# INVESTING IN LOW-PAID ARKANSANS

## A STATE-LEVEL EARNED INCOME TAX CREDIT WOULD PUT MONEY BACK IN THE BANK FOR 300,000 ARKANSANS

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## A STATE-LEVEL EARNED INCOME TAX CREDIT WOULD PUT MONEY BACK IN THE BANK FOR 300,000 ARKANSANS

by Bruno Showers, Senior Policy Analyst

### KEY TAKEAWAYS

- The Earned Income Tax Credit (EITC) is a bipartisan tool to reduce poverty and make sure low-paid workers aren't paying so much in taxes they cannot afford a dignified life. That's why more than half the states in the nation have implemented their own state-level EITCs.

- Around 300,000 low-paid Arkansans, many of whom are parents with children at home, would receive a state-level EITC if one were passed.

- Despite providing big benefits to working Arkansans, a state-ETIC would only have a moderate impact on the state budget. A modest Arkansas EITC would cost approximately $40 million.

### INTRODUCTION

The Earned Income Tax Credit (EITC) is a bipartisan tax policy that helps families with low-paying jobs make ends meet and provide for their children. The federal EITC gives working families who struggle with low wages a boost in income by providing credits at tax time. While every household has different needs, most families use this extra income to pay bills, pay off debt, or pay for childcare expenses like clothes and school supplies.

This small investment in working families has big payoffs, especially for kids. That's why 29 states plus the District of Columbia (D.C.) have adopted their own state-level versions. It's past time for Arkansas to adopt its own state EITC.

A state-level EITC would supplement the federal version, which lifts millions of working families[1] across the nation out of poverty every year. It would also help reduce the unfairness of Arkansas's tax system, which currently has the poor paying more than the wealthy[2] as a share of their income.

## A LIFE-CHANGING INVESTMENT

You have to work and earn a wage to get an EITC, with the amount of the credit increasing up to a certain income level and then tapering off as the taxpayer begins to earn a more livable wage. The federal EITC has, with bipartisan support, helped working families move up the income ladder since the 1970s. President Ronald Reagan called the EITC, "the best anti-poverty, the best pro-family, the best job creation measure to come out of Congress." What did he mean?

- The EITC helps people maintain stable employment. The EITC rewards work, because the defining feature is that you need to work to get it. For families in very low-paying jobs, the credit increases with every dollar earned. This has been shown to encourage work, which has the added benefit of reducing the need for safety net participation. Research has shown that expansions of the EITC in the 1990s did more to increase employment[3] and reduce welfare caseloads[4] among single mothers than either welfare reform or the substantially improving economy. And these effects seem to be long-term; moms who had access to the EITC in the 1990s ended up with higher wages[5] than those who didn't.

- Healthier and more successful kids. The extra income an EITC provides helps families pay for little things that some of us take for granted, like regular checkups at the doctor or being able to pay rent on time. That's why increases to the EITC have been linked to improved infant and maternal health[6], better test scores, a better chance at attending college[7], and even higher salaries later in life[8].

- Good for local economies. Tax credit refunds are usually spent close to home. Economists estimate that for every $1.00 spent on the EITC there is a $1.50 to $2.00[9] impact on the local economy. That means more revenue for local businesses, more local job opportunities, and more tax revenue for cities and counties[10].

While Arkansas is currently experiencing record-low levels of unemployment, even full-time wages are often too low for families to make ends meet. Arkansas's median income lags behind both the national average and our neighboring states with similar economies and demographics. A state EITC is a straightforward and evidence-based policy designed to address low wages and move families out of poverty for good.

Another reason to implement a state EITC is to promote awareness about the EITC program in Arkansas in general. About one in five[11] Arkansas families who qualify for the federal credit do not receive it. Most who fail to participate simply don't know they qualify. There are free tax assistance programs that help people with low income correctly file their taxes so they don't miss out, but there is a lot of room for improvement.

The only significant outreach in Arkansas is from a network of private groups that promotes the EITC through advertising, community information events and Volunteer Income Tax Assistance (VITA) sites. The state of Arkansas could partner with these groups and invest in a state-wide coordinated campaign. Every working Arkansan who doesn't claim their EITC leaves federal money on the table that could be remitted to Arkansas and spent on our state economy.

