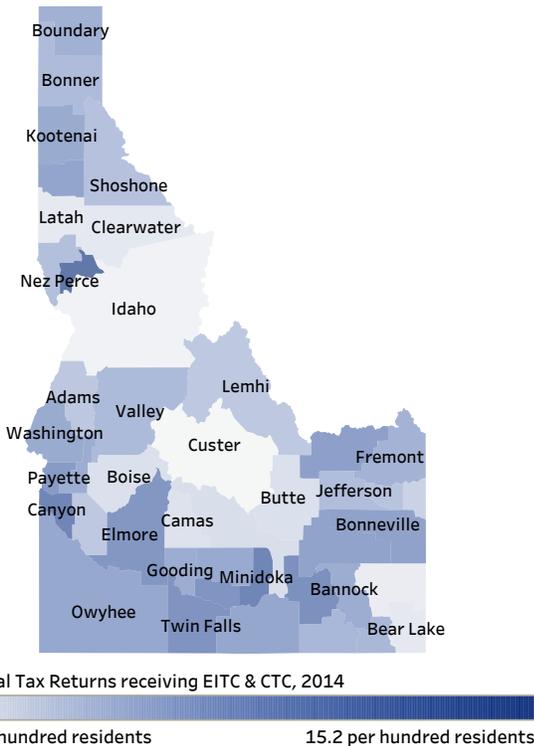


## Exploring Working Family Tax Credit Options in Idaho

Idahoans believe that everyone should pay their fair share. But the passage of the federal Tax Cuts and Jobs Act in December 2017 raised concerns about potential negative impacts on Idaho families with children. If Idaho chooses to update its tax code to align fully with the federal changes (a policy choice called ‘conformity’), an estimated 66 percent of Idaho families with 1 to 2 dependents will see a state tax increase and 80 percent of Idaho families with 3 or more dependents will see a state tax increase. To mitigate these negative impacts, Idaho lawmakers are considering the creation of state tax credits for working families.

If the 2018 Idaho Legislature chooses to fully conform, residents will pay an additional \$118.8 million in taxes to the state, while businesses will see a reduction of \$21.4 million in taxes, according to the Idaho State Tax Commission. The state’s estimated \$97.4 million net increase in 2018 revenue could finance tax credits to offset the tax increases for families. Beyond a tax offset, the credits are linked with additional positive impacts when properly designed, a lesson learned from experiences with the Earned Income Tax Credit (EITC) and Child Tax Credit (CTC), two federal Working Family Tax Credits. States have the option of mirroring federal Working Family Tax Credits in their own tax code and Utah, along with others, are taking up the issue this year.<sup>1</sup>

**Figure 1: Federal Working Family Tax Credit Claims per Resident, Idaho 2014**



**This issue brief reviews the impact of federal Working Family Tax Credits and discusses options for designing similar credits in Idaho. Highlights include:**

- Full conformity to the federal tax overhaul has projected tax increases for Idaho families with children.
- An estimated 66 percent of Idaho families with 1 to 2 dependents will see a tax increase and 80 percent of Idaho families with 3 or more dependents will see a tax increase if Idaho adopts full conformity.
- New state Working Family Tax Credits could offset some of these tax increases; revenue raised through full conformity could be used to cover such policies.
- If Idaho enacted a refundable state CTC targeted to families earning less than \$100,000 (\$50,000 if single), 92 percent of the credit would go to the bottom 80 percent of earners.
- Among the three examined options in this brief, a combined state EITC and CTC approach would benefit the highest share of Idaho taxpayers (31 percent) and the highest share of families with kids (74 percent).
- A combined state EITC and CTC approach would eliminate the expected \$374 average tax increase from conformity for middle-income families with children.

### History of the Federal Earned Income Tax Credit (EITC)



The federal Earned Income Tax Credit (EITC) was enacted under the Ford administration as part of the Tax Reduction Act of 1975. The EITC was made permanent by

the Revenue Act of 1986 and expanded with the Tax Reform Act of 1986 under the Reagan administration. President Reagan's tax proposals in 1985 recommended a faster phase in of the credit, a larger maximum credit and a slower phase out to increase the number of families eligible. He also proposed an index of the EITC to inflation so that the program would remain effective for future generations of Americans. President Reagan applauded the resulting Tax Reform Act of 1986, stating that it was "the best anti-poverty, the best pro-family, the best job creation measure to come out of Congress."

