



Why Pennsylvania Needs a State Earned Income Tax Credit (EITC)

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August 26, 2020

Introduction¹

If one thing has become clear during the COVID-19 pandemic, it is that workers who do essential things like providing care for the sick, stocking shelves at grocery stores, and cleaning facilities to keep our buildings clean and safe are undervalued in our society. Despite their hard work, many Pennsylvanians earn such low wages that it remains difficult to pay for rent, food, childcare, transportation, and other necessities. We must raise wages and strengthen worker protections for low- and middle-income workers. In addition, there is another easy step Pennsylvania can take to support low-wage workers. That is a state Earned Income Tax Credit (EITC), which has been effective at reducing poverty in more than half the states across the country.

The federal Earned Income Tax Credit (EITC) is a program that puts more money into the pockets of low- and middle-income families by giving them a credit against the taxes they pay. No federal program other than Social Security, reduces poverty as much. Twenty-nine other states have expanded the benefits of a federal EITC by enacting a state EITC.

Pennsylvania should follow their lead. A state EITC is a relatively inexpensive program that is easy for states to implement, especially if it is modelled on the federal EITC. The benefits of increasing the annual income for low-income families and reducing poverty is indisputable. It improves maternal and infant health, enhances school performance for children, and leads to both higher high school graduation and college attendance rates. The EITC has even been shown to boost future earnings and work prospects for children whose families receive it.

Passing a state EITC plan would also have a stimulus effect during this COVID-related economic downturn. State EITC money would help low- and middle-income workers in the state and would go directly back into the economy.

In this report, we examine the problem of poverty and low wages in Pennsylvania and how a state EITC can improve the well-being of working families. We look at how the federal EITC functions and what its benefits are. We then make recommendations and examine the potential impact of a Pennsylvania state EITC, including how it would interact with Pennsylvania's existing Tax Forgiveness Program.

¹ We thank Shane Dermanjian, Hibah Khan, Saaliha Khan, Vanessa Kolb and Jimmy McHugh, students in the H. John Heinz III College at Carnegie Mellon University. They did incredible research culminating in the paper "Policy Proposal for Adoption of a State Earned Income Tax Credit by the Commonwealth of Pennsylvania" in the spring of 2019, setting the stage for this paper. We pull from their research in this report.

Poverty in Pennsylvania

Poverty remains a very serious problem in Pennsylvania and it has been exacerbated by the current pandemic. Even when evaluated by the extremely low standard of the federal poverty line, 12.2% of Pennsylvanians—1,548,720 people—lived in poverty in our state in 2018.² At the slightly higher, but still low, standard of twice (200%) the federal poverty line, 19% of working families with children under age 18 were low-income, defined as earning at or below 200% of the federal poverty line which varies by family structure in 2018. For example, 200% of the poverty line was \$50,930 a year for a family of two adults and two children.³

As figure 1 shows, 36% of Pennsylvania children lived below 200% of the poverty level in 2018.⁴ And this varied by race, with children of color much more likely to be in families earning less than 200% of the poverty level. Sixty-four percent of Black or African-American children in Pennsylvania were in families living below 200% of the federal poverty level as were 60% of Latino children. This is more than two times higher the rate of non-Hispanic white children (26%). In total, nearly one million children in Pennsylvania lived below 200% of the poverty line in 2018.

² Center for American Progress. Talk poverty website. Accessed data on Pennsylvania at: <https://talkpoverty.org/state-year-report/pennsylvania-2018-report/>.

³ The Annie E. Casey Foundation Kids Count Data Center. Data accessed from: <https://datacenter.kidscount.org/data/tables/10381-low-income-working-families-with-children?loc=40&loct=2#detailed/2/40/false/37,871,870,573,869,36,868,867,133,38/any/20052,20053>

⁴ The Annie E. Casey Foundation Kids Count Data Center. Data accessed from: <https://datacenter.kidscount.org/data/tables/5144-poverty-level--population-age-0-17?loc=40&loct=2#detailed/2/any/false/37,871,870,573,869,1218,1049,995,932,757/1231,22,666,1232,1233,1234,1235,1236,1237/11593,11594>

Figure 1

Children below 100% and 200% of poverty by race in Pennsylvania, 2018				
Race	Percent below 100% of poverty	Number below 100% of poverty	Percent below 200% of poverty	Number below 200% of poverty
Black or African American	35%	122,000	64%	222,000
Hispanic or Latino	34%	110,000	60%	195,000
Two or more races	23%	36,000	45%	71,000
Asian and Pacific Islander	13%	13,000	36%	35,000
Non-Hispanic White	10%	173,000	26%	452,000
American Indian	*	*	*	*
Total Children in PA below poverty	17%	435,000	36%	942,000
*American Indian data not released because the confidence interval around the percentage is greater than or equal to 10 percentage points.				
Source: Data from Kids Count using ACS data. Found at: https://datacenter.kidscount.org/data#PA/2/0/char/0				

An even more accurate standard by which to examine the impact of poverty in our state is the ALICE threshold—Asset Limited, Income Constrained, Employed. The ALICE standard captures individuals who earn more than the Federal Poverty Level and make too much to qualify for government assistance yet struggle to pay for life’s basic necessities. Considering this ALICE threshold and those living below the official poverty level, 37% of Pennsylvania households face significant financial hardships.⁵

Low-wage jobs, an inadequate social safety net, and unemployment all contribute to poverty in our state. Many workers in Pennsylvania are stuck in low-wage jobs because the Commonwealth has not raised the minimum wage in over ten years—it is still stuck at the federal minimum of \$7.25 per hour. In fact, Pennsylvania is surrounded by states that have higher minimum wages. Pennsylvania’s impoverished families are also held back by limitations on, and underfunding of, our safety net programs, including SNAP and childcare benefits. That so many Pennsylvania families struggle to make ends meet amidst great wealth is a failing and moral stain on our Commonwealth and a detriment to all of us.

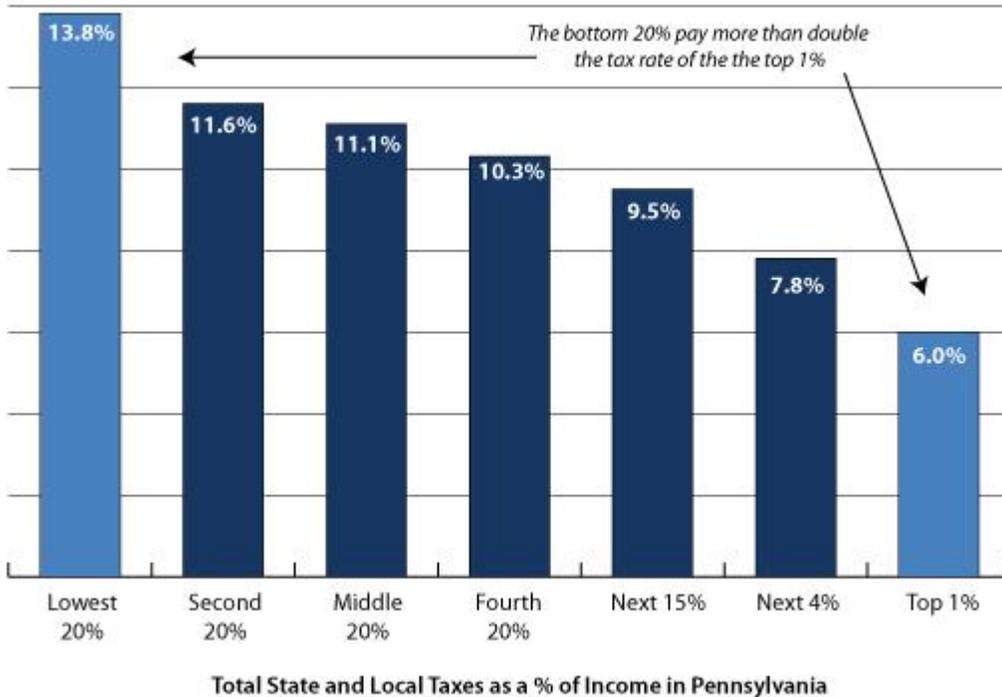
Pennsylvania’s low-income families also are held back by our upside-down state and local tax system. The uniformity clause of our constitution necessitates a flat state income tax. As a result, low-income families end up paying state and local taxes at more than double the rate of families in the top 1% (figure 2).

