



# A Hand Up: An Earned Income Credit Will Help Working Families

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The Pennsylvania House of Representatives is considering a bill to establish a state earned income credit for Pennsylvania's low income working families.<sup>1</sup> If enacted the credit would help to blunt the impact of a proposed increase in the state sales tax that will pay for property tax relief—including relief for some of Pennsylvania's wealthiest property owners.

The Pennsylvania Earned Income Credit would:

- Provide a refundable credit based on the Federal Earned Income Credit (EIC).
- Potentially help more than 600,000 Pennsylvanians across the commonwealth.
- Put money in the pockets of hardworking families with children to help pay for groceries, utility bills, and basic needs.
- Be offered as an alternative to the state's current Tax Forgiveness program.
- Coupled with the federal EIC, help families earning the minimum wage escape poverty.
- Make Pennsylvania's tax system more fair.

## In Pennsylvania, lower-income people pay proportionally more in taxes than those with higher incomes

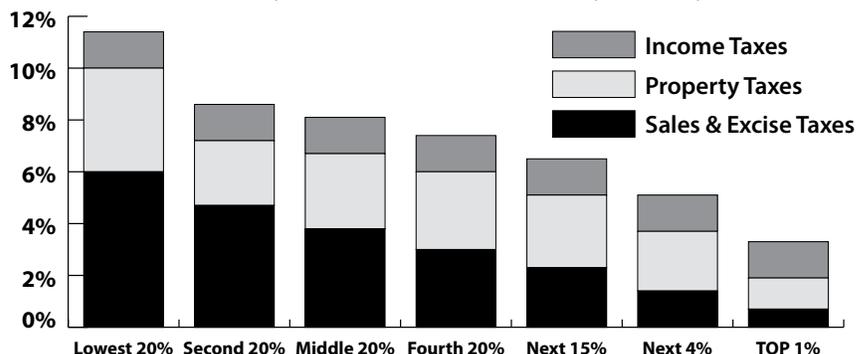
Pennsylvania's tax system is hard on low-income working families. The Institute on Taxation & Economic Policy ranks Pennsylvania as one of the 10 most regressive state and local tax systems in the nation.

- In 2002, the poorest fifth of Pennsylvanian taxpayers paid 11.4% of their income in taxes, well over twice the 4.8% share of income paid by the top 1% of taxpayers (see Figure 1).<sup>2</sup>
- Sales and excise taxes, such as gasoline taxes, take a particularly large bite out of the income of low-income households — 6% of the income for the poorest fifth and 4.7% for the second-poorest fifth. In contrast, the highest 1% of earners pays only 0.7% of income in sales taxes.<sup>3</sup>

## Lifting children out of poverty

Despite a growing economy, the share of Pennsylvanians in poverty remains stubbornly unchanged. According to the most recent US Census data, 12.1% of Pennsylvanians, and 16.5% of Pennsylvania children, live in poverty.<sup>4</sup> The recent increase in Pennsylvania's minimum wage has had an important effect on wages for the lowest-income earners, but a family of three with one full-time, full-year minimum wage earner still remains below the poverty level (\$17,170 for a family of three).<sup>5</sup>

**Figure 1. State and Local Taxes in Pennsylvania, 2002**  
**Shares of Family Income for Non-Elderly Taxpayers**



Source: Institute on Taxation and Economic Policy

Pennsylvania policy makers can make a positive difference in the lives of working families with children by adopting an Earned Income Credit (EIC) as a complement to the Commonwealth's current Tax Forgiveness program. This credit would be based on the successful federal Earned Income Credit that has been helping people rise from poverty through income tax relief since 1975.<sup>6</sup> In 2005, over 765,000 Pennsylvanians received an average Earned Income Credit of \$1,678 from this federal program (Table 1). This time-tested and effective federal program helps taxpayers throughout the commonwealth, averaging 40,000 recipients and \$68 million in benefits across Pennsylvania's 19 congressional districts. Because the credit is refundable, it pumps millions of dollars back into local economies.