### Background of the Federal Earned Income Tax Credit (EITC)

The federal EITC was established four decades ago and expanded under President Reagan in 1986. The credit increases labor market participation and employment.<sup>2</sup> Eligibility is determined by income, family size and marital filing status. Among those with very low incomes, the EITC incentivizes work by increasing with each dollar earned, as seen in **Figure 2**. Most families only claim the EITC for one or two years.<sup>3</sup> In 2017, approximately 127,000 Idahoans claimed the federal EITC.<sup>4</sup>

### Background of the Federal Child Tax Credit (CTC)

Adopted two decades ago, the federal CTC offsets the cost of child rearing by allowing taxpayers to claim up to \$1,000 per child under 17 years old. The CTC is designed to phase in and phase out at certain income levels, a structure that decreases benefit levels as households increase their income, as seen in **Figure 3**. Though all income groups benefit from the CTC, the majority of benefits are targeted to middle-income families. Families earning less than \$3,000 are ineligible for the credit. In 2017, the credit phased out in value for families earning more than \$110,000 (\$75,000 for single parents). Starting in 2018, the maximum federal CTC is \$2,000 and the credit phase

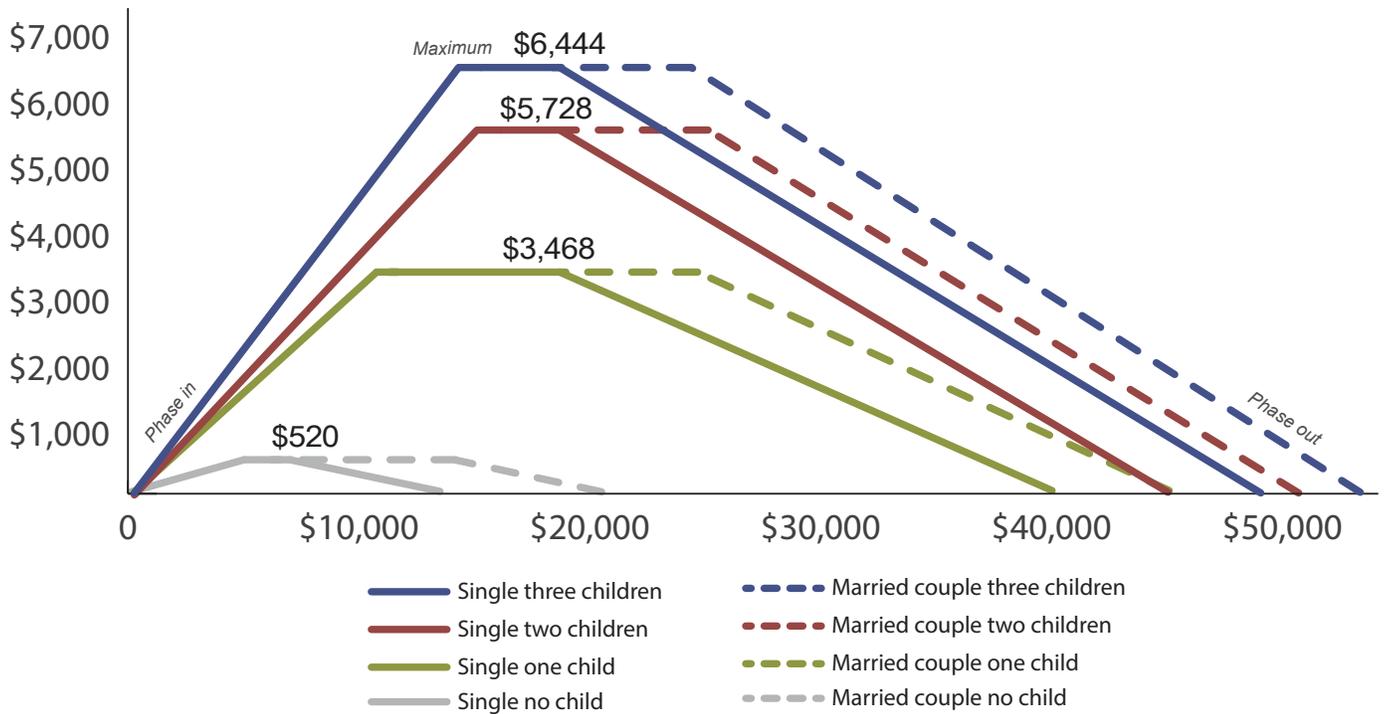
out begins at \$400,000 (\$200,000 for single parents). In recent years, about 100,000 working Idahoans received a refund from the federal CTC.<sup>5</sup>