Concerns about the impact of high taxes on low-income families was an impetus to creating the federal Earned Income Tax Credit. As we show later, a state EITC can help to lessen the tax burden on an overstretched low-income population.

⁵ For more information about the ALICE threshold, see <https://www.uwp.org/alice/about-alice/>

Figure 2

In Pennsylvania, Higher Income Taxpayers Pay A Lower Share of Their Income in State and Local Taxes



Source: Institute on Taxation and Economic Policy, Who Pays? <http://www.itep.org/whopays/>

Background on EITC

The Earned Income Tax Credit (EITC) is an effective and efficient program that, by cutting the tax burden on low-income families and thus putting more money in their pockets, supplements the minimum wage and social safety net programs in reducing poverty.

The federal EITC program was originally suggested by President Nixon and was enacted in 1975 under President Ford. It was later expanded under Presidents Reagan and Clinton.

The EITC was originally put forward by Republicans who, concerned that traditional welfare programs discouraged work, were looking for an alternative that would relieve poverty and encourage work. While Democrats have often disputed the idea that safety net programs like traditional welfare discourage work, they welcomed a new way of reducing poverty. And members of both parties understood that the taxes paid by low-income families drove them further into poverty. Thus, they embraced a credit that reduced the tax burden of families headed by workers.

The EITC today remains a popular bipartisan approach to reducing poverty even though problems with the policy still exist and there are proposals before Congress to expand the program.⁶

State Earned Income Tax Credits

While efforts to expand the federal EITC go forward, we in Pennsylvania could, and should, follow the examples of the 29 states (plus the District of Columbia and Puerto Rico) that have state EITC programs (figure 3). Most states “piggyback” their EITC program on the federal program by giving a state match to the federal tax credit at a rate that ranges from 5% (in Louisiana, Maine, and Oklahoma) to 40% (in D.C. and New Jersey). This piggyback model is the simplest way to structure a state EITC because it is easy for tax filers and for state tax administrators who just have to add a single question to state tax forms.⁷

State EITCs complement other poverty reduction measures, including higher minimum wages; job-creation efforts; and expansions of other safety net programs, including subsidies for child care and food. State EITCs complement those programs, especially by offsetting the taxes that increase when low-income workers secure higher wages or work for more hours. Enacting a state EITC is not a replacement for increasing the minimum wage, but it can be helpful for working families. And it is especially helpful given the vagaries of employment and wages in low-income communities. The majority of people who benefit from the EITC don’t benefit from it year after year, but do so when times are difficult for them and their wages or hours are reduced. Between 1989 and 2006, 61% of EITC recipients received the benefit for only one or two years.⁸

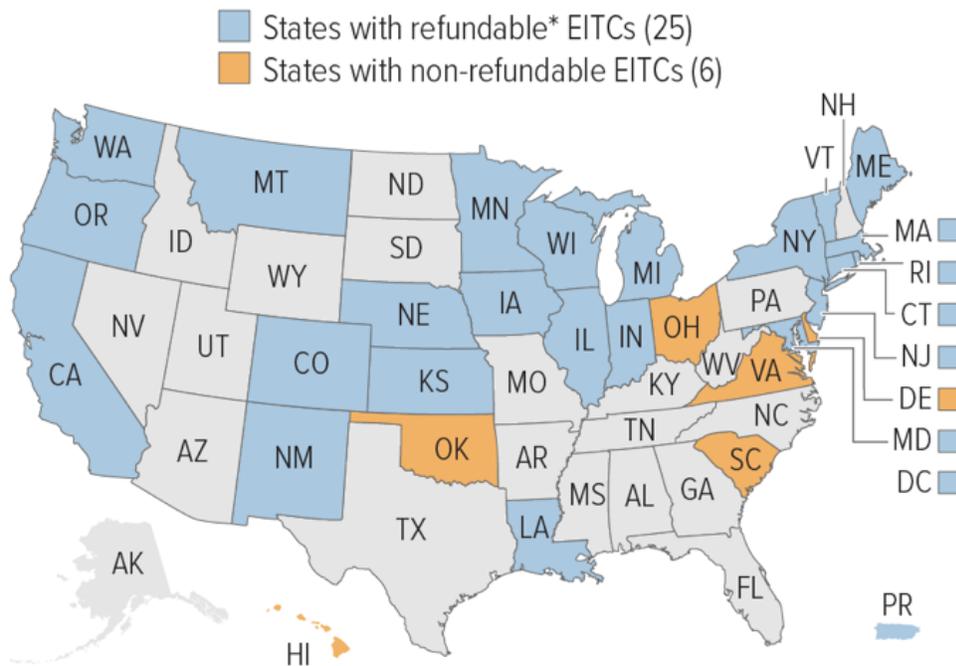
⁶ The benefits for families without children are very small. And the program does not help poor families in which no one is able to work. Legislation in Congress sponsored by Representatives Rashida Tlaib, Alexandria Ocasio-Cortez, and Ayanna Pressley would extend the federal EITC to everyone and raise benefits.

⁷ An additional benefit of aligning the state EITC with the federal benefit is that if a more progressive federal EITC is passed that expands the federal EITC and provides the benefit to non-workers, the benefits would be extended to Pennsylvanians through the Pennsylvania state EITC.

⁸ Deena Ackerman, Janet Holtzblatt, and Karen Masken, “The Pattern of EITC Claims Over Time: A Panel Data Analysis,” Internal Revenue Service, 2009, <http://www.irs.gov/pub/irs-soi/09resconpatterneitc.pdf>; and https://www.cbpp.org/research/federal-tax/eitc-and-child-tax-credit-promote-work-reduce-poverty-and-support-childrens#_ftn57.

Figure 3

Twenty-Nine States, D.C., and Puerto Rico Have Enacted EITCs as of 2018



*Refundable EITCs give working households the full value of the credit they earn even if it exceeds their income tax liability.

Source: CBPP analysis

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How the Federal EITC Works

The federal EITC Program is a refundable tax credit that relieves poverty for low- and moderate-income workers by offsetting the burden of federal taxes and increasing take-home pay. Working families with children who have yearly incomes below a range of \$41,100 to \$56,000 are potentially eligible for the federal EITC. Low-wage single persons or married couples without kids can receive an EITC as well, although the benefits are significantly lower than for those with children.⁹ The EITC is refundable so that even if households pay no federal income tax, they receive a tax credit. This is important because low- and middle-income workers often pay more in payroll taxes than they do in income taxes. And because payroll taxes are a straight percentage of income below a cap, they are regressive in nature. By making

⁹ Center on Budget and Policy Priorities. "Policy Basics: The Earned Income Tax Credit." December 10, 2019.

Accessed at: <https://www.cbpp.org/sites/default/files/atoms/files/policybasics-eitc.pdf>.

the EITC refundable, Congress ensured that it could be used to help offset all federal taxes paid, not just the income tax.¹⁰

Under the federal EITC guidelines, eligibility is limited to working families who qualify based on tax filer status, number of qualifying children claimed, income limits, investment income limit, and the maximum credit amount, among other things.