## HOW THE FEDERAL EITC AND STATE EITC WORK TOGETHER

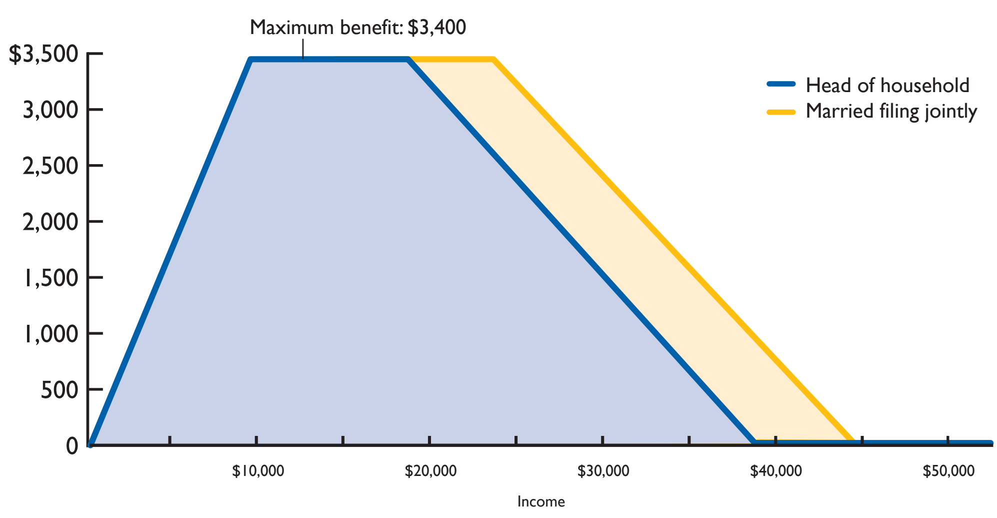
The success of the federal EITC has enabled more than half of the states to follow in enacting their own supplementary versions. At the state level, the EITC is set as a percentage of your federal credit amount. For example, if you are working in Kansas (where there is a 17 percent state EITC), and your federal credit is worth $1,000, your state credit would be $170.

You need to be working to get the EITC, but the amount of the credit varies depending on things like marital status, family size and income. Since it's designed to encourage work, the EITC increases up to a certain income level. It then plateaus and eventually begins to decrease until it zeroes out when taxpayers achieve a sufficient income — usually somewhere around $39,000 a year[12] or slightly more, depending on family size. The EITC is designed to provide more relief to taxpayers with children to reflect the additional costs associated with raising children in the home.

The graph below shows how this works in practice for a household with one child.

Every year around 300,000 Arkansans claim the federal EITC. The average amount[13] is about $2,700. State EITCs range from 3.5 percent in Louisiana to as high as 35 percent of the federal EITC in New Jersey[14]. Even if Arkansas adopted a modest EITC equal to 5 percent of the federal credit, that would mean an additional $130 on average for qualifying Arkansans. Some of this amount offsets income taxes; but most of the credit, especially for poorer tax payers, is returned as a refund to the filer and is usually spent in the local economy. A 10 percent state EITC would provide an average credit of $270 for Arkansans claiming it.

FEDERAL EARNED INCOME TAX CREDIT FOR HOUSEHOLDS WITH ONE CHILD, 2017




Note: Assumes all income is from earnings (as opposed to investments, for example).
Source: Internal Revenue Service

## A STATE EITC WOULD HELP FIX AN UNFAIR SYSTEM

Arkansas's tax system is very regressive. That means that, as you earn more money, you pay a smaller share of your income toward state and local taxes. Arkansas families in the bottom 40 percent of the income distribution — those with incomes below $30,600 yearly — pay more than 11 cents in state and local taxes for every dollar they earn. In contrast, the top one percent — those making more than $422,400 yearly — pay less than 7 cents on the dollar[15]. The EITC provides tax relief targeted at exactly those working families with low wages who need it most.