**Table 1. EIC Receipts by 110th Congressional District, Tax Year 2004**

Pennsylvania Congressional District	Representative*	EIC Returns	EIC Amount (\$)	Average EIC Amount (\$)
1	Robert A. Brady	72,979	140,573,983	1,926
2	Chaka Fattah	67,845	126,736,656	1,868
3	Phil English	42,696	71,545,412	1,676
4	Jason Altmire	31,626	49,438,509	1,563
5	John E. Peterson	41,287	65,780,211	1,593
6	Jim Gerlach	21,992	34,816,301	1,583
7	Joe Sestak	33,925	56,200,090	1,657
8	Patrick J. Murphy	23,099	34,222,834	1,482
9	Bill Shuster	42,260	67,945,771	1,608
10	Christopher P. Carney	39,724	64,859,517	1,633
11	Paul E. Kanjorski	43,868	71,506,321	1,630
12	John P. Murtha	42,552	68,908,812	1,619
13	Allyson Y. Schwartz	32,202	53,759,582	1,669
14	Michael F. Doyle	42,875	70,815,637	1,652
15	Charles W. Dent	38,966	66,336,750	1,702
16	Joseph R. Pitts	37,413	64,491,581	1,724
17	Tim Holden	42,473	69,790,617	1,643
18	Tim Murphy	32,534	49,656,213	1,526
19	Todd Russell Platts	35,056	56,813,162	1,621
<b>Total</b>		<b>765,371</b>	<b>1,284,197,958</b>	<b>1,678</b>

\* Current members of 110th Congress

Source: The Brookings Institution Metropolitan Policy Program

## The Earned Income Credit helps families who have left welfare for work

The federal EIC program was designed to reward work. It encourages low-income families to increase their earnings through a refundable tax credit that is based on income and family size. If the credit exceeds the family's income tax liability, the difference is refunded back to the family, supplementing wages, and helping to offset payroll and other taxes.

The federal program is indexed to inflation, preserving the purchasing power of the credit to recipients over time.

The federal EIC helps move more than four million people, including two million children, out of poverty each year<sup>7</sup> and has significantly increased labor market participation among single mothers.<sup>8</sup> A study by researchers at Northwestern University found that the Federal Earned Income Credit explains more than one-half the increase in employment of single mothers between 1984 and 1996, and that state EIC programs, where available, also helped to increase labor force participation.<sup>9</sup>

## Tax forgiveness and a Pennsylvania EIC: A winning combination

Pennsylvania's Tax Forgiveness (also called SP or Tax Back) program delivers critical tax relief to families who need it. It eliminates or substantially reduces the Personal Income Tax owed by many low-income Pennsylvanians. Currently, taxpayers (individuals, couples, and families with children) can have all of their Pennsylvania income tax liability "forgiven," or refunded, up to certain income thresholds based on family size and composition. The threshold for 100% forgiveness of tax for a family of two adults and two children is \$32,000.<sup>10</sup> With income of \$33,250, that same family would have 50% of its tax liability forgiven. At \$34,250 in income, the family would receive 10% forgiveness.

Families with income up to 150% of the Federal Poverty Level (FPL) pay no state income taxes in Pennsylvania. (The exact percent of the poverty level above which families begin to pay taxes varies based on the number of adults and children in the

family). Of 42 states with a state income tax, Pennsylvania’s tax threshold of \$25,500 for single parent families ranks 7<sup>th</sup> highest and \$32,000 for two parent families is the 5<sup>th</sup> highest in the nation.<sup>11</sup>

In tax year 2005, the program forgave \$320 million of tax for 1.3 million Pennsylvanians, with an average benefit of \$240 per claimant. Still, since the benefits of Tax Forgiveness are limited to the amount of tax owed, it is not particularly helpful to those who pay little tax, including the lowest income working families and many of those just entering the workforce from welfare. The EIC can greatly benefit these Pennsylvanians. Adding a Pennsylvania EIC as an alternative to the existing Tax Forgiveness program would help more families with children to climb out of poverty and more families entering the workforce from welfare to get help with new transportation and child care costs.

Twenty-three states and the District of Columbia have created state EIC programs to target tax assistance, ranging from 3.5% to 35% of the federal credit.<sup>12</sup> Three of these states combine an EIC with another low-income state tax credit program (Maryland, New Mexico, and Wisconsin). It’s time that Pennsylvania joined them.

### How would it work?

Many people are familiar with the federal EIC program and apply for the federal income tax credit on their tax returns each year. The current proposal would create a Pennsylvania EIC equal to 15% of the federal credit for tax year 2008, and 30% for tax year 2009. This amount would be the filer’s Pennsylvania EIC (PA-EIC). Like the federal credit, the PA-EIC should be refundable, meaning that any credit that exceeds the amount of Pennsylvania Personal Income Tax due would be paid to the recipient. Since the PA-EIC is based on the federal credit, it would grow with inflation, preserving the value of the benefit to families over time.

