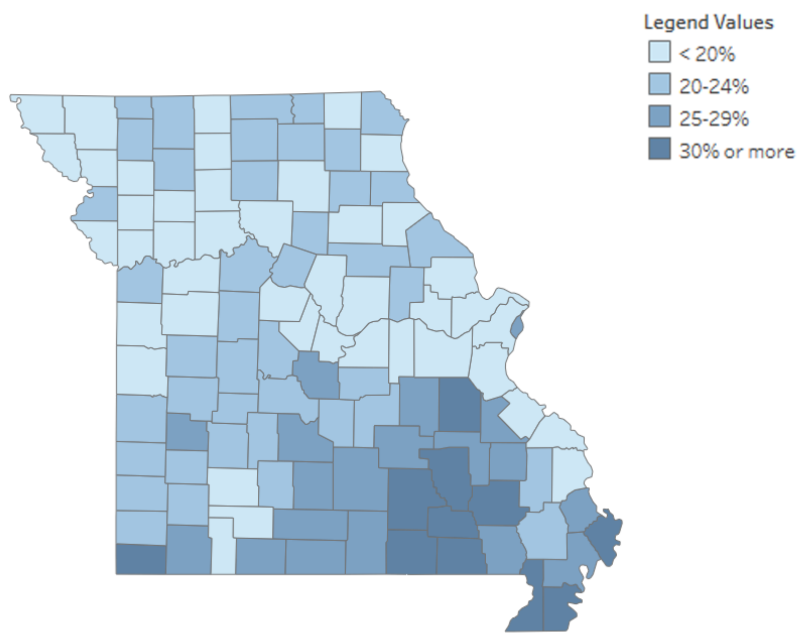
Missouri Foundation for Health

Strengthening the Safety Net: The Earned Income Tax Credit

The federal Earned Income Tax Credit (EITC) was established in 1975 as a mechanism to reduce tax liability for low-income working families.[i] It is regarded as one of the largest anti-poverty programs in the social safety net.[ii] The EITC is credited with lifting 6.5 million people, including 3 million children, out of poverty nationwide in 2015 alone.[iii]

In 2016, approximately 515,000 Missourians received the federal EITC at an average amount of $2,433.[iv] In 2017, the maximum annual credit ranged from $510 to $6,318 depending on family size.[v] Originally, childless adults were not eligible to receive the EITC. They have since been added to eligible recipients, although still receive significantly less than families with children. In 2015, almost half of Missourians who claimed the federal credit were single parents while 28 percent were single and without children.[vi]

Figure 1. Federal Earned Income Tax Credit (EITC) payments by county, 2015.



Missouri Budget Project. (2017). "Interactive Map: EITC by County."

Opportunity to Improve

Despite 19.8 percent of Missouri tax filers claiming the federal EITC, a state program would be beneficial to Missourians as well. Currently 29 states and the District of Columbia utilize a state EITC. Research shows that increasing the tax credit amount improves financial stability, increases human capital, and spurs economic growth. Missouri has ample room to improve in each of these areas.

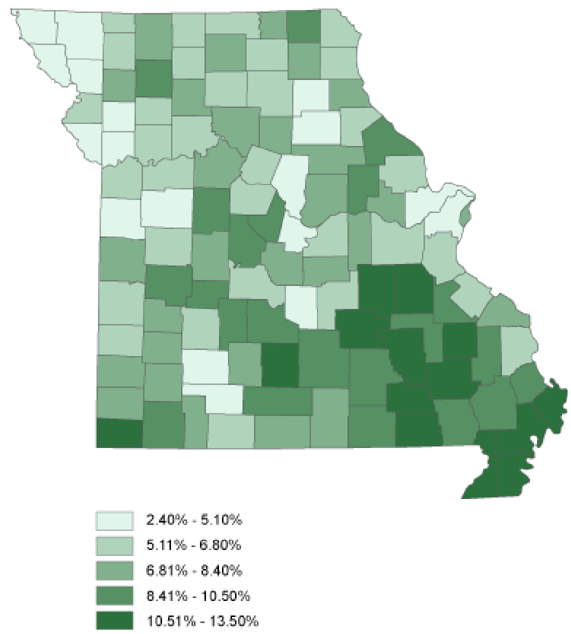
Financial Stability

The EITC improves recipients' financial stability by helping them meet their basic needs (e.g., child care, transportation, and utilities). In 2016, Missouri's poverty rate was 15.3 percent. Among female-headed households with children (a population shown to benefit from the EITC), the poverty rate was 41.2 percent.[vii]