### Recipients & Impact of Working Family Tax Credits

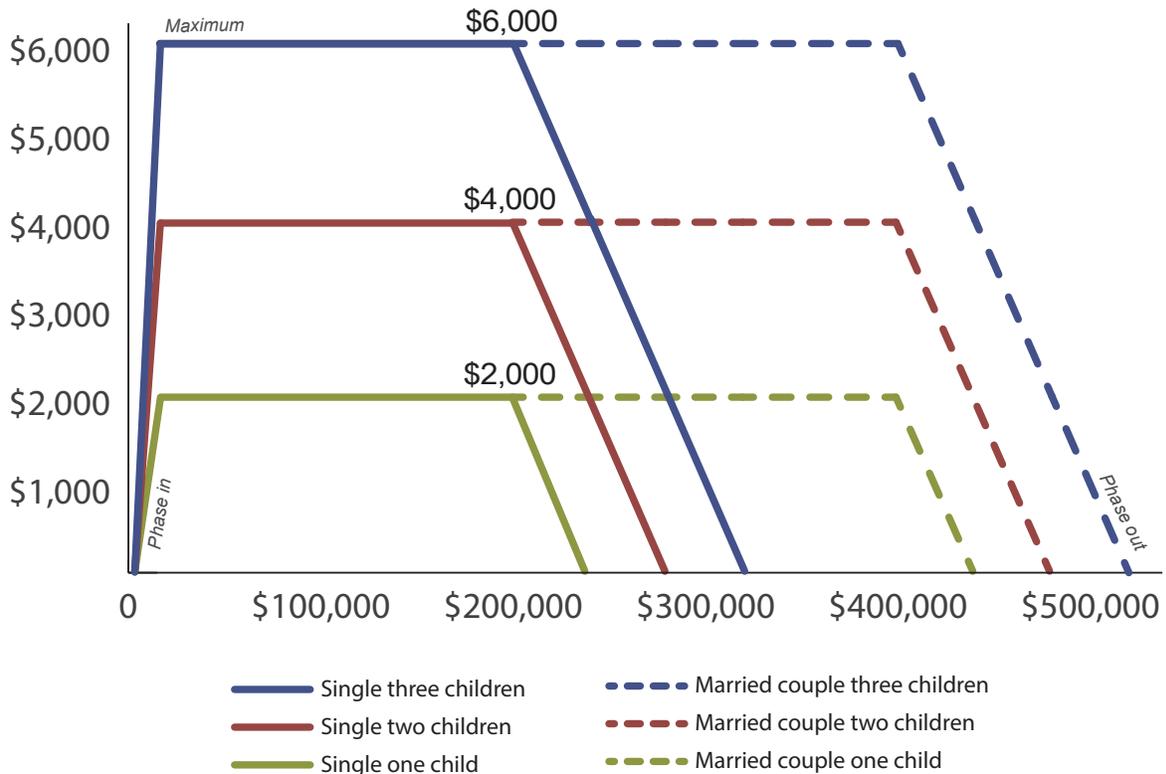
Together, the CTC and EITC are often referred to as 'Working Family Tax Credits' because recipients are required to work and most support families. Almost half of recipients work in manufacturing, health care, accommodation and food services and retail.<sup>6</sup> More than a third of federal Working Family Tax Credit participants in Idaho are from rural counties, as seen in **Figure 1**.<sup>7</sup> Lewis, Minidoka and Canyon counties have the highest rate of federal Working Family Tax Credit claims.<sup>8</sup> Working Family Tax Credits also support veterans who have returned to work. In Idaho, nearly one in ten federal EITC recipients is a veteran or currently in the armed forces.<sup>9</sup> In total, 11,700 Idaho veterans or members of the armed forces benefited from the federal EITC and 5,900 use the refundable portion of the CTC.<sup>10</sup>

State EITC policies are linked with improved economic circumstances over the long-run.<sup>11</sup> Working Family Tax Credits also result in increased household spending on necessities and more dollars to local economies in the short-term.<sup>2</sup> Household spending for EITC recipients is concentrated in vehicle purchases and car repairs.<sup>12</sup>