**Table 2. Benefit/(Cost)of Selecting 30% EIC Rather Than Tax Forgiveness (Tax Year 2006)**

Family Income	Single Parent, Two Children	Two Parents, Two Children
\$12,000	\$991	\$991
\$15,000	\$887	\$899
\$20,000	\$415	\$541
\$25,000	\$(54)	\$73
\$30,000	\$399	\$(396)
\$35,000	\$81	\$210

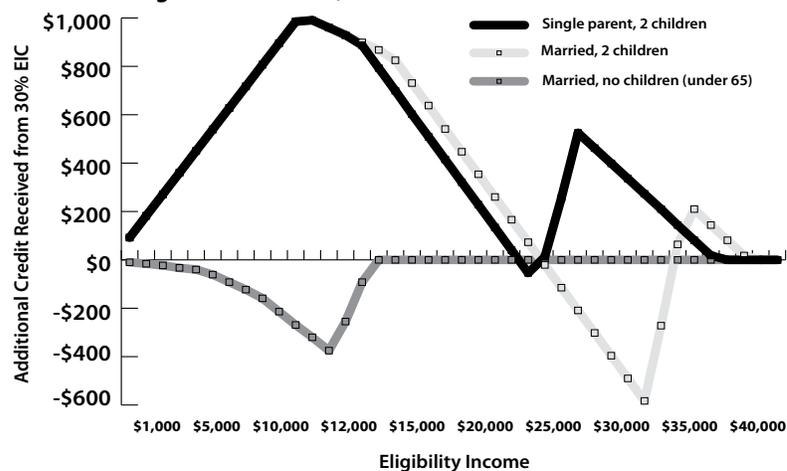
The PA-EIC amount would be compared to the benefit that could be received from Pennsylvania’s Tax Forgiveness program. The taxpayer would be entitled to take the larger of the two credits.

### Who would benefit from this program?

The program would benefit certain low-income working families in Pennsylvania. Exactly who would benefit depends on the percentage of the federal EIC that Pennsylvania ultimately adopts as well as family size and earnings.

Most single parent families earning up to \$30,000 would benefit from a refundable EIC. A one- or two-parent family with two children earning \$12,000 could receive an additional \$991 under the PA-EIC program as compared to Tax Forgiveness.<sup>13</sup>

**Figure 2. Difference Between 30% State-Based EIC and Tax Forgiveness Benefits, 2006**



Source: Pennsylvania Budget and Policy Center calculations based on Pennsylvania Department of Revenue Tax Forgiveness and Internal Revenue Service Earned Income Credit eligibility tables.

A 30% PA-EIC would provide a greater benefit to a married couple with two children than Tax Forgiveness until family income reaches approximately \$25,000 (Table 2).<sup>14</sup> For example, a married couple with two children earning \$20,000 would receive an additional \$541 with an EIC. (The PA-EIC also slightly benefits some higher-income families who are above the thresholds at which Tax Forgiveness begins to phase out).

A married couple without children earning between \$0 and \$20,000 would benefit more from the Tax Forgiveness program than a 30% PA-EIC and would elect Tax Forgiveness.<sup>15</sup> Tax Forgiveness is also more advantageous to single filers with no children up to \$8,750 in income, as well as families with three or more children with incomes in excess of \$25,000.<sup>16</sup> Some legislative proposals exclude single filers and married couples without children.

(Figure 2 compares benefits under Tax Forgiveness and under a state EIC at 30% of the federal EIC for three family types earning different income levels.)

## A Pennsylvania EIC can help working families escape poverty

An illustration of the power of adding a Pennsylvania EIC to the federal EIC can be seen in its impact on a minimum wage earner and his or her family. A single parent working 40 hours per week, 52 weeks per year, earning the new Pennsylvania minimum wage of \$7.15 an hour, would earn \$13,734 after subtracting Social Security taxes. Despite full-time work, the family's gross earnings would be only 87% of the federal poverty level of \$17,170 for a family of three. At that wage level, and assuming no other income, the federal EIC contributes an additional \$4,520 to the household. Adding a 30% state EIC adds \$1,356 more, bringing the family to an income of \$19,610 and across the poverty threshold to 114% of poverty.