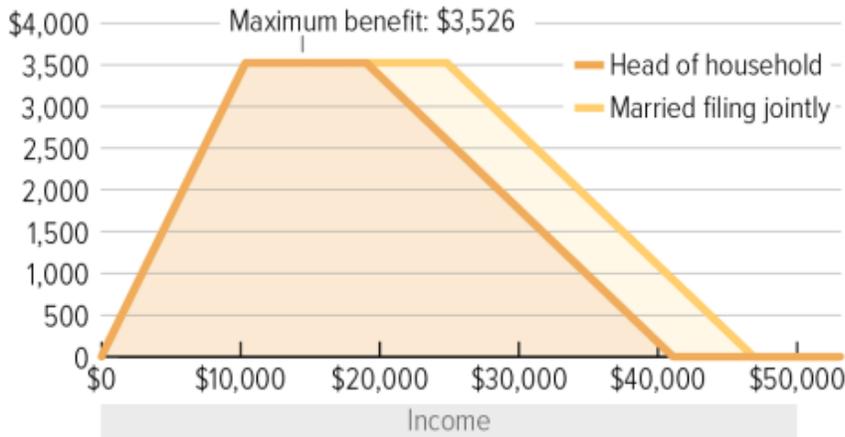
In tax year 2018, the average EITC was \$3,191 for a family with children and \$298 for a two-person family without children. Figure 4 shows an example of the three phases of the EITC for a single mom with one child who earned the minimum wage in 2019. In the first phase, the credit gradually ramps up from the first dollar of earned income to the income level where the maximum credit can be earned. In this example, this single mother earned 34 cents in EITC benefits for each dollar earned—families with three or more children earn 45 cents for each dollar earned. The second phase, known as the “peak income range” or “flat range” includes the income range in which the credit earned is maintained at its peak amount. Her EITC maxes out at \$3,526 once she earns \$10,370 a year. She receives that max benefit until her earnings are higher than \$19,030. At that point she enters phase 3, the “phase-out period,” at which point her credit decreases steadily until it is completely phased out at about \$41,000 in earnings. The gradual phase-out of the EITC ensures the program has no benefit cliff—at no point does additional income earned lead to a reduction of the EITC benefits that is greater than the additional income earned.¹¹

¹⁰ Tax Provisions for Poverty Relief: An Analysis of the Federal and State Earned Income Tax Credit and the Pennsylvania Special Tax Forgiveness Program. (2009, August). Accessed at: <http://jsg.legis.state.pa.us/publications.cfm>.

¹¹ Erica Williams and Samantha Waxman. “States Can Adopt or Expand Earned Income Tax Credits to Build a Stronger Future Economy.” Center on Budget and Policy Priorities. Updated on March 7, 2019. Accessed at: <https://www.cbpp.org/research/state-budget-and-tax/states-can-adopt-or-expand-earned-income-tax-credits-to-build-a>

Figure 4

Earned Income Tax Credit for Households with One Child, 2019



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

Source: Internal Revenue Service

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Benefits of the EITC

There is strong evidence that the EITC program is among the most cost-effective anti-poverty policies for working families in the nation.¹² The policy was designed, in part, to reward work as its structure gives people an incentive to join the labor force and increase their work hours. The U.S. Department of Treasury has confirmed that the EITC program **keeps families working**, particularly less-educated women and families with children. Other research shows that unmarried working mothers, in particular, work more hours as a result of EITC and are more able to provide the necessities needed to continue working, like transportation and child care.¹³ In the long run, increasing work effort can lead to opportunities for better jobs and higher pay. The largest EITC credit recipients are working families that are most in need, those well below 75%-150% of the federal poverty level. Its anti-poverty effects are magnified by up to 50% due to increases in employment.¹⁴

Most important is EITC's **poverty reducing effect**. EITCs that are refundable give working families the full value of the credit even if it exceeds their income tax liability, providing families money to help make ends meet. In 2018, the EITC lifted 5.6 million people out of poverty, including around 3 million children.

¹² Hilary Hoynes, Jesse Rothstein, and Krista Ruffini, "Making Work Pay Better Through an Expanded Earned Income Tax Credit," *The Hamilton Project*, October 2017.

¹³ Williams and Waxman, 2019. Accessed at: <https://www.cbpp.org/sites/default/files/atoms/files/1-30-14sfp.pdf>

¹⁴ Ibid.

The program reduced poverty for another 16.5 million people, including 6.1 million children.¹⁵ In tandem with the refundable component of the Child Tax Credit, the EITC lifts more children out of poverty than any other federal program. Only Social Security has a larger anti-poverty effect for the entire U.S. population.¹⁶ State EITC programs can be especially helpful to women and people of color, who are overrepresented in the low-wage labor market. State EITCs serve a larger number of white households but a larger share of households headed by people of color. The EITC has been found to lift a larger share of non-white and Hispanic people out of poverty.¹⁷

The poverty-reducing effect has **long-term affects** beyond just putting more money into the pockets of low-wage families. The EITC has been shown to improve infant and maternal health. This includes improvement in health indicators of mothers and reduced rates of babies born with low-birth weight.¹⁸ In fact, studies that examined the expansion of the EITC in 1986, 1990, and 1993 showed that a \$1,000 increase in the EITC reduces low-birth rates by 5.6% overall and 7.2% among African Americans.¹⁹ The EITC is associated with better school performance among children in elementary and middle school, greater high school graduation and college enrollment, and an increase in work and earnings with the next generation.²⁰ This is due to the proven benefits of reducing poverty. Researchers project that each dollar of income through tax credits may increase the value of a child's earning in the future by more than a dollar.²¹ By improving the earnings and employment of working-age women, the EITC also increases individuals' Social Security benefits, which also has a poverty-reducing benefit for the elderly.

¹⁵ Center on Budget and Policy Priorities. "Policy Basics: The Earned Income Tax Credit." Accessed at: <https://www.cbpp.org/sites/default/files/atoms/files/policybasics-eitc.pdf>

¹⁶ Ibid.

¹⁷ Center on Budget and Policy Priorities. "State Earned Income Tax Credits Help Build Opportunity for People of Color and Women." Accessed at: <https://www.cbpp.org/sites/default/files/atoms/files/7-24-18sfp.pdf>

¹⁸ Chuck Marr, Chye-Ching Huang, Arloc Sherman and Brandon Debot. "EITC and Child Tax Credit Promote Work, Reduce Poverty, and Support Children's Development, Research Finds." Center on Budget and Policy Priorities. Updated October 1, 2015. Accessed at: <https://www.cbpp.org/research/federal-tax/eitc-and-child-tax-credit-promote-work-reduce-poverty-and-support-childrens>; and William N. Evans and Craig L. Garthwaite, "Giving Mom a Break: The Impact of Higher EITC Payments on Maternal Health," *American Economic Journal: Economic Policy* (6)2, 2014, pp. 258-290.

¹⁹ Hilary W. Hoynes, Douglas L. Miller and David Simon. "The EITC: Linking Income to Real Health Outcomes." U.C. Davis Center for Poverty Research, Policy Brief. Vol. 1, No. 2. Accessed at: www.poverty.ucdavis.edu/sites/main/files/file-attachments/policy_brief_hoyes_eitc_1.pdf

²⁰ Marr et al. 2015. Accessed at: <https://www.cbpp.org/research/federal-tax/eitc-and-child-tax-credit-promote-work-reduce-poverty-and-support-childrens>

²¹ Raj Chetty, John N. Friedman, and Jonah Rockoff, "New Evidence on the Long-Term Impacts of Tax Credits," Statistics of Income Paper Series, November 2011. Accessed at: <http://www.irs.gov/pub/irs-soi/11rpcchetyfriedmanrockoff.pdf>.

