

# HOW TO BUILD An Economy that Works for All



## BRING BACK THE STATE EITC

North Carolina should have an economy that works for all and ensures every family can make ends meet. Our state once had a policy in place with that exact goal — the Earned Income Tax Credit.

The EITC is a tax credit for working families that reduces poverty and rewards work for low- and moderate-income households. Until recently, these households could claim the state EITC as a way to cover the basics and plan for the future. But in 2013 our state lawmakers eliminated the state credit, which made North Carolina the first state in nearly 30 years to roll back this crucial and effective anti-poverty measure. Nearly one million working North Carolinians claimed the state EITC for the last time in 2014, benefitting more than 1.2 million children and pumping \$100.8 million into local economies.<sup>1</sup>

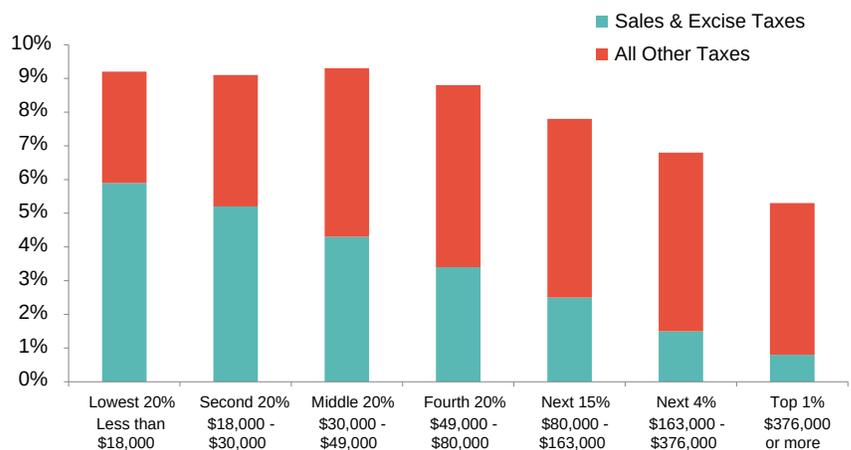
### Reduces poverty

Simply put, the EITC is the most effective anti-poverty tool that legislators have at their disposal. This is especially important today, when North Carolina is facing a 16 percent poverty rate (12th highest in the nation) and a 25 percent child poverty rate.<sup>2</sup> One in three workers in the state earns poverty-level wages.<sup>3</sup> We literally can't afford to ignore this option when one out of every four children in our state live in poverty. The credit works to target low-income households with children, which makes it particularly important for workers early in their careers.

### Promotes tax fairness

By converting our state's personal income tax to a flat rate, expanding the sales tax base, and eliminating credits like the EITC, legislators have created a system that has the lowest-income households carrying a heavier tax load than everyone else. According to the Institute on Taxation and

FIGURE 1: Lower income taxpayers pay greater share of income in sales taxes compared to higher income taxpayers



SOURCE: "Who Pays?", Institute on Taxation & Economic Policy, January 2015.

FOR MORE INFORMATION: **Marion Johnson, Policy Advocate, Budget & Tax Center**  
(919) 856-2176 | [marion@ncjustice.org](mailto:marion@ncjustice.org)  
P.O. BOX 28068 | 224 S. Dawson Street | Raleigh, NC 27611





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Economic Policy, low-income North Carolinians pay nearly twice the share of their income in taxes as our state's richest residents. Reinstating the EITC would be a crucial step towards rebalancing the tax load for all North Carolina taxpayers.<sup>4</sup>

### Enables and encourages work

Individuals must work in order to claim the EITC. For those with very low pay, the credit increases with earnings, which incentivizes more work hours. It allows working households to keep more of what they earn while also paying for the basic essentials.

### Creates short term benefits...

In the short term, the EITC boosts the income of working families, and keeps them out of poverty. At the state level, the extra money helps offset regressive taxes, like the sales tax or the gas tax. It also pumps money into local economies, since low-income workers are most likely to spend their money locally.

It's also mostly used as a temporary support system: three out of five recipients use the EITC for just one or two years at a time. That means workers can use it to stay afloat during short-term struggles resulting from reduced hours, or reduced pay; and their connection to the labor market despite low wages gives opportunities to move up a career ladder.<sup>5</sup>

### ...and long-term gains

While the actual usage can be short-term, the positive effects of the EITC are long-lasting. Low-income children whose families use tax supports like the EITC perform better in school, are more likely to attend college, and earn more on average when they grow up.<sup>6</sup> Bottom-up tax cuts like this provide a ladder out of poverty, a ladder that's been missing and is sorely needed.

## Policy Recommendation

**North Carolina should reinstate a refundable earned income tax credit, allowing workers and their families to keep more of what they earn and make ends meet.** Here are some design considerations.

1. **First, the state EITC should be refundable**, meaning that a taxpayer could reduce his or her income tax liability to zero and earn a refund based on any additional value from the EITC. The credit's refundability is a crucial aspect to offsetting high state and local taxes for the lowest-income workers, particularly as policymakers increasingly rely on the sales tax to raise the revenue needed for communities.
2. **Second, the state EITC builds on the federal EITC**, leveraging the policy established through bipartisan support at the national level. As designed in the past, state legislation is presented as a percent of the federal Earned Income Tax Credit so that the federal law guides all of the eligibility and implementation.
3. **Finally, policymakers can protect North Carolina's working families from abuse**

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and ensure dollars are efficiently delivered to working families and children by certifying tax preparers and supporting the network of Volunteer Income Tax Assistance sites across the state. Efforts to ensure accuracy and reduce overpayments at the federal level will also mean these efforts will benefit the state credit when the two are connected by design.

For the last few years, our lawmakers have been pursuing deep tax cuts that primarily benefit powerful businesses and wealthy residents. It's time to prioritize working families with a bottom-up tax cut and bring back the EITC.

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  2. Current Population Survey Annual Social and Economic Supplements (CPS ASEC). September 2016.
  3. Mitchell, Tazra and Alexandra Sirota. October 2016. "North Carolina's Greatest Challenge: Elevated Poverty Hampers an Economy for All." NC Justice Center, Raleigh, NC.
  4. Institute on Taxation and Economic Policy. "North Carolina: State and Local Taxes in 2015." [http://www.itep.org/whopays/states/north\\_carolina.php](http://www.itep.org/whopays/states/north_carolina.php)
  5. Tim Dowd and John B. Horowitz. "Income Mobility and the Earned Income Tax Credit: Short-Term Safety Net or Long-Term Income Support." Public Finance Review. September 2011.
  6. Center on Budget and Policy Priorities. "The Earned Income Tax Credit and Refundable Child Tax Credit in Rural America." April 2013.