### Why not increase the Tax Forgiveness program instead?

Tax Forgiveness does not encourage work in the way the EIC does, as none of the income on which tax is forgiven has to be from work. As currently administered, many of the beneficiaries of Tax Forgiveness are retirees, some of whom receive generous pensions as well as Social Security payments which are not subject to tax in Pennsylvania.

In addition, while Tax Forgiveness helps over 1.3 million lower-income Pennsylvanians each year by reducing their Personal Income Tax liabilities, it is limited to the amount of state income tax paid. At most, currently, it is limited to 3.07% of a family's income. This is not enough to offset 7.65% in Social Security, Medicare, and Medicaid taxes, let alone property and sales taxes.

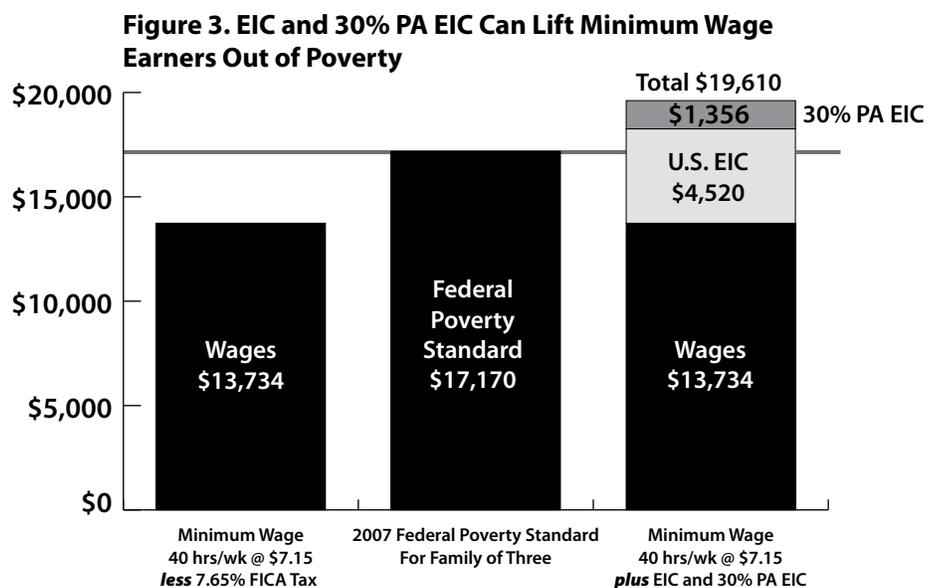
Given the choice, the PA-EIC is a better option for many lower-income working families.

## A Pennsylvania EIC would not harm those already receiving Tax Forgiveness

If the PA-EIC is enacted as an alternative to Tax Forgiveness and taxpayers could choose the more advantageous program, it would be a powerful partner to Tax Forgiveness and offer significant benefits to low-income families with children.

### How much would a Pennsylvania EIC cost?

A fiscal note prepared by the Pennsylvania House Appropriations Committee estimates the cost of a 15% EIC at \$25 million



Source: Pennsylvania Budget and Policy Center

in the first year and the cost of a 30% EIC at \$254 million by year three. First year costs could be higher depending on take-up rates.

## Conclusions

In a state with one of the most regressive tax systems in the nation, a Pennsylvania EIC could provide needed assistance to low-income working families. This can be done without jeopardizing the popular Tax Forgiveness program. The PA-EIC is based on a successful federal program that currently helps over 765,000 Pennsylvanians through the encouragement of work. Twenty-three other states have successfully adopted programs like the PA-EIC.

The PA-EIC:

- Encourages work
- Lifts working families out of poverty, thereby helping us all
- Provides more assistance than the current Tax Forgiveness program to many low-income working families
- Does not replace the current Tax Forgiveness program, only serves as an alternative for those who would choose it
- Grows with inflation, preserving the purchasing power of the credit for recipients over time
- Allows taxpayers to choose which program best meets their needs.

## Endnotes

<sup>1</sup> The General Assembly of Pennsylvania, Session of 2007, House Bill 377, Printer's Number 441.

<sup>2</sup> Taking into account the federal deduction offset, the lowest fifth remains at 11.4% while the top 1%'s burden falls to 3.5%.