Because it is part of the federal tax system, the EITC is inexpensive to administer and relatively easy for families to claim—though as we pointed out above, some families who need to file federal tax forms are not aware of the benefit. State EITC programs are also relatively **inexpensive, and they are easy for a state to administer and recipients to claim**. Especially when structured as a percentage of the federal EITC, there are no expenses for states to identify eligibility and only one question is added to state tax forms. It is also easy for tax filers to claim because the EITC is set at a percentage of the federal credit. Low-income families make up a large share of taxpayers, but their income represents a smaller share of tax revenue. Providing tax cuts that amount to several hundred dollars is not very costly for the state yet provides working families much needed support.

State EITCs complement the federal EITC by addressing one of the difficulties of the program—about 20% of the families who are eligible for the federal EITC do not claim it because doing so requires them to complete an IRS form even though they owe no federal income taxes. We estimate that more than 253,000 filers in Pennsylvania are currently not receiving the federal EITC credit. The failure to claim all the benefits earned by Pennsylvanians costs the state, and these families, an estimated \$201 million in federal benefits.²² **A state EITC would create an additional incentive for Pennsylvanians to file for the federal EITC**, particularly if county assistance offices encourage people to do so. There is evidence that shows a state-EITC can lead to increased participation in the federal EITC program, particularly among single adults with children.²³

How Pennsylvania Should Structure a State EITC

State-level EITCs parallel to the federal EITC reinforce these benefits at a reasonable cost. State EITCs help families struggling on low wages to make ends meet and provide basic necessities for their children. State EITCs build on the benefits of the federal EITC and are easy to administer with nearly every dollar going directly to the working families that the credits were created to help.²⁴

The simplest way to create a state EITC is the piggyback model which builds the state EITC on the federal program. Implementing the program would only require one additional question on the state personal income tax form. State residents would simply receive a percentage of what they receive from the federal EITC. This model ensures ease of filing for earners and ease of administering the program for the state. And it strengthens the incentive of taxpayers to file for a federal EITC.

²² Data from the Center on Budget and Policy Priorities analysis of IRS data. Tax Year 2017.

²³ David Neumark and Katherine E. Williams. “Do State Earned Income Tax Credits Increase Participation in the Federal EITC?” Economic Self-Sufficiency Policy Research Institute (ESSPRI) Working Paper Series, Paper #20163, University of California, Irvine. 11-29-2016. Accessed at: <https://www.esspri.uci.edu/files/docs/2016/ESSPRI%20Working%20Paper%2020163%20Neumark%20and%20Williams.pdf>

²⁴ Aidan Davis, “Rewarding Work Through State Earned Income Tax Credits in 2017,” *Institute on Taxation and Economic Policy*, September 11, 2017. Accessed at: http://itep.org/wp-content/uploads/ITEP-EITC-Brief-2017_FINAL.pdf.

State EITCs can be refundable or non-refundable. A refundable tax credit is one that allows tax filers to receive the full credit, even if it exceeds their income tax bill. A non-refundable credit limits the benefit of a reduction in the tax bill to zero. Refundable credits help offset all taxes paid by low-income families, including sales and property taxes as well as income taxes.²⁵ A refundable EITC makes the most sense in Pennsylvania given our upside-down tax system.

One problem with a basic piggyback model (without other modifications) is that Pennsylvania would accept the limitations of the federal EITC. For example, the federal EITC currently requires individuals to have a social security number, which essentially leaves out undocumented workers, despite their important contribution to our economy, tax system and communities. Expanding the federal EITC to include ITIN filers would result in between approximately \$31 million and \$38 million of federal dollars going into the hands of immigrant workers in Pennsylvania, which could significantly improve many workers lives. Expansions at the federal level would be reflected in the state EITC if done as a basic piggyback model.²⁶ Part of our federal advocacy includes strengthening the federal EITC so that people are not left out.²⁷

If there is no movement on this at the federal level, states can and should include these workers in state EITCs. California and Colorado just expanded their state EITCs to include ITIN filers.²⁸ Considering these taxpayers have been left out of federal COVID-19 relief programs, these state actions will help to provide more support to this population, who have disproportionately been impacted by the current health emergency.

²⁵ Misha Hill. "What to Watch in the States: State Earned Income Tax Credits (EITC) on the Move." ITEP, March 24, 2017. Accessed at: <https://itep.org/what-to-watch-in-the-states-state-earned-income-tax-credits-eitc-on-the-move/>

²⁶ Community Change. "End the tax penalty against immigrant workers: Give 2.4 million families a cost-of-living boost." April 2020. Accessed at: https://communitychange.org/wp-content/uploads/2020/04/ITIN_EITC_Fact_Sheet_Tables_April_2020-002.pdf

²⁷ There is a provision in the Heroes Act that would increase the EITC benefit to childless workers. See: <https://www.forbes.com/sites/elainemaag/2020/06/03/heroes-act-would-expand-the-eitc-for-childless-workers-and-help-fight-recession/#43b000fc6810>. For more on the EITC Modernization Act of 2018 which would expand EITC to include caregivers and students, see <https://watsoncoleman.house.gov/newsroom/documentsingle.aspx?DocumentID=485>.

²⁸ Michael J. Bologna, Laura Mahoney and Tripp Baltz. "States Eye Anti-Poverty Tax Credit to Ease Covid Impact." July 29, 2020. Accessed at: https://news.bloombergtax.com/daily-tax-report-state/states-eye-anti-poverty-tax-credit-to-ease-covid-impact?utm_source=National%20Conference%20of%20State%20Legislatures&utm_campaign=59852e86e4-29_JULY_2020_NCSL_TODAY&utm_medium=email&utm_term=0_1716623089-59852e86e4-377904996&fbclid=IwAR1kMuqYSJru6phiBlxShwoAn99cagOS8dDasRD9b_7jVLmYqjzCO1-uK18; and Kim Bojorquez. "It's a game changer: California budget includes tax breaks for undocumented families." Sacramento Bee, June 27, 2020. Accessed at: <https://www.sacbee.com/news/politics-government/capitol-alert/article243742367.html>

There are other limitations to the federal EITC. Individuals married or single who do not have kids can benefit from the federal EITC but the benefits are very low. Also, individuals under age 25 without children are not eligible for the federal EITC. Some states have included these young workers in their state EITCs including Maine, Maryland and Minnesota. Pennsylvania legislators should consider ways to expand the state EITC to benefit individuals left out of the federal EITC.²⁹

A State EITC Program Builds on Pennsylvania's Existing Tax Forgiveness Program

Pennsylvania has an existing tax forgiveness program that allows eligible taxpayers to reduce all or part of their personal income tax liability. This program was established in 1974 to establish special tax provisions because of poverty. Eligibility for the program is determined using one's total taxable income received in the form of cash or property and the make-up of one's family (single or married, number of children). There are currently more than 1.1 million returns for the existing tax forgiveness program at a cost to the state of about \$259 million.³⁰

Pennsylvania's tax forgiveness program is important because it reduces the tax burden for families earning very little. But in order to qualify, one's income needs to be very low and it phases out very quickly. For example, a single parent with one child is eligible for 100% tax forgiveness if she earns less than \$16,000 per year (that is, if the parent worked full-time at \$7.69/hour). With each \$250 jump in yearly salary, tax forgiveness decreases by 10%. For example, once this single mom earns \$16,250, she gets 90% tax forgiveness. This program phases out incredibly fast - at \$18,250/year, she will receive only 10% tax forgiveness and is no longer eligible once earning above this.³¹

The federal (and state, if passed) EITC benefits a broader range of workers. For example, working families with children who have yearly incomes below a range of \$41,100 to \$56,000 are potentially eligible—and the phase out is much slower than Pennsylvania's tax forgiveness program. For example, a single mother with one child (same example as in previous paragraph) would no longer be eligible for any tax forgiveness once her salary is above \$18,250. But, for the EITC she would receive the maximum amount starting at about \$10,000 per year until she makes \$18,750 per year, at which point the benefit slowly phases out until she makes \$40,300/year.³² The other benefit of a state EITC, if structured as a refundable tax credit, is that families will receive a check if the benefit is above their tax liability, unlike the tax forgiveness program.

