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BLUEPRINT *for* KENTUCKY'S CHILDREN

ISSUE BRIEF SERIES

The Blueprint for Kentucky's Children is a unified policy agenda for child advocates across the Commonwealth.

Our goal is to make Kentucky the best place to be young.



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To learn more about the Blueprint for Kentucky's Children and current legislative priorities, visit www.blueprintky.org

A State Earned Income Tax Credit Would Help Kentucky Families and Local Economies

Kentucky children thrive when parents can earn a living and meet basic needs for the family. For years, the federal Earned Income Tax Credit (EITC) has encouraged work while also helping working families who earn low incomes make ends meet. The EITC was designed to encourage and reward work while also delivering much-needed support to low-income families. The EITC has a proven record of getting and keeping people working. It can only be claimed by people who earn income through work, and the credit is structured to encourage people to work more hours.

The EITC has become the nation's most successful anti-poverty program and has a thirty-year proven track record of lifting children and families out of poverty.¹ In 2015, the EITC lifted about 6.5 million people out of poverty, including about 3.3 million children. The number of poor children would have been more than one-quarter higher without the EITC. The credit reduced the severity of poverty for another 21.2 million people, including 7.7 million children.²

Twenty-eight states and the District of Columbia have gone one step further by establishing a state EITC to further encourage work among low-income families, reduce poverty, and stimulate local economies.³

In today's economic climate, even hard-working Kentucky families may struggle to make ends meet. This has a negative ripple effect in our communities, with families unable to pay bills like rent and utilities and unable to purchase necessities like food, clothing, and car repairs. Families make these purchases locally so when they decrease, local businesses feel

the pinch as well. A strong Kentucky economy truly hinges upon all residents – particularly low-income families – having more money in their paychecks. Implementing a state EITC in Kentucky would help thousands of low-income families and, in turn, our local businesses and our economy.

This brief examines the federal EITC and the benefits a state EITC would provide to Kentucky's working families and local economies if such a credit were implemented in the Commonwealth.

A Proven Approach

The federal EITC was instituted in 1975 to encourage and reward work by offsetting the cost of federal payroll taxes for low-income families. In the early 1990s, the EITC was expanded to ensure that full-time workers earning the minimum wage would not have to live in poverty.⁴ Research shows that the EITC increases the number of people working and helps families build their assets.⁵

Benefits to Families

The federal EITC helps more parents, particularly single mothers, move into the workforce.⁶ When wages alone are not enough for families to make ends meet, the addition of the EITC encourages parents to work more while also supplementing annual income. Research shows that over time these parents experience growth in their earnings.⁷ Research also indicates state EITCs contribute to even more increases in workforce participation in states where there is a credit available.⁸



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The EITC also directly benefits families by helping them cover the costs of basic needs. Many families who are working, many at more than one job, have low wages. This often means they don't earn enough to meet their daily living expenses or access routine health care. In 2015, 397,000 Kentucky taxpayers claimed \$968 million from the federal EITC; the average amount received was \$2,436.⁹

Benefits to Children

All children benefit when they live in families with adequate resources to meet their basic needs. The EITC lifts more children out of poverty than any other federal program. Without the EITC, the poverty rate among children would be as much as 25 percent higher.¹⁰ Between 2011 and 2013, the federal EITC along with the Child Tax Credit (CTC) kept more than 90,000 Kentucky children out of poverty each year.¹¹ With the fifth highest child poverty rate in the nation (26 percent), Kentucky needs to implement proven poverty reduction strategies.¹²

Although most families only receive the federal EITC for one or two years at a time, the temporary support can have lifelong implications for children. Increased income for families with very low income (under \$25,000) results in children doing better in school and working and earning more as adults. For example, an increase of \$3,000 in family income in early childhood means the children will work almost a month more each year and earn 17 percent more as adults.¹³ Research shows a direct link between families of young children receiving additional income through the federal EITC and the improvement of their children's math and reading comprehension.¹⁴