The EITC also allows recipients to save for future expenses.[viii] In 2015, 8.5 percent of Missouri households did not have a savings or checking account, representing a decrease of 1 percent from 2011. At the same time, the number of underbanked Missourians increased more rapidly from 20.4 to 22.3 percent.[ix] An underbanked household is one that has obtained alternative financial services such as payday loans, money orders, and pawn shop loans despite having a checking or savings account. Use of these alternative financial services suggests that the households have a need for improved financial security.[x]

The credit was designed to incentivize individuals to enter the workforce. It has been particularly effective at increasing employment among adults with children, perhaps due to the higher potential credit amount.[ii] Missouri's unemployment rate was 3.5 percent in December of 2017; however, unemployment was generally higher in southeastern Missouri similar to where the federal EITC is claimed at a high rate.[xi, xii] For example, Pemiscot County had the highest unemployment rate (6.9 percent) in Missouri in December 2017 as well as the highest rate of tax filers who claimed the federal EITC in 2015 (36 percent).[xiii]

Figure 2. Percent of Missourians age 25 and older with less than a high school diploma, 2016.



Missouri Census Data Center. (2016). "Educational Attainment in Missouri."

Human Capital

Evidence shows that the EITC increases educational attainment of recipients' children and improves the likelihood of employment when they reach adulthood.[xiv] In 2016, the highest degree obtained by 31 percent of Missourians was a high school diploma or equivalent.[xv] As shown in Figures 1 and 2, southeastern counties and McDonald County in the southwest corner have the highest rates of residents who claim the EITC and who also have not completed high school, suggesting the area could benefit from an increase in credit.[xvi]

The tax credit is also associated with improved health, particularly maternal and child health outcomes. Research suggests this is due to recipients receiving more prenatal care and improving their health behaviors.[xvii] In 2016, 8.71 percent of Missouri infants were born with low birthweight, an increase from 8.09 percent in 2006. The percentage of Missouri mothers who received inadequate prenatal care also increased from 10.61 percent in 2006 to 19.19 percent in 2016.[xviii]

Economic Growth

The tax credit is estimated to generate growth in local economies. A "multiplier effect" is based on the notion that recipients spend their refunds on necessities at local businesses. The increased spending benefits employers, allowing them to hire additional personnel.[xix] In 2016, Missouri's average annual wage was $46,564, which ranks 26th when compared to other states. In the past 15 years, wages grew slightly slower than the United States' growth rate, 2.4 percent compared to 2.6 percent.[xx] The south-central portion[1] of the state was the only region of Missouri to experience a negative employment growth rate between 2011 and 2015.[xxi] In 2015, 30 percent or more of tax filers claimed the federal EITC in six counties (Ripley, Oregon, Carter, Shannon, Reynolds, and Wayne) in this region (shown in Figure 1).[xiii]

[1]Regions defined by Missouri Department of Economic Development. See "Missouri Economic Report: 2016." https://www.missourieconomy.org/pdfs/2016_MO_Economic_Report.pdf

Policy Intervention

Lawmakers of the 2018 Missouri General Assembly have proposed legislation (HB 1357, HB 1736, SB 939 and SB 615) that would create a state tax credit at 20 percent of the federal EITC.[xxii] The Internal Revenue Service (IRS) estimates that approximately 20 percent of eligible tax filers do not claim the federal EITC.[xxiii] For this reason, the bills would require the Missouri Department of Revenue to notify taxpayers of their potential eligibility and contract with nonprofits to raise awareness.

A state tax credit has been proposed consistently in Missouri for the past two decades but has not been prioritized highly enough to pass. Opposition stems from the projected cost, which is estimated to be more than $57 million per fiscal year.[xxiv] In addition, the federal government has made significant overpayments due to tax payer filing errors. In 2015, the IRS estimated that almost 24 percent of federal EITC payments were issued in error.[xxv] The most common causes of overpayment were due to mistakes reporting income, filing status, and the number of qualifying children.

Most states with their own EITC issue a credit that amounts to a percentage of the federal EITC (average is 16 percent). Two states vary the amount based on the number of qualifying children, and others include a maximum amount that is lower than the federal threshold. Only Minnesota disregards the federal EITC and instead uses household income.

Conclusion

Federal and state EITCs have positive effects on the financial stability of recipients, increase human capital, and generate economic activity. Missourians benefit from the federal tax credit; yet there is room for improvement. Poverty, education, and unemployment metrics suggest that areas with many federal EITC recipients are still experiencing worse outcomes compared to other portions of the state. Lawmakers could establish a state credit to strengthen the program. Previously failed legislative attempts suggest that a compromise is needed to reduce cost and address filing errors. Missouri lawmakers should look to models from other states to find a solution.