²⁹ See Table 1 in this paper for a list of which states have expanded their state EITCs beyond the federal: <https://www.cbpp.org/research/state-budget-and-tax/states-can-adopt-or-expand-earned-income-tax-credits-to-build-a>

³⁰ Data from the Pennsylvania Department of Revenue.

³¹ Income eligibility increases with more children. PA Department of Revenue webpage on Tax Forgiveness, accessed at: <https://www.revenue.pa.gov/FormsandPublications/PAPersonalIncomeTaxGuide/Pages/Tax-Forgiveness.aspx>

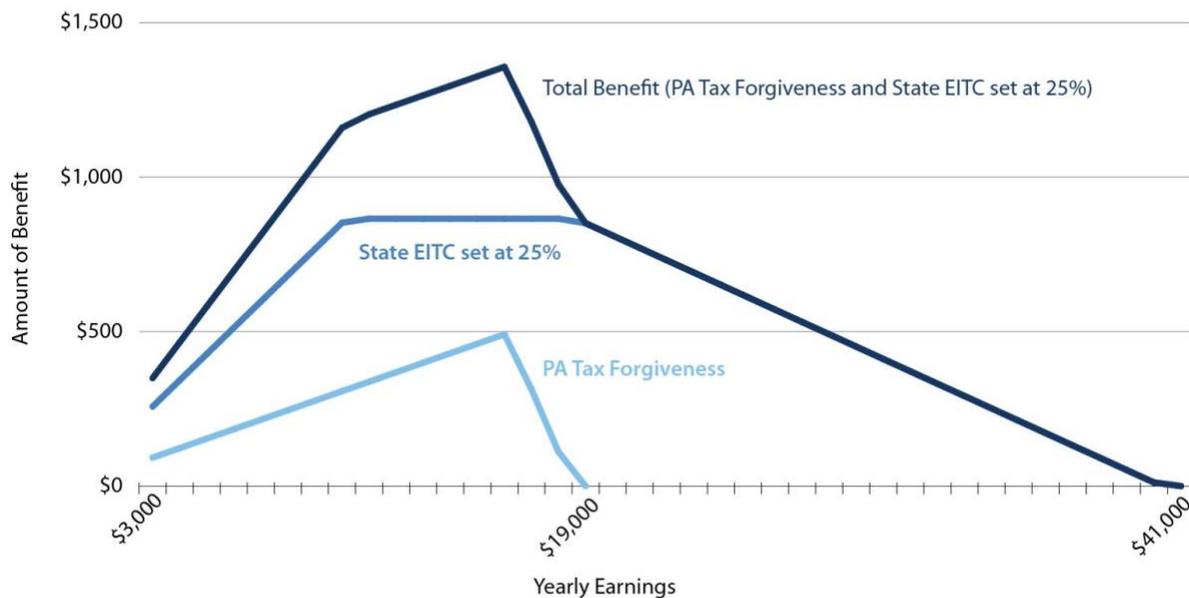
³² These numbers from the IRS are from the EITC in 2018, accessed at: <https://taxmap.irs.gov/taxmap2018/pubs/p596-025.htm#TXMP4e6ded1d>

One important policy question Pennsylvania must consider in devising a state earned income tax credit plan is how to treat the existing tax forgiveness program. The tax forgiveness program and the EITC have partly overlapping and partly different purposes. Both of them are designed to reduce the impact of our flat income tax on low-income Pennsylvanians. But the EITC has three broader purposes: to address the regressive nature of the entire state and local tax system; to create an incentive that also partly offsets the benefit cliffs of other safety net programs; and to relieve poverty directly. Those three additional goals explain why the EITC should be refundable while the tax forgiveness program is not.

Figure 5 below shows the benefit amount of the existing PA tax forgiveness program (lightest blue line), a proposed state EITC set at 25% of the federal EITC (blue line), and a combination of the two (dark blue line) for a single parent with one child. For the tax forgiveness program, this benefit amount comes in the form of decreased or no taxes. For a state refundable EITC, it comes as no or decreased taxes, a check or both. As you can see, the existing tax forgiveness program has a gradual increase, increasing with one’s tax burden, and then a quick phaseout, starting once the person earns \$16,000 per year and entirely phased out by \$19,000 per year. A state refundable EITC set at 25% of the federal EITC would allow a family to receive a benefit above their tax liability. A state EITC would have a very gradual phaseout. For a single parent with one child, the benefit would phase out completely once this person earns just over a \$40,000 in yearly income.

Figure 5

Benefits from the PA Tax Forgiveness Program, a State EITC Program and Both Programs Combined for a Single Mother with One Child



Source: Pennsylvania Budget and Policy Center analysis of data on the EITC from the IRS (2018) and data on PA Tax Forgiveness from: <https://www.revenue.pa.gov/FormsandPublications/PAPersonalIncomeTaxGuide/Pages/Tax-Forgiveness.aspx>

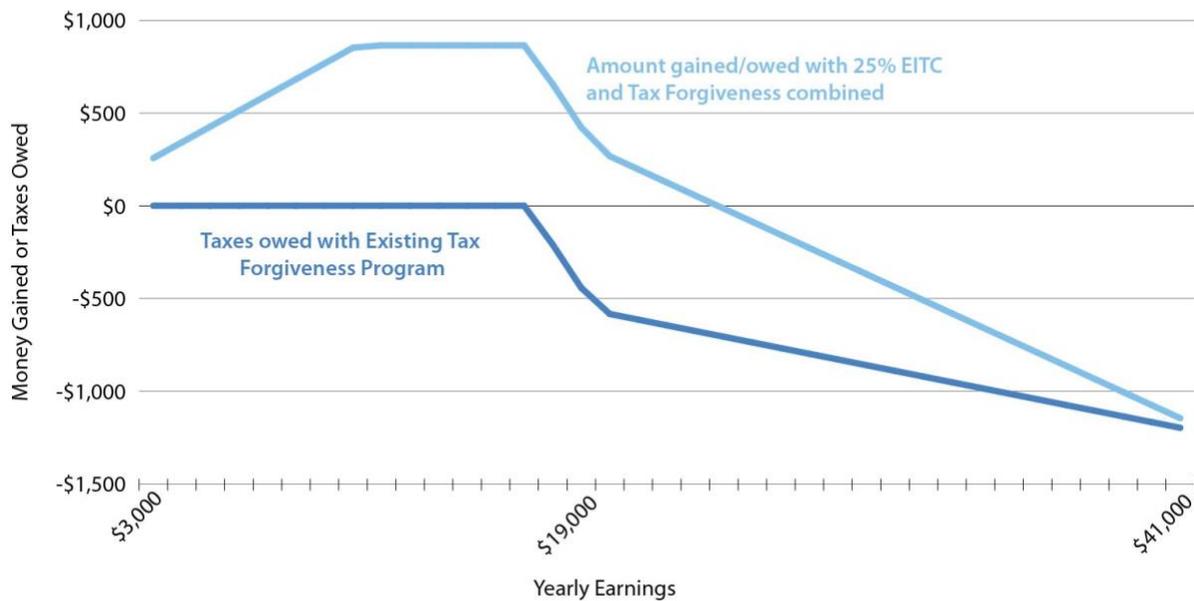
We propose enacting a state refundable EITC on top of the existing tax forgiveness program. One could also structure a state EITC program in a way where the tax payer can chose the best benefit \-tax

forgiveness or state EITC. However, structuring the state EITC as a credit on top of the existing tax forgiveness program will give working families the greatest benefit.