State EITCs are also correlated with healthier babies and better outcomes across the course of children's lives.¹⁵ A 2010 study revealed that living where there is a state EITC reduces the odds of maternal smoking by five percent.¹⁶ This is of particular importance for Kentucky where more than one in five mothers smoke during pregnancy.¹⁷ The same study also revealed a link between the presence of a state EITC and increased birth weights among infants.¹⁸ Nearly one in ten babies in Kentucky is born at a low birth weight, which is linked to increased risk for future health issues.^{19,20}

Benefits to Communities, Businesses, and Economies

Supplementing the federal EITC with a state EITC has a significant positive outcome on communities, businesses, and overall economies. After implementing a 20 percent EITC, Michigan was able to considerably bolster their economy.²¹ While the state contributed \$260 million to supplement the \$1.3 billion Federal EITC, the net impact infused into the economy was \$2.2 billion through increased incomes and consumption.

Small businesses depend on reliable workers. The EITC can be used to repair or maintain vehicles or pay for childcare, thus increasing a family's ability to keep existing jobs or secure new employment opportunities. The EITC can also help Kentucky businesses in the future by providing a more skilled workforce. An estimated 62 percent of all jobs in Kentucky will require postsecondary education by 2020.²² Presently, only 30 percent of all adults in Kentucky ages 25 and older have an associate's degree or higher.²³ Kentucky businesses, and the Kentucky economy, would benefit from more children being better prepared for the workforce as a result of their families' access to a state EITC.

The EITC also strengthens local economies. Families mostly use the federal EITC to pay for basic necessities.²⁴ That spending takes place at local stores and businesses, stimulating the local economy. In the last decade, several studies have measured the economic effect of the credit. These studies have demonstrated that every dollar of EITC refund to taxpayers generates local economic activity worth: \$1.07 in Nashville; \$1.40 in Fresno; \$1.58 in San Antonio; and \$1.67 in Michigan.²⁵ Additionally, according to a 2008 report by the U.S. Conference of Mayors: "Economists suggest that every increased dollar received by low- and moderate-income families has a multiplier effect of between 1.5 to 2 times the original amount, in terms of its impact on the local economy and how much money is spent in and around the communities where these families live."²⁶

In addition to paying taxes now, EITC recipients can be expected to continue contributing to the tax system over time. Three out of every five federal EITC recipients claim the credit for only one or two years at a time. Additionally, most recipients pay more in federal taxes over the long run than they receive in EITC benefits during these short periods of time.^{27,28}

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How the Federal Earned Income Tax Credit Works

The federal EITC is a tax credit extended to low-wage workers. The tax filer must earn wages in order to qualify for the credit. The credit benefits families with children the most, and the value of the credit varies depending upon family size and income level. Married couples qualify for credits at higher earned incomes than single filers (see Chart 1), and the

more workers earn, the more their EITC credit is worth, up to the maximum benefit. For tax year 2016 the maximum benefit levels are as follows:

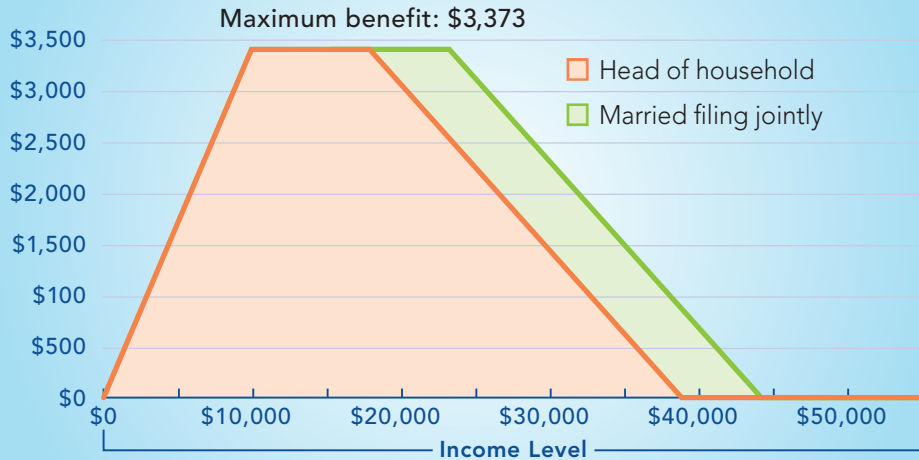
- » \$6,269 with three or more children;
- » \$5,572 with two qualifying children;
- » \$3,373 with one qualifying child; and
- » \$506 with no qualifying children.²⁹