**Figure 2: 2018 Federal EITC Structure  
Phase In, Maximum and Phase Out**



**Figure 3: 2018 Federal CTC Structure  
Phase In, Maximum and Phase Out**



## Idaho Working Family Tax Credit Options

States have the option of adopting Working Family Tax Credits in their own tax code. Five states have enacted a CTC and 29 states have enacted an EITC. To counteract potential tax increases on Idaho families resulting from full conformity to recent federal tax changes, Idaho could implement a state Working Family Tax Credit. Three Working Family Tax Credit options have been identified, with details for each option provided in **Table 1**:

1. An Idaho CTC limited to households earning less than \$100,000 (\$50,000 if single)
2. An Idaho EITC tied to current federal income eligibility limits
3. An Idaho Working Family Tax Credit that combines both an EITC and CTC

**Table 1: Idaho Working Family Tax Credit Options**

	<i>Option 1:</i> Idaho CTC	<i>Option 2:</i> Idaho EITC	<i>Option 3:</i> Idaho CTC & EITC Combined Approach
Average credit amount for middle 20% of earners that have dependents	\$535	\$206	\$375
Highest income level eligible to receive maximum credit ( <i>married couple w/ 2 children</i> )	\$80,000	\$24,400	\$80,000 for CTC and \$24,400 for EITC
Highest income level eligible to receive any credit ( <i>married couple w/ 2 children</i> )	\$100,000	\$51,598	\$100,000 for CTC and \$51,598 for EITC
Maximum credit amount	\$285 per child	30% of federal EITC	\$145 per child plus 15% of federal EITC
Share of Idaho families with children that would receive credit	68%	39%	74%
Share of credit going to bottom 80% of earners	92%	96%	94%
Cost to State of Idaho	\$99 million	\$89 million	\$94 million

### **Option 1: Idaho Child Tax Credit (CTC)**

Using the general revenue gained from tax conformity, Idaho could afford to create a refundable CTC of \$285. Idaho could choose to target the state CTC to families most negatively impacted by state tax conformity by establishing maximum income limits for families earning \$100,000 (\$50,000 if single), as seen in **Figure 4**. Phasing out the credit gradually would ensure that families are not penalized as they earn more. In a phase out model, the Idaho CTC would decrease in value beginning at \$80,000 in earnings (\$40,000 if single). This scenario would result in more than 92 percent of the credit going to the bottom 80 percent of earners. Making the CTC refundable would allow low-wage families facing a small tax bill to use the entire credit.

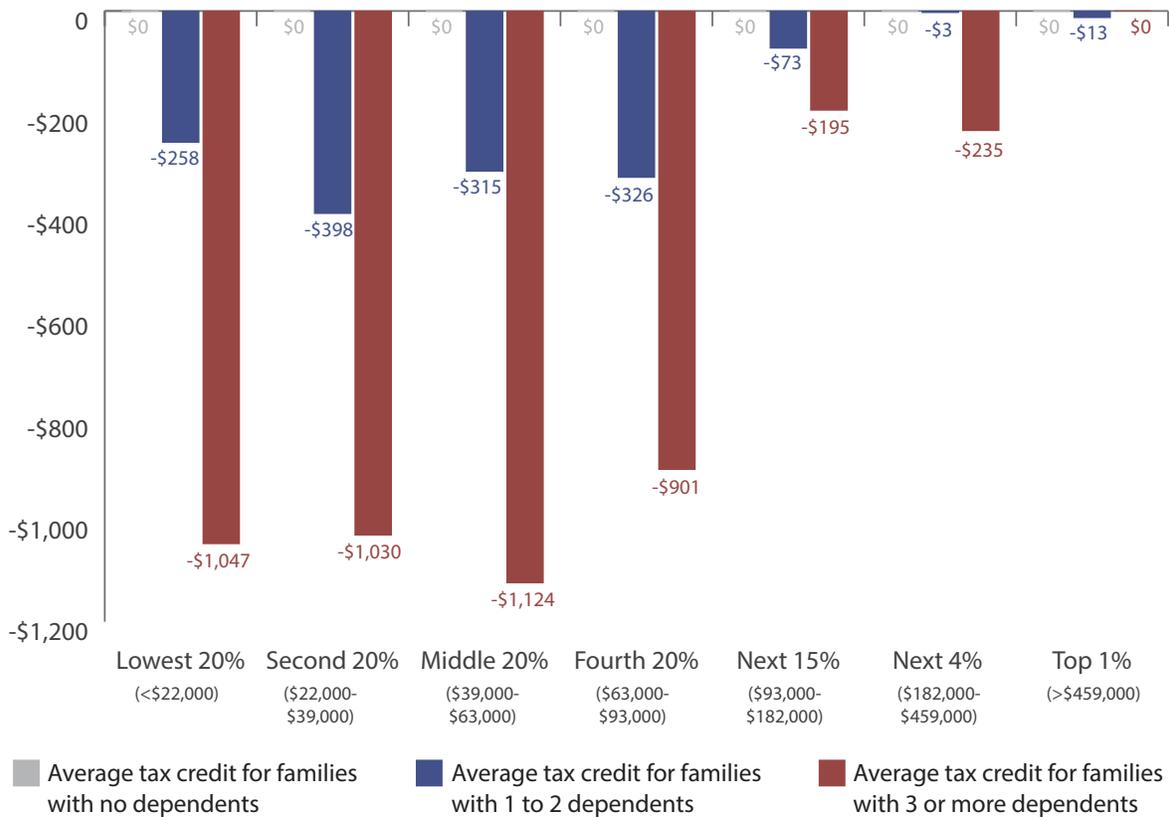
### Option 2: Idaho Earned Income Tax Credit (EITC)