Figure 6 shows the money gained or taxes paid with a) the existing tax forgiveness program (dark blue) and b) the existing tax forgiveness program plus a state EITC set at 25% of the federal EITC (light blue) for a single parent with one child. You can see the additional benefit to low-income families of adding a state EITC on top of the tax forgiveness program—it will provide additional resources until that family earns over \$22,000 per year and it will lessen their state tax burden until they earn just over \$40,000 per year.

Figure 6

Money Gained or Taxes Paid with Tax Forgiveness and Tax Forgiveness+State EITC (set at 25% federal) for Single Parent with One Child



Source: Pennsylvania Budget and Policy Center analysis of data on the EITC from the IRS (2018) and data on PA Tax Forgiveness from: <https://www.revenue.pa.gov/FormsandPublications/PAPersonalIncomeTaxGuide/Pages/Tax-Forgiveness.aspx>

Impact and Cost of a State EITC Program

Enacting a state EITC program would benefit nearly 900,000 tax units (or households) in Pennsylvania. This is based on the current number of people who claim the federal EITC in Pennsylvania (see figure 7 below). Of those eligible for a state EITC, approximately 410,000 people would be newly eligible for state tax benefits—that is, they are currently not receiving state tax benefits from the existing tax forgiveness program. The Pennsylvania Department of Revenue estimates a state EITC would result in more than half a million households receiving a tax refund, which would bring much needed additional resources to these families. Below, we examine the impact and cost if Pennsylvania were to enact a state EITC at 20%, 25%, and 30% of the federal EITC.

Figure 7

Impact of a Pennsylvania State EITC Program*	Set at % of Federal EITC		
	20%	25%	30%
Number of Estimated Returns (based on number of federal EITC recipients)	892,540	892,750	892,750
Total tax benefit for people stacking EITC and Tax Forgiveness	\$576,627,901	\$675,955,645	\$775,169,863
Number of Estimated Returns for Newly Eligible Recipients under EITC	409,857	410,067	410,067
Fiscal Impact of the State EITC	-\$397,004,270	-\$496,332,014	-\$595,546,232
Number of Estimated Returns Receiving a Tax Refund	517,493	545,022	571,916
Total Refund Amount	\$274,116,767	\$352,249,591	\$433,981,983

* Only includes counts and benefit amounts for those currently receiving federal EITC (whereas in Figure 10 includes cost of including all eligible). Does not include filers who receive only Tax Forgiveness

Source: Data from the Pennsylvania Department of Revenue

Figures 8 and 9 are drawn from data provided by the Institute on Taxation and Economic Policy (ITEP) and gives an overview of the benefits of a Pennsylvania EITC by income quintile. (The complete ITEP data is in the appendix.)

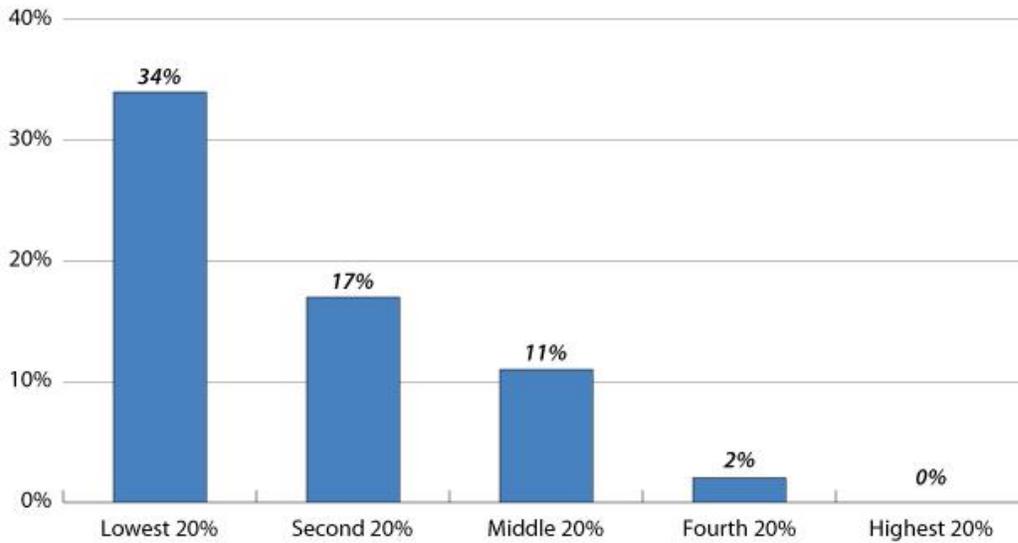
In households earning less than \$24,000 per year with an average income of \$14,000 (Pennsylvania’s bottom quintile of income earners), 34% would receive the credit (figure 8). The average credit for these families would be \$484 if the state tax credit is set at 20% of the federal EITC, \$605 if it is set at 25%, and \$726 if set at 30% (figure 9).

Seventeen percent of households in the second quintile—those earning between \$24,000 and \$45,000 per year with an average income of \$34,000—would receive a tax credit (figure 8). The average credit for these families would be \$517 if the state tax credit is set at 20% of the federal EITC, \$646 if it is set at 25%, and \$775 if set at 30% (figure 9).

A smaller number of families in the middle and fourth quintiles receive a tax credit under a Pennsylvania EITC. Eleven percent of households in the middle quintile—those earning between \$45,000 and \$70,000 per year with an average income of \$56,000—receive a tax credit (figure 8). As we would expect, only 2% families in the fourth quintile receive a tax credit under a Pennsylvania EITC.

Figure 8

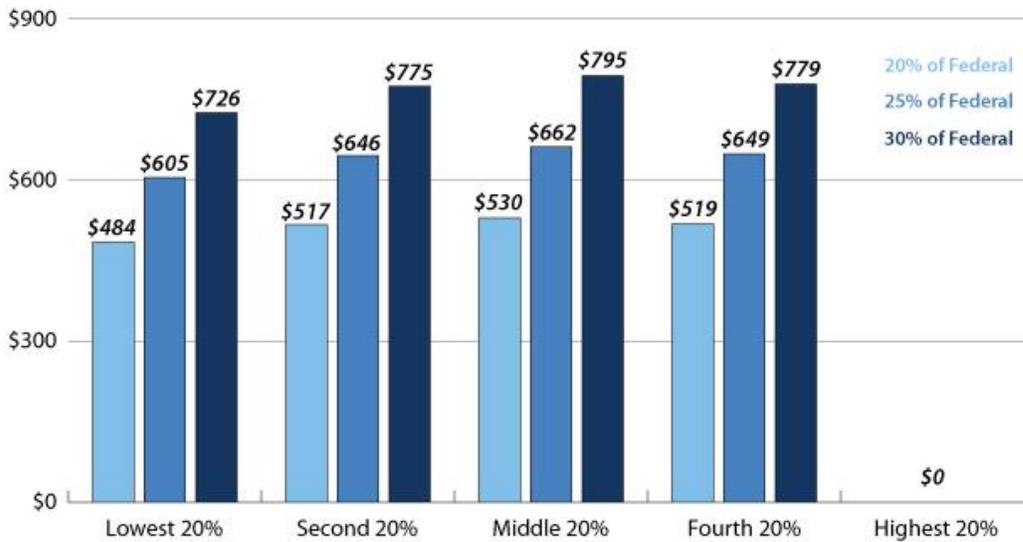
Percent Receiving Tax Credit by Income Level with a Pennsylvania State EITC



Source: Pennsylvania Budget and Policy Center using ITEP data.