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Chart 1

Federal Earned Income Tax Credit, Tax Year 2016 (One Child)



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

After the worker's earnings become high enough that the taxpayer is receiving the maximum credit amount, the value of the credit remains the same as earnings grow until the earnings reach a phase-out range where the credit begins to fall as the worker earns more income, until the credit disappears.³⁰

The federal EITC is a refundable tax credit, meaning that if the value of the credit exceeds the tax filer's tax liability, the taxpayer receives a refund for the full value of the credit, not just a refund of any taxes due before considering the credit.³¹ The refundable portion of the credit helps offset other taxes that low-income workers pay, such as payroll taxes.

Federal EITC Returns Over \$968 Million to Kentucky Taxpayers

In 2015, the federal Earned Income Tax Credit put over \$968 million into the Kentucky economy, helping families close the gap between what they earn and what it takes to make ends meet.³² For Kentuckians working but still within the grasp of poverty, the EITC helps them pay for basic necessities. EITC recipients may also apply their tax credit toward longer-term investments that help them build assets, including modest savings, education, and housing improvements.³³ Individual development accounts offered by community-based organizations in Kentucky offer matched savings programs to encourage individuals to save at least a portion of their EITC.

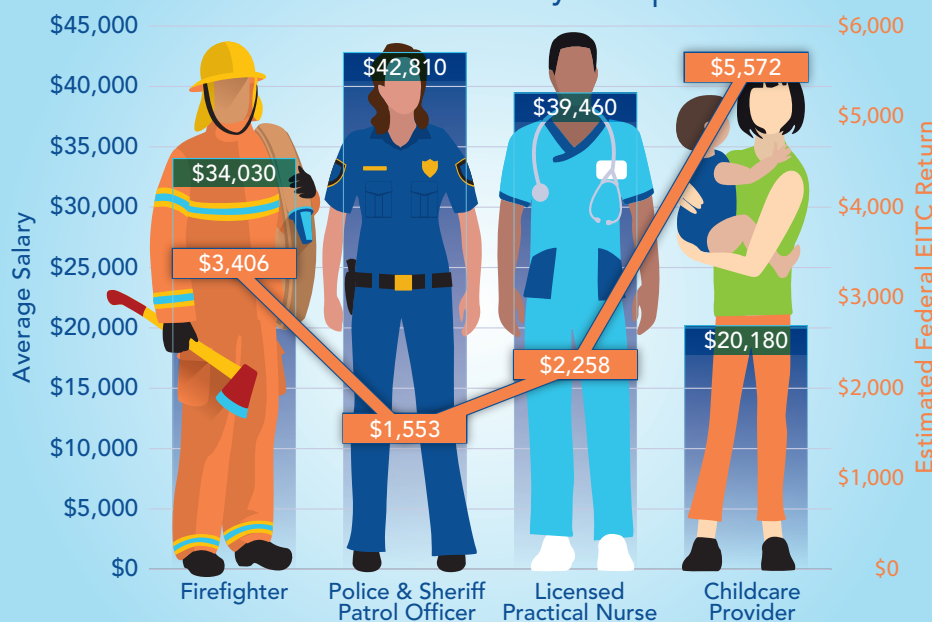
How Would a State EITC Work in Kentucky?

In most states that have enacted a state EITC, the credit is set as a percentage of the federal EITC. This allows the credit to be implemented with little administrative cost. State credits range from three percent to 125 percent of the federal credit.³⁴ If state policymakers choose not to model a state EITC as a percentage of the federal EITC, then they must also determine how marital status and family size would affect the size of the credit. Most states with an EITC follow federal provisions in establishing the size of the credit that each family type receives. That is, low-income families receive a certain credit amount based on based on their family size.