Alternatively, revenue gained from tax conformity could be used to create an Idaho EITC calculated at 30 percent of the federal EITC. Similar to the federal EITC, an Idaho EITC would increase with more dependents in the family, as seen in **Figure 5**. Under the federal EITC, a married couple filing jointly with two children is eligible for the maximum amount if they earn up to \$51,598. An Idaho EITC would therefore also be targeted to the middle- and lower-income families most negatively impacted by tax conformity. The bottom 40 percent of earners would receive over 79 percent of the benefits of an Idaho EITC. An Idaho EITC is more targeted to low earning families than an Idaho CTC and has a relatively stronger impact on low earning families with 1 to 2 children. Low earning families with 3 or more children would receive a comparable credit under both an Idaho CTC and an Idaho EITC.

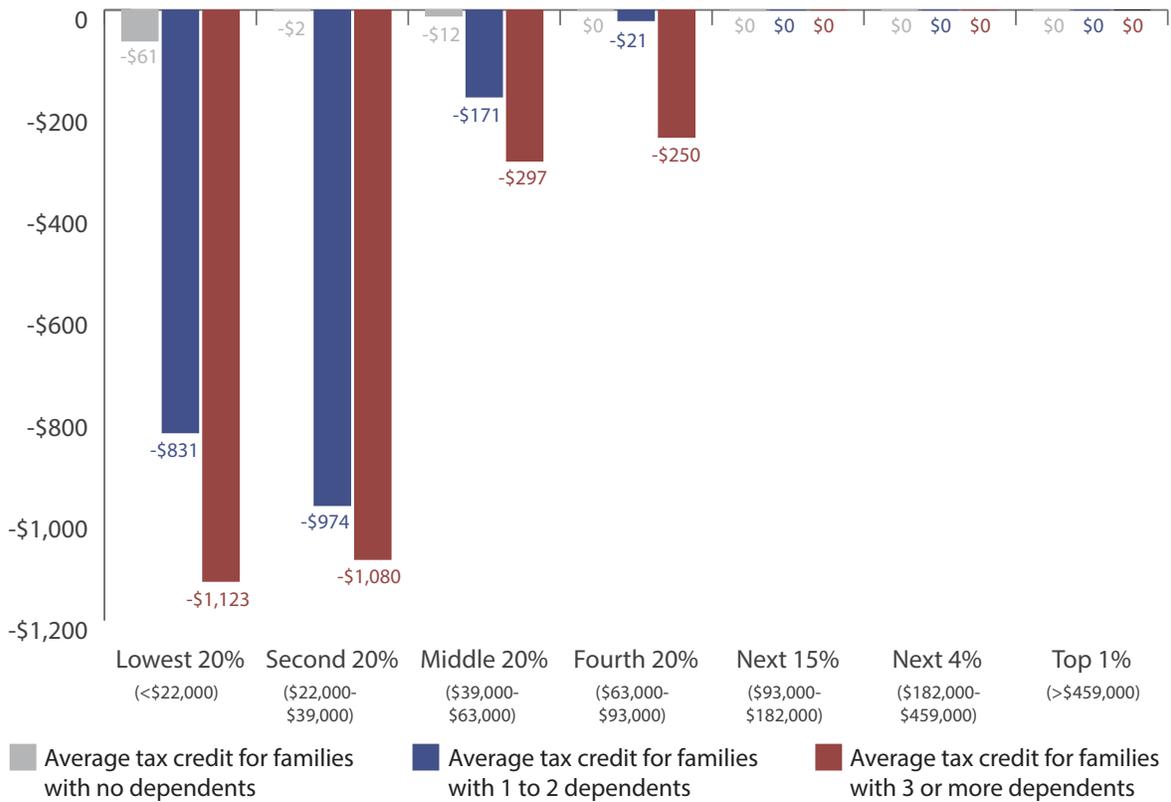
### Option 3: Idaho CTC & EITC Combined Approach