Figure 9

Average Pennsylvania EITC Tax Credit by Income Quintile and Share of Federal Credit

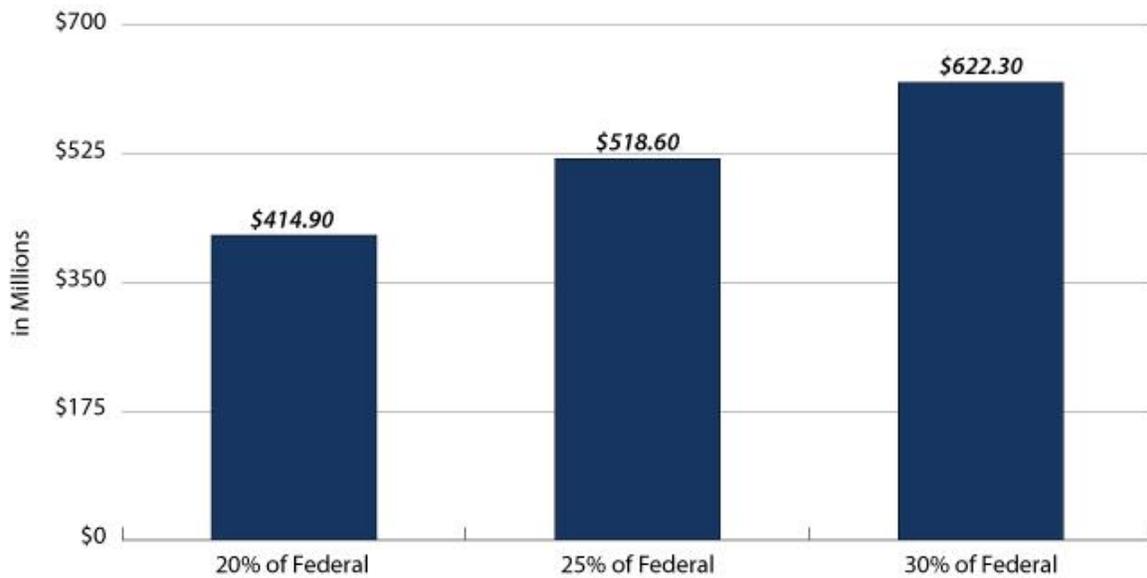


Source: Pennsylvania Budget and Policy Center using ITEP data.

The cost to Pennsylvania for such a program varies depending on the percentage of the federal EITC matched by the state EITC. Setting the matching percentage at 20% of the federal EITC would cost the state about \$414.9 million if all eligible households were to take advantage of the program. This is 1.15% of the governor’s proposed General Fund for 2020-21, and the average tax credit would be between \$484 and \$519 per year. A Pennsylvania match of 25% of the federal EITC would cost the state \$518.6 million, 1.43% of the 2020-21 proposed General Fund, and the average tax credit would be between \$726 and \$779 per year. A 30% Pennsylvania match of the federal EITC would cost the state \$622.3 million, 1.73% of the 2020-21 proposed General Fund, and the average tax credit would be between \$726 and \$779 per year.

Figure 10³³

Cost of a Pennsylvania State EITC Program, by Percentage of the Federal Program



Source: Pennsylvania Budget and Policy Center using ITEP data.

While the program is an investment for the state, it will have a stimulus effect and put much needed money into the hands of low- and middle- wage income earners that need it the most. It will also begin to improve Pennsylvania’s upside-down tax system. Earlier in the paper (figure 2), we showed that the bottom 20% of income earners in our state pay more than double their share of income on state and local taxes than the top 1% does (13.8% versus 6.0% respectively). Adopting a state EITC would lessen this burden on our state’s lowest income earners. As figure 11 shows, if Pennsylvania adopts a state EITC set at 30% of the federal EITC, the lowest 20% of income earners would see their tax burden decrease

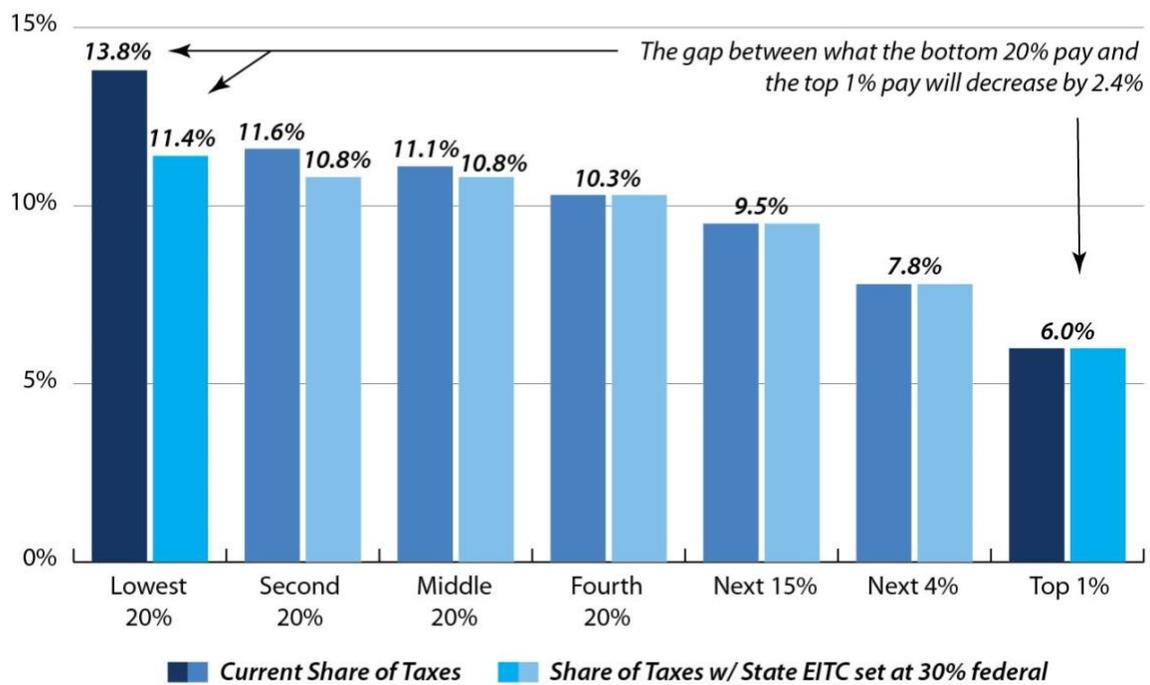
³³ Cost estimates by ITEP are based on IRS SOI data—the estimates are calculated assuming all eligible individuals in PA benefit.

from 13.8% of their income to 11.4%, a decrease of 2.4%. Those in the second 20% of income earners would also see a decrease from 11.6% to 10.8%. (See Appendix B for a more detailed chart on how a state EITC set at 20% or 25% would impact our upside-down tax system). When taken in combination with the enactment of other tax proposals that would increase taxes on the very rich (like the Fair Share Tax plan), Pennsylvania’s tax system would begin to look more fair.