<sup>3</sup> Institute on Taxation & Economic Policy (ITEP), *Who Pays: A Distributional Analysis of the Tax Systems in All 50 States*, 2<sup>nd</sup> Ed. (Washington, D.C.: ITEP, 2003).

<sup>4</sup> US Census Bureau, 2006 American Community Survey, August 2007 <[http://factfinder.census.gov/servlet/ADPTable?\\_bm=y&-geo\\_id=04000US42&-qr\\_name=ACS\\_2006\\_EST\\_G00\\_DP3&-ds\\_name=ACS\\_2006\\_EST\\_G00\\_-&-\\_lang=en&-\\_sse=on](http://factfinder.census.gov/servlet/ADPTable?_bm=y&-geo_id=04000US42&-qr_name=ACS_2006_EST_G00_DP3&-ds_name=ACS_2006_EST_G00_-&-_lang=en&-_sse=on)> (accessed Oct. 23, 2007).

<sup>5</sup> A full-time, full-year minimum wage worker earns \$14,872 in a year (2,080 hours times \$7.15). The poverty level for a family of three is \$17,170.

<sup>6</sup> The federal EIC program is also commonly referred to as the Earned Income Tax Credit (EITC).

<sup>7</sup> State EITC Online Resource Center, State EITC Basics: What is the Federal EITC? <[http://www.stateEITC.com/basics/fed\\_EITC.asp](http://www.stateEITC.com/basics/fed_EITC.asp)> (accessed Oct. 23, 2007).

<sup>8</sup> V. Joseph Hotz, et al., "The Earned Income Tax Credit and Labor Market Participation of Families on Welfare", *Incentive of Government Programs and the Well Being of Families: Chapter Three*, Ed. Bruce Meyer and Greg Duncan, Joint Center for Poverty Research, July 2001 <<http://www.jcpr.org/book/index.html>>.

<sup>9</sup> Bruce D. Meyer and Dan T. Rosenbaum, "Welfare, the Earned Income Tax Credit and Single Mothers," September 1999, and "Making Single Mothers Work," *National Tax Journal* 53 (4, Part 2), December 2000.

<sup>10</sup> Pennsylvania Department of Revenue, 2006 PA Schedule SP Eligibility Income Tables, Jan. 11, 2007 <<http://www.revenue.state.pa.us/revenue/cwp/view.asp?a=3&q=237877>> (accessed Oct. 23, 2007).

<sup>11</sup> Jason A. Levitas, “The Impact of State Income Taxes on Low-Income Families in 2006”, Center on Budget and Policy Priorities, March 27, 2007 < <http://www.cbpp.org/3-27-07sfp.htm>>.

<sup>12</sup> State EITC Online Resource Center, State EITC Basics: FAQs about State EITC <[http://www.stateeitc.com/basics/state\\_eitc.asp](http://www.stateeitc.com/basics/state_eitc.asp)> (accessed Oct. 26, 2007).

<sup>13</sup> Both a one- or two-parent family with two children that earn \$12,000 is eligible for complete forgiveness of the \$368 they would pay with the current Pennsylvania income tax of 3.07%. These families are also eligible for the same federal EIC amount and thus the same amount under a PA EIC set at 30% of the federal level--\$1,359. The difference between \$1,359 and \$368 is the \$991 cited in the text.

<sup>14</sup> At \$25,000 of income, a two-parent family with two children is eligible to receive 100% tax forgiveness (\$768 at a tax rate of 3.07%). That same family, assuming a 30% Pennsylvania EIC would be eligible to receive \$840. The net benefit the family would receive for switching to the PA EIC program would be \$73. By \$30,000 in income, the Tax Forgiveness program would provide a higher benefit to a two-parent family of four than the PA EIC. By \$35,000, the PA EIC program becomes beneficial once again, providing a \$210 refund as the Tax Forgiveness program has phased out completely. By \$40,000, both the PA EIC and the Tax Forgiveness programs would provide no benefits for the family of four used in the example.

<sup>15</sup> The federal Earned Income Credit program provides a very small benefit (peaking at \$380 at \$5,000 in income – phasing out by \$15,000) for married couples without children, while the Tax Forgiveness program provides a modestly higher benefit through \$20,000 in income.

<sup>16</sup> Tax preferences determined by comparing PA Tax Forgiveness benefits and a calculation of 30% of EIC benefits at different income levels.