Finally, Idaho could split revenue gains from tax conformity to create a combined CTC and EITC approach, referred to as a state ‘Working Family Tax Credit.’ A combined approach would afford a \$145 refundable Idaho CTC and an Idaho EITC at 15 percent of the federal EITC. Among the three proposed options, a combined approach would benefit the highest share of Idaho families with children (74 percent). Under a Working Family Tax Credit, the average high earning family with children would still receive a small credit to offset their expected increase in taxes due to conformity, while families with 1 to 2 children would receive a credit closer to that of families with more children, as seen in **Figure 6**.

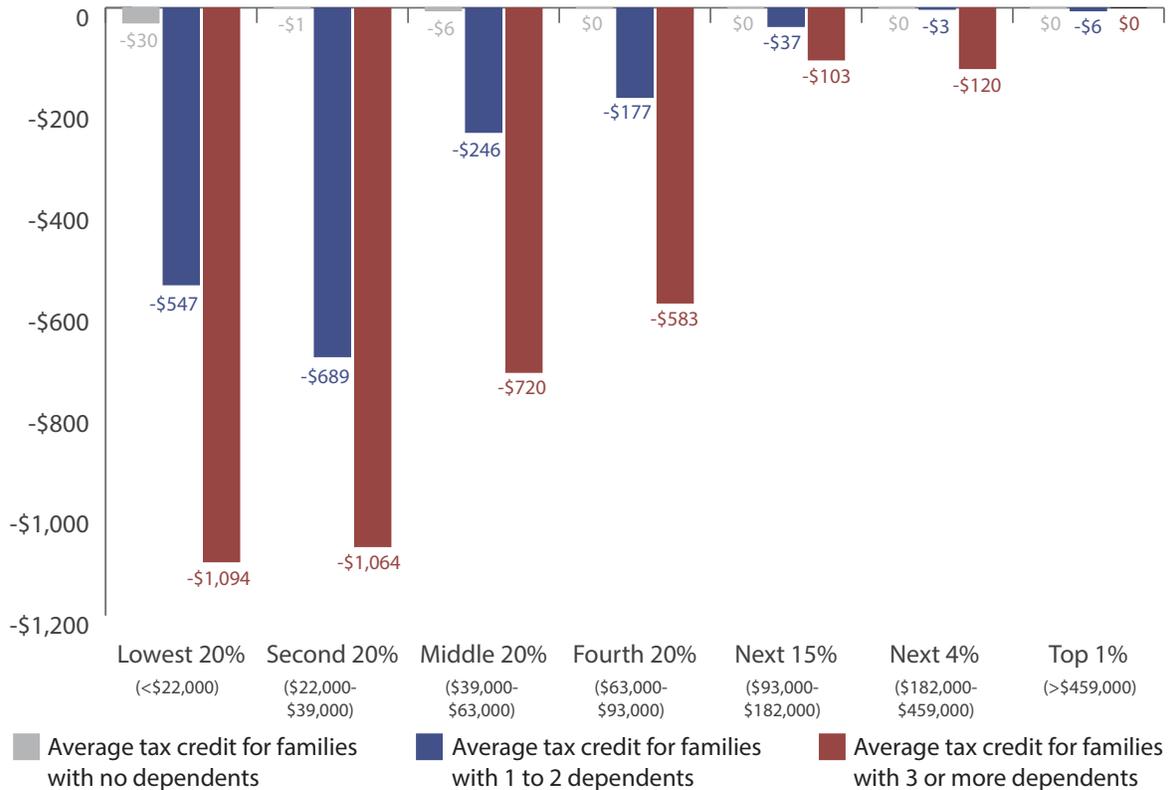
**Figure 4: Average Tax Change from a \$285 Refundable Idaho CTC, By Household Income**