Figure 11

A State EITC Set at 30% the Federal EITC, Would Improve Our Upside Down Tax System

Share tax payers in each income bracket pay in state and local taxes



Source: Pennsylvania Budget and Policy Center analysis of Institute on Taxes and Economic Policy (ITEP) data, June 2020.

A Pennsylvania EITC complements an increase in the minimum wage

The minimum wage and the EITC reach overlapping but different populations. Enacting an increased minimum wage and a state EITC would have a significant impact on low-wage workers and their families. The EITC’s main target is low-income families with children and it benefits families earning more than three and a half times the minimum wage. The minimum wage impacts the very lowest wage earners,

regardless of family income, family status, age, etc. Increasing both at the same time provides added support to a variety of working individuals and families.³⁴

Workers would receive the benefits of the two policies on different schedules. The minimum wage comes in every paycheck and can help with everyday expenses. The EITC would come once a year and can help with bigger purchases like a security deposit or a much-needed car repair. Additionally, increasing the state minimum wage and passing a state EITC allows both the public and the private sector to share in the cost of boosting workers income.³⁵

³⁴ Erica Williams and Samantha Waxman. "State Earned Income Tax Credits and Minimum Wages Work Best Together." Center on Budget and Policy Priorities. Updated March 7, 2019. Accessed at: <https://www.cbpp.org/sites/default/files/atoms/files/7-12-06sfp.pdf>

³⁵ <https://www.cbpp.org/sites/default/files/atoms/files/7-12-06sfp.pdf>

Appendix

Appendix A:

Impact of Income Tax Credit Changes								
All Pennsylvanians, 2020 income levels								
2020 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%	State Tax Change
Income Range	Less Than \$24,000	\$24,000 – \$45,000	\$45,000 – \$70,000	\$70,000 – \$117,000	\$117,000 – \$262,000	\$262,000 – \$617,000	\$617,000 – Or More	
Average Income in Group	\$ 14,000	\$ 34,000	\$ 56,000	\$ 91,000	\$ 164,000	\$ 376,000	\$ 1,671,000	
1a. Impact of a refundable state EITC set at 20 percent of the federal credit								
Tax Change as a % of Income	-1.2%	-0.3%	-0.1%	-0.0%	—	—	—	-414,900,000
Average Tax Change	-165	-87	-56	-12	—	—	—	
% Receiving Tax Cut	34%	17%	11%	2%	—	—	—	
Average Tax Cut for Those Receiving Cut	-484	-517	-530	-519	—	—	—	
Share of Tax Cut	52%	27%	17%	4%	—	—	—	
Additional Detail								
Total % with Tax Cut	13%							
2a. Impact of a refundable state EITC set at 25 percent of the federal credit								
Tax Change as a % of Income	-1.5%	-0.3%	-0.1%	-0.0%	—	—	—	-518,600,000
Average Tax Change	-207	-109	-70	-14	—	—	—	
% Receiving Tax Cut	34%	17%	11%	2%	—	—	—	
Average Tax Cut for Those Receiving Cut	-605	-646	-662	-649	—	—	—	
Share of Tax Cut	52%	27%	17%	4%	—	—	—	
Additional Detail								
Total % with Tax Cut	13%							
3a. Impact of a refundable state EITC set at 30 percent of the federal credit								
Tax Change as a % of Income	-1.8%	-0.4%	-0.1%	-0.0%	—	—	—	-622,299,378
Average Tax Change	-248	-131	-84	-17	—	—	—	
% Receiving Tax Cut	34%	17%	11%	2%	—	—	—	
Average Tax Cut for Those Receiving Cut	-726	-775	-795	-779	—	—	—	
Share of Tax Cut	52%	27%	17%	4%	—	—	—	
Additional Detail								
Total % with Tax Cut	13%							

SOURCE: Institute on Taxation and Economic Policy, January 2020

Appendix B

Pennsylvania Who Pays Analysis: EITC							
<i>Non-Elderly Pennsylvania Residents, 2015 Incomes</i>							
Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than \$ 19,100	\$ 19,100 \$ 38,100	\$ 38,100 \$ 62,200	\$ 62,200 \$ 102,700	\$ 102,700 \$ 228,700	\$ 228,700 \$ 511,000	\$ 511,000 And up
Average Income in Group	\$ 11,600	\$ 28,600	\$ 49,400	\$ 81,200	\$ 142,600	\$ 329,400	\$ 1,327,500
SALES & EXCISE TAXES	6.6%	5.2%	4.4%	3.3%	2.4%	1.5%	0.7%
General Sales- Individuals	2.1%	2.0%	1.8%	1.5%	1.1%	0.7%	0.4%
Other Sales & Excise- Ind.	2.6%	1.6%	1.2%	0.9%	0.6%	0.3%	0.1%
Sales & Excise on Business	1.9%	1.6%	1.4%	1.0%	0.7%	0.4%	0.2%
PROPERTY TAXES	4.6%	2.6%	2.7%	2.8%	2.9%	2.7%	1.6%
Home, Rent, Car- Ind.	4.5%	2.4%	2.5%	2.7%	2.7%	2.2%	0.4%
Other Property Taxes	0.1%	0.1%	0.1%	0.1%	0.2%	0.4%	1.2%
INCOME TAXES	2.6%	3.8%	4.1%	4.2%	4.2%	3.7%	3.7%
Personal Income Tax	2.5%	3.7%	4.0%	4.1%	4.0%	3.5%	3.3%
Corporate Income Tax	0.1%	0.1%	0.1%	0.1%	0.1%	0.2%	0.4%
Share of Taxes currently	13.8%	11.6%	11.1%	10.3%	9.5%	7.8%	6.0%
Proposed Recommendation: Impact of creating an EITC at 20 percent of the federal credit							
Change to SALES & EXCISE TAXES	—	—	—	—	—	—	—
Change to PROPERTY TAXES	—	—	—	—	—	—	—
Change to INCOME TAXES	-1.6%	-0.5%	-0.2%	-0.0%	—	—	—
Personal Income Tax	+0.9%	+3.2%	+3.8%	+4.0%	—	—	—
Total Change	-1.6%	-0.5%	-0.2%	-0.0%	—	—	—
Revised Total Taxes	12.2%	11.1%	10.9%	10.3%	9.5%	7.8%	6.0%
Proposed Recommendation: Impact of creating an EITC at 25 percent of the federal credit							
Change to SALES & EXCISE TAXES	—	—	—	—	—	—	—
Change to PROPERTY TAXES	—	—	—	—	—	—	—
Change to INCOME TAXES	-2.0%	-0.6%	-0.2%	-0.0%	—	—	—
Personal Income Tax	+0.5%	+3.0%	+3.8%	+4.0%	—	—	—
Total Change	-2.0%	-0.6%	-0.2%	-0.0%	—	—	—
Revised Total Taxes	11.8%	11.0%	10.9%	10.3%	9.5%	7.8%	6.0%
Proposed Recommendation: Impact of creating an EITC at 30 percent of the federal credit							
Change to SALES & EXCISE TAXES	—	—	—	—	—	—	—
Change to PROPERTY TAXES	—	—	—	—	—	—	—
Change to INCOME TAXES	-2.4%	-0.7%	-0.3%	-0.0%	—	—	—
Personal Income Tax	+0.1%	+2.9%	+3.7%	+4.0%	—	—	—
Total Change	-2.4%	-0.7%	-0.3%	-0.0%	—	—	—
Share of Taxes with State EITC set	11.4%	10.8%	10.8%	10.3%	9.5%	7.8%	6.0%
<i>Source: Institute on Taxation and Economic Policy, June 2020</i>							