Chart 3

It is time for Rhode Island to increase its EITC credit from 15% of the federal EITC to at least 20%—to get closer to some of our New England neighbors, to help offset the weakening of the federal credit, and most of all to help low-income and middle-income Rhode Islanders. When working people can keep up basic spending, it boosts families, communities, and our economy.

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[1] The Economic Progress Institute, 2018. *The 2018 Rhode Island Standard of Need*. http://www.economicprogressri.org/index.php/rhode-island-standard-of-need-8/

[2] 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

[3] See the House Fiscal Office's presentation on Article 19 of the Governor's FY2021 budget: http://www.rilin.state.ri.us/housefiscalreport/Briefings%20and%20Presentations/2020%20Session/Articles/February%2011%20-%20Article%2019%20Workforce%20Development.pdf.

[4] 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

[5] Institute on Taxation and Economic Policy, October 2018, *Who Pays? 6th Edition A distributional analysis of the tax systems in all 50 states*. https://itep.org/whopays/

[6] 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.

[7] 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

[8] American Community Survey, Table S1903, Median Income in the Past 12 Months (in 2018 Inflation-Adjusted Dollars), 2018: ACS 5-Year Estimates Subject Tables.

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

[10] 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.