**Figure 5: Average Tax Change from a 30% Idaho EITC, By Household Income**



**Figure 6: Average Tax Change from a \$145 Refundable Idaho CTC and 15% Idaho EITC, By Household Income**



## Next Steps Warrant Careful Deliberation

More than 414,000 Idahoans live in families that qualify for the federal EITC and CTC.<sup>13</sup> Idaho is one of only a few states that have not yet instituted state Working Family Tax Credits modeled on the federal EITC or CTC.

At this time, Idaho legislators may be particularly interested in directing benefits to working families to balance out the lopsided impacts of the federal Tax Cuts and Jobs Act. The top 1 percent of Idaho households will see a \$45,436 federal tax cut, on average, compared to a \$150 cut for the bottom 20 percent (see Appendix A).

This issue brief reviewed several state Working Family Tax Credit options that would offset the anticipated state tax increase families with children would face. Previous analysis of a proposed \$130 nonrefundable CTC found that it would not offset the tax increases to larger working families that come with conformity. The state will have to do more if it intends to hold families harmless.

There is uncertainty surrounding revenue impacts, and projected state gains from conformity should be examined with caution. Taxpayer behavior changes over time, and many provisions of the recent federal tax overhaul are set to expire in 2025. Combined with full state conformity, any of the three state Working Family Tax Credit options could have a negative impact on state revenue if real gains fall short of Idaho State Tax Commission projections.

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<sup>1</sup> Tax Policy Center. (2017). What is the child tax credit (CTC)? Retrieved from <http://www.taxpolicycenter.org/briefing-book/what-child-tax-credit-ctc>

<sup>2</sup> Eissa, N., & Liebman, J. B. (1996). Labor supply response to the earned income tax credit. *The Quarterly Journal of Economics*, 111(2), 605-637.

<sup>3</sup> Dowd, T., & Horowitz, J., B. (2011). Income mobility and the Earned Income Tax Credit: Short-term safety net or long-term income support. *Public Finance Review*, 39(5), 619-652.

<sup>4</sup> Internal Revenue Service. (2017). Statistics for tax returns with EITC. Retrieved from <https://www.eitc.irs.gov/eitc-central/statistics-for-tax-returns-with-eitc/statistics-for-tax-returns-with-eitc>

<sup>5</sup> Center on Budget and Policy Priorities. (2017). Program participation by state. [Data set].

<sup>6</sup> Brookings. (2016, December 21). Earned Income Tax Credit (EITC) interactive and resources. [Data set]. Retrieved from <https://www.brookings.edu/interactives/earned-income-tax-credit-eitc-interactive-and-resources/>

<sup>7</sup> Center on Budget and Policy Priorities. (2017). Program participation by state. [Data set].

<sup>8</sup> Brookings. (2016, December 21). Earned Income Tax Credit (EITC) interactive and resources. [Data set]. Retrieved from <https://www.brookings.edu/interactives/earned-income-tax-credit-eitc-interactive-and-resources/>

<sup>9</sup> Center on Budget and Policy Priorities. (2017). Program participation by state. [Data set].

<sup>10</sup> Center on Budget and Policy Priorities. (2017). Program participation by state. [Data set].

<sup>11</sup> Chetty, R., Hendren, N., Kline, P., & Saez, E. (2015, April). The economic impact of tax expenditures: Evidence from spatial variation across the U.S. Retrieved from <https://www.irs.gov/pub/irs-soi/14rpttaxexpenditures.pdf>

<sup>12</sup> Goodman-Bacon, A., & McGranahan, L. (2008). How do EITC recipients spend their refunds? Retrieved from <file:///C:/Users/spierson/Downloads/ep-2qtr2008-part2-goodman-et-al-pdf.pdf>

<sup>13</sup> Brookings. (2016, December 21). Earned Income Tax Credit (EITC) interactive and resources. [Data set]. Retrieved from <https://www.brookings.edu/interactives/earned-income-tax-credit-eitc-interactive-and-resources/>

### Appendix A: Impact of Federal Tax Cuts and Jobs Act on Idaho Households, By Household Income