There are two primary reasons our tax system is so unfairly balanced. The first is that we rely heavily on sales tax revenue. Unlike income taxes, which are progressive in the sense that the rate at which you are taxed goes up as your income goes up, sales taxes take the same flat rate from everyone regardless of their ability to pay. High-income taxpayers are able to save or invest a greater portion of their income on things not subject to sales taxes than the poor, because a larger share of a low-income family's budget goes to everyday expenses.

The other reason is that we collect far fewer taxes on capital gains — income from the sale of an asset, like stocks or land — than we do on earned income. Unsurprisingly, the vast majority of capital gains income goes to wealthier households. According to the Congressional Budget Office, capital gains income accounts for only about 10 percent of income for all households on average. But within the top one percent of households by wealth, capital gains accounted for more than one-third of their income[16]. That means that taxing capital gains at a reduced rate and exempting all capital gains income over $10 million from taxes — the way we do in Arkansas — provides a benefit to a tiny number of the very wealthiest households but costs the state millions every year in foregone revenue.

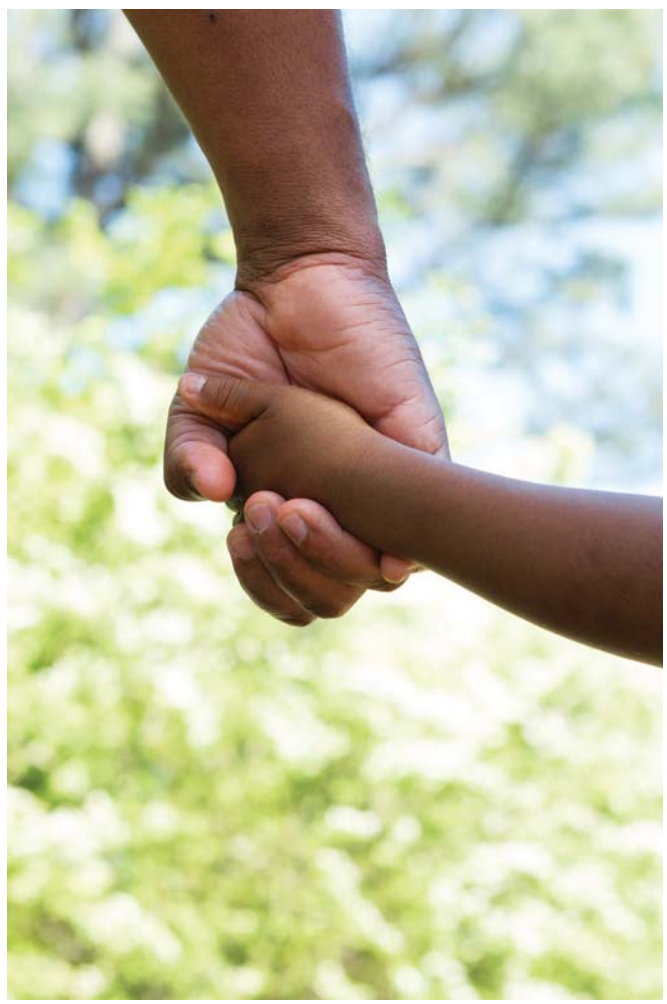
A state EITC could partially offset the unfairness of the existing tax system for Arkansas's low- and middle-income workers. The more generous the state EITC, the bigger impact it could have in righting the state's upside-down tax system.

## PUTTING THE POLICY IN PLACE

A state-level EITC continues to gain momentum in Arkansas. We have had multiple proposals over the last few legislative sessions, and the EITC was a serious part of the Tax Relief and Reform Task Force's discussions, though they did not endorse it in their final recommendations.

A state EITC at a modest 5 percent level would cost just $39 million a year[17] — that's less than the $57 million in tax cuts proposed by the Tax Task Force. Even a very generous 20 percent match would only cost about $155 million every year. That's less than the $170 million share of the personal income tax cuts that would accrue every year to Arkansans making over $80,000 based on the fiscal analysis included in their final recommendations.

A state EITC in Arkansas is just common sense. One in four Arkansas kids live in poverty, thanks in no small part to the inequities in our tax system. A state EITC would help reduce poverty and create a fairer tax system for low-paid Arkansans.



# ENDNOTES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