One compelling reason to base a state EITC on the federal credit is its modest administration costs. By having a state credit "piggyback" on the federal credit, state tax agencies often need to add only one new line to a state tax form.³⁵ In addition, many tax filers are already familiar with the federal EITC, and many community-based outreach efforts, like Volunteer Income Tax Assistance (VITA) sites, are already in place to assure that all eligible families take advantage of the federal EITC. Such efforts would help ensure eligible tax filers know about a state tax credit and take advantage of it too.

Chart 2

Estimated Salary & Federal EITC Return Based on Kentucky Occupation

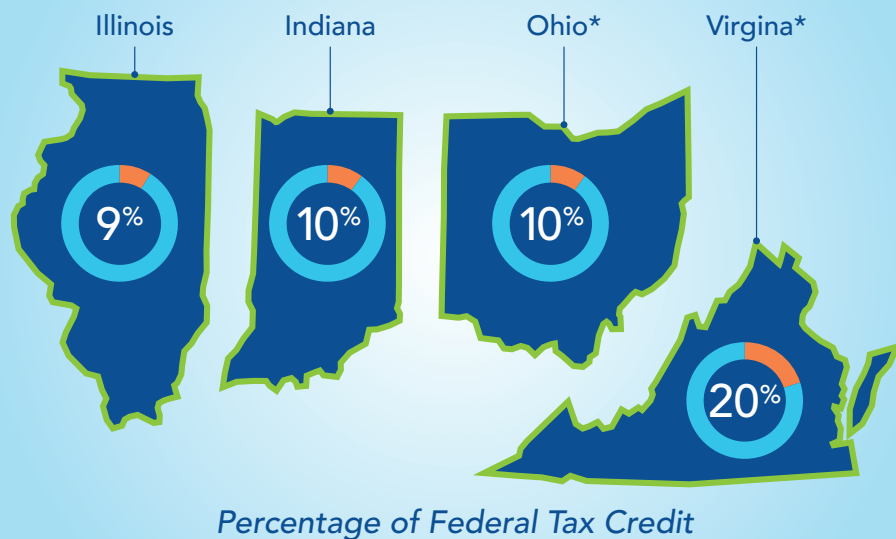


Source: BLS State Occupational Wage Estimates & EITC Benefit Table. Estimate based on family of four
https://apps.irs.gov/app/vita/content/globalmedia/earned_income_credit_table_1040i.pdf

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Chart 3

Neighboring States with State Earned Income Tax Credit



*Non-Refundable Credit

Source: https://apps.irs.gov/app/vita/content/globalmedia/earned_income_credit_table_1040i.pdf

Enacting a State EITC for Kentucky

Budget decisions require tough choices, and a state EITC is a way to boost incomes for hard-working families while supporting local economies. Enacting a state EITC is a worthwhile investment given the resulting gains to local economies, the increased workforce

participation of adults, and improved workforce preparedness of youth.

In 2005, Kentucky established a nonrefundable, Family Size Tax Credit (FSTC), which provides income tax relief for individuals and married couples earning less than 133 percent of the federal poverty level. While the FSTC has been valuable to many working families, it does not carry all of the benefits of a state EITC.

Since it is not refundable, the FSTC does not supplement wages as a refundable EITC would. Just last year, the non-refundable FSTC cost Kentucky \$112.4 million. A refundable state EITC would provide tax relief to low-income working families who earn slightly more than the current income cutoffs under the FSTC. For example, a family of four with two children with earnings of \$14,000 receives a family size tax credit equal to its income tax liability, which lowers the amount of taxes owed to zero. If a refundable state EITC of 15 percent were implemented, the family would receive a credit of \$835.