[i] Hathaway. (2017). "Tax Credits for Working Families: Earned Income Tax Credit (EITC)." National Conference of State Legislatures. http://www.ncsl.org/research/labor-and-employment/earned-income-tax-credits-for-working-families.aspx

[ii] Crandall-Hollick. (2016). "The Earned Income Tax Credit (EITC): An Economic Analysis." Congressional Research Service. https://fas.org/sgp/crs/misc/R44057.pdf

[iii] Center on Budget and Policy Priorities. (2016). "Policy Basics: The Earned Income Tax Credit." https://www.cbpp.org/research/federal-tax/policy-basics-the-earned-income-tax-credit

[iv] Internal Revenue Service. (2017). "Statistics for 2016 Tax Returns with EITC." https://www.eitc.irs.gov/eitc-central/statistics-for-tax-returns-with-eitc/statistics-for-2016-tax-year-returns-with-eitc

[v] Internal Revenue Service. (2017). "Earned Income and AGI Limits." https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/eitc-income-limits-maximum-credit-amounts

[vi] Brookings. (2016). "Interactive: Earned Income Tax Credit (EITC) Interactive and Resources." https://www.brookings.edu/interactives/earned-income-tax-credit-eitc-interactive-and-resources/

[vii] United States Census Bureau, American Fact Finder. https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?src=CF

[viii] Mendenhall, et al. (2012). "The Role of Earned Income Tax Credit in the Budgets of Low-Income Families." NBER. http://users.nber.org/~kling/eitc.pdf

[ix] Federal Deposit Insurance Corporation. (2016). "FDIC National Survey of Unbanked and Underbanked Households: Appendix Tables." https://www.fdic.gov/householdsurvey/2015/2015appendix.pdf

[x] Federal Deposit Insurance Corporation. (2016). "FDIC National Survey of Unbanked and Underbanked Households." https://www.fdic.gov/householdsurvey/2015/2015report.pdf

[xi] Missouri Department of Economic Development. "Unemployment Rates: Current Employment Situation Release." https://www.missourieconomy.org/indicators/unemp/index.stm

[xii] Missouri Department of Economic Development. "Unemployment Rates – December 2017." https://missourieconomy.org/images/indicators/unemp/unemp_1712.jpg

[xiii] Missouri Budget Project. (2017). "Interactive Map: EITC by County." http://www.mobudget.org/eitc-by-county/

[xiv] Chetty, Friedman, and Rockoff. (2011). "New Evidence on the Long-Term Impacts of Tax Credits." https://www.irs.gov/pub/irs-soi/11rpchettyfriedmanrockoff.pdf

[xv] Missouri Census Data Center. (2016). "ACS Profile Report: 206 (1-year estimates)." https://census.missouri.edu/acs/profiles/report.php?period=1&g=04000US29|01000US

[xvi] Missouri Census Data Center. (2016). "Educational Attainment in Missouri." https://census.missouri.edu/category/economics/

[xvii] Hoynes, Miller, and Simon. (2012). "Income, the Earned Income Tax Credit, and Infant Health." NBER, working paper 18206. http://www.nber.org/papers/w18206

[xviii] Missouri Department of Health & Senior Services. "Missouri Information for Community Assessment: Data MICAs." https://webapp01.dhss.mo.gov/MOPHIMS/QueryBuilder?qbc=BM&q=1&m=1

[xix] Wicks-Lim and Arno. (2017). "Improving Population Health by Reducing Poverty: New York's Earned Income Tax Credit." SSM – Population Health, 3 (373-381). doi: j.ssmph.2017.03.006

[xx] Missouri Department of Economic Development. (2017). "MERIC Information Brief: 2016 Average Annual Wages." https://www.missourieconomy.org/pdfs/annual_wages_brief_2016.pdf

[xxi] Missouri Department of Economic Development. (2016). "Missouri Economic Report: 2016." https://www.missourieconomy.org/pdfs/2016_MO_Economic_Report.pdf

[xxii] Missouri Foundation for Health. "Health-Related Legislation Under Consideration by the Missouri General Assembly in 2018." https://mffh.org/our-focus/policy/legislative-updates/

[xxiii] Berube. (2004). "Background on EITC Campaigns." The Brookings Institution. https://www.brookings.edu/wp-content/uploads/2016/06/20040621_EITC.pdf

[xxiv] Missouri House of Representatives. "Fiscal Note HB1357." http://house.mo.gov/billtracking/bills181/fiscal/fispdf/4162-01N.ORG.pdf

[xxv] Treasury Inspector General for Tax Administration. (2016). "Without Expanded Error Correction Authority, Billions of Dollars in Potentially Erroneous Earned Income Tax Credit Claims May Go Unaddressed." https://www.treasury.gov/tigta/press/press_tigta-2016-14.htm