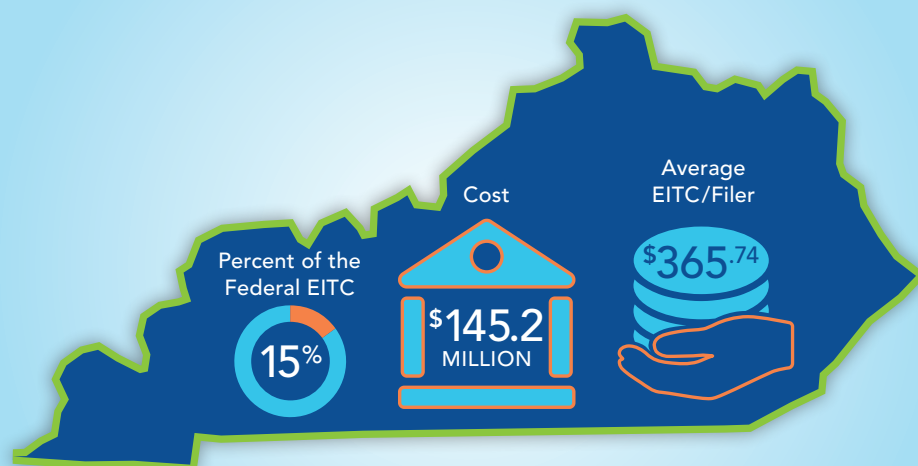
A refundable state EITC would begin paying benefits quickly – with little administrative cost and without requiring the creation of more governmental infrastructure. By implementing an EITC in Kentucky, thousands of low-income working families would have additional funds to address their immediate needs and, in some cases, more money to put toward achieving long-term economic success. As parents work more and spend their EITC in local communities, a state EITC would strengthen local economies as well.

EITC Is Right Step to Encourage Work for the Neediest Kentuckians

It is time for Kentucky to join the 24 other states across the nation and enact a refundable state EITC. The EITC gets and keeps people working through its structure that places an emphasis on earned income. The EITC keeps more working families out of poverty and can easily be modeled after the federal EITC. As a temporary support, three out of five recipients only receive the credit for one or two years and it can serve as a bridge for workers facing temporary job loss or reduced hours. A state EITC would inject millions into the state and generate economic activity. Lastly, and most importantly, the federal EITC has been linked to improvement in children's math and reading comprehension and increased future earnings as adults. A state EITC would improve outcomes for 442,000 Kentucky children.

Chart 4

Estimated Cost of a State EITC in Kentucky



Source: Calculations by Kentucky Youth Advocates based on Tax Year 2016 data from IRS

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Appendix: EITC Returns by County, Tax Year 2014

County	EITC Claims	County EITC Amount	Average Fed. Return	Estimated State Return (15%)
Adair	1,906	\$4,900,956	\$2,571.33	\$385.70
Allen	1,928	\$4,818,295	\$2,499.12	\$374.87
Anderson	1,954	\$4,481,181	\$2,293.34	\$344.00
Ballard	900	\$2,116,776	\$2,351.97	\$352.80
Barren	4,290	\$10,531,247	\$2,454.84	\$368.23
Bath	1,415	\$3,576,412	\$2,527.50	\$379.12
Bell	3,265	\$8,685,328	\$2,660.13	\$399.02
Boone	8,011	\$18,161,460	\$2,267.07	\$340.06
Bourbon	1,844	\$4,299,830	\$2,331.80	\$349.77
Boyd	4,445	\$10,148,379	\$2,283.10	\$342.46
Boyle	2,748	\$6,514,543	\$2,370.65	\$355.60
Bracken	890	\$2,161,387	\$2,428.52	\$364.28
Breathitt	1,461	\$3,869,568	\$2,648.57	\$397.29
Breckinridge	1,419	\$3,303,991	\$2,328.39	\$349.26
Bullitt	5,908	\$13,388,762	\$2,266.21	\$339.93
Butler	1,042	\$2,481,721	\$2,381.69	\$357.25
Caldwell	1,273	\$3,107,440	\$2,441.04	\$366.16
Calloway	2,914	\$6,364,984	\$2,184.28	\$327.64
Campbell	6,178	\$14,038,973	\$2,272.41	\$340.86
Carlisle	398	\$943,163	\$2,369.76	\$355.46
Carroll	1,112	\$2,782,753	\$2,502.48	\$375.37
Carter	2,839	\$7,003,725	\$2,466.97	\$370.05
Casey	1,486	\$3,670,855	\$2,470.29	\$370.54
Christian	8,581	\$23,044,595	\$2,685.54	\$402.83
Clark	3,332	\$8,073,884	\$2,423.13	\$363.47
Clay	2,356	\$6,607,175	\$2,804.40	\$420.66
Clinton	1,180	\$3,138,569	\$2,659.80	\$398.97
Crittenden	689	\$1,665,879	\$2,417.82	\$362.67
Cumberland	778	\$1,943,697	\$2,498.33	\$374.75
Daviess	8,881	\$20,709,322	\$2,331.87	\$349.78
Edmonson	802	\$1,924,197	\$2,399.25	\$359.89
Elliott	443	\$1,231,088	\$2,778.98	\$416.85
Estill	1,588	\$4,020,273	\$2,531.66	\$379.75
Fayette	23,879	\$52,263,675	\$2,188.69	\$328.30
Fleming	1,516	\$3,606,439	\$2,378.92	\$356.84
Floyd	4,009	\$10,494,574	\$2,617.75	\$392.66
Franklin	4,868	\$11,182,850	\$2,297.22	\$344.58
Fulton	843	\$2,284,646	\$2,710.14	\$406.52
Gallatin	747	\$1,845,124	\$2,470.05	\$370.51
Garrard	1,451	\$3,598,912	\$2,480.30	\$372.04



A STATE EARNED INCOME TAX CREDIT

Appendix: EITC Returns by County, Tax Year 2014 (CONTINUED)

County	EITC Claims	County EITC Amount	Average Fed. Return	Estimated State Return (15%)
Grant	2,647	\$6,444,801	\$2,434.76	\$365.21
Graves	3,791	\$9,496,384	\$2,504.98	\$375.75
Grayson	2,914	\$7,375,373	\$2,531.01	\$379.65
Green	987	\$2,390,375	\$2,421.86	\$363.28
Greenup	3,128	\$7,382,872	\$2,360.25	\$354.04
Hancock	713	\$1,665,428	\$2,335.80	\$350.37
Hardin	10,742	\$25,513,973	\$2,375.16	\$356.27
Harlan	3,197	\$8,396,272	\$2,626.30	\$393.94
Harrison	1,656	\$3,773,199	\$2,278.50	\$341.78
Hart	1,748	\$4,251,401	\$2,432.15	\$364.82
Henderson	4,284	\$9,979,764	\$2,329.54	\$349.43
Henry	1,380	\$3,219,021	\$2,332.62	\$349.89
Hickman	328	\$821,068	\$2,503.26	\$375.49
Hopkins	4,199	\$9,903,141	\$2,358.45	\$353.77
Jackson	1,382	\$3,511,787	\$2,541.09	\$381.16
Jefferson	73,726	\$171,293,796	\$2,323.38	\$348.51
Jessamine	4,528	\$11,108,320	\$2,453.25	\$367.99
Johnson	2,219	\$5,557,891	\$2,504.68	\$375.70
Kenton	12,916	\$29,830,539	\$2,309.58	\$346.44
Knott	1,273	\$3,379,747	\$2,654.95	\$398.24
Knox	3,985	\$11,069,576	\$2,777.81	\$416.67
Larue	1,490	\$3,720,299	\$2,496.84	\$374.53
Laurel	6,121	\$15,433,821	\$2,521.45	\$378.22
Lawrence	1,497	\$3,836,230	\$2,562.61	\$384.39
Lee	700	\$1,778,501	\$2,540.72	\$381.11
Leslie	1,094	\$2,803,338	\$2,562.47	\$384.37
Letcher	2,454	\$6,407,367	\$2,610.99	\$391.65
Lewis	1,322	\$3,386,976	\$2,562.01	\$384.30
Lincoln	2,398	\$5,750,917	\$2,398.21	\$359.73
Livingston	778	\$1,796,700	\$2,309.38	\$346.41
Logan	2,639	\$6,285,780	\$2,381.88	\$357.28
Lyon	500	\$1,095,560	\$2,191.12	\$328.67
McCracken	5,969	\$14,172,069	\$2,374.28	\$356.14
McCreary	1,935	\$5,390,238	\$2,785.65	\$417.85
McLean	859	\$2,022,141	\$2,354.06	\$353.11
Madison	7,061	\$16,089,486	\$2,278.64	\$341.80
Magoffin	1,268	\$3,309,932	\$2,610.36	\$391.55
Marion	1,764	\$4,309,345	\$2,442.94	\$366.44
Marshall	2,422	\$5,542,134	\$2,288.25	\$343.24
Martin	1,004	\$2,770,708	\$2,759.67	\$413.95

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Appendix: EITC Returns by County, Tax Year 2014 (CONTINUED)

County	EITC Claims	County EITC Amount	Average Fed. Return	Estimated State Return (15%)
Mason	1,729	\$4,196,877	\$2,427.34	\$364.10
Meade	2,090	\$5,007,959	\$2,396.15	\$359.42
Menifee	727	\$1,770,907	\$2,435.91	\$365.39
Mercer	1,965	\$4,383,455	\$2,230.77	\$334.61
Metcalfe	1,233	\$3,148,333	\$2,553.39	\$383.01
Monroe	1,215	\$3,125,623	\$2,572.53	\$385.88
Montgomery	2,797	\$7,012,945	\$2,507.31	\$376.10
Morgan	1,155	\$2,968,965	\$2,570.53	\$385.58
Muhlenberg	2,730	\$6,498,235	\$2,380.31	\$357.05
Nelson	4,306	\$9,963,284	\$2,313.81	\$347.07
Nicholas	707	\$1,741,302	\$2,462.94	\$369.44
Ohio	2,075	\$5,042,786	\$2,430.26	\$364.54
Oldham	2,603	\$5,666,501	\$2,176.91	\$326.54
Owen	706	\$1,809,395	\$2,562.88	\$384.43
Owsley	551	\$1,504,643	\$2,730.75	\$409.61
Pendleton	1,212	\$2,758,073	\$2,275.64	\$341.35
Perry	3,310	\$8,079,081	\$2,440.81	\$366.12
Pike	5,203	\$12,256,919	\$2,355.74	\$353.36
Powell	1,605	\$4,117,249	\$2,565.26	\$384.79
Pulaski	6,869	\$16,703,967	\$2,431.79	\$364.77
Robertson	169	\$415,033	\$2,455.82	\$368.37
Rockcastle	1,570	\$3,674,591	\$2,340.50	\$351.08
Rowan	2,122	\$5,018,180	\$2,364.84	\$354.73
Russell	1,888	\$4,647,895	\$2,461.81	\$369.27
Scott	3,763	\$8,804,009	\$2,339.63	\$350.94
Shelby	3,023	\$7,034,681	\$2,327.05	\$349.06
Simpson	1,896	\$4,496,351	\$2,371.49	\$355.72
Spencer	1,055	\$2,282,445	\$2,163.45	\$324.52
Taylor	2,684	\$6,601,728	\$2,459.66	\$368.95
Todd	1,058	\$2,598,583	\$2,456.13	\$368.42
Trigg	1,279	\$2,888,905	\$2,258.72	\$338.81
Trimble	714	\$1,765,899	\$2,473.25	\$370.99
Union	1,168	\$2,655,416	\$2,273.47	\$341.02
Warren	11,817	\$27,608,363	\$2,336.33	\$350.45
Washington	1,024	\$2,472,510	\$2,414.56	\$362.18
Wayne	2,279	\$5,765,252	\$2,529.73	\$379.46
Webster	1,110	\$2,555,560	\$2,302.31	\$345.35
Whitley	4,727	\$12,606,872	\$2,666.99	\$400.05
Wolfe	890	\$2,309,393	\$2,594.82	\$389.22
Woodford	1,847	\$4,256,773	\$2,304.70	\$345.70



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Endnotes

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