

February 2007

*Timely, accessible,  
and credible  
analysis of  
state and local  
budget and tax  
issues*

## A State EITC: A Hand Up, Not a Hand Out

There is growing momentum for enacting a state Earned Income Tax Credit (EITC) in North Carolina and for good reason. The federal EITC is the country's most effective program for supporting low- and moderate-income working families. Enacted in 1975, the EITC has garnered strong bipartisan support because it rewards work, increases fairness in the tax code and helps low- and moderate-income workers close the gap between what they earn and what they need to afford basic necessities.

### A state EITC is Not a Hand Out

A state EITC is a refundable credit for earned income and, therefore, it promotes and supports work. It cannot be categorized as "welfare." It not only offsets income taxes owed, but also helps to offset sales and property taxes, which hit North Carolina's lowest-paid workers disproportionately hard. According to data provided by the Institute on Taxation and Economic Policy, North Carolina's lowest-paid workers (bottom 20 percent) pay 10.9 percent of their income to state and local taxes while the wealthiest taxpayers (top 1 percent) pay only 6.3 percent. Moreover, the impact of the sales tax on low-income families is five times greater than the impact on the wealthiest 1 percent. A refundable state EITC would increase fairness of the state and local tax system and ensure that paying taxes does not push low- and moderate-income working families closer to or deeper into poverty.

### Scaling Up, Not Down: Offsetting state income and sales taxes would require a state EITC of at least 11 percent

Recently, there has been talk of **scaling down** proposals currently on the table supporting a state EITC (bills have been introduced that would establish a five-percent refundable state EITC and a ten-percent refundable EITC). The new proposal suggests limiting state EITC refunds to the amount taxpayers owe in state income taxes plus their estimated sales tax payments. This proposal would actually considerably **scale up** the proposed state EITC program. This is because **low- and moderate-income families pay much more in sales taxes than they would get from a five- or ten-percent state EITC.**

The Institute on Taxation and Economic Policy found that the average taxpayer in the bottom twenty percent of earners (\$17,000 or less) will pay an estimated \$500 in state and local sales taxes in 2007. The average taxpayer in the next 20% of income earners (\$17,000-\$29,000 annual income), who would also benefit from a state EITC, will pay an estimated \$1,015 in state and local sales taxes in 2007. A five-percent state EITC would provide a maximum credit of \$236 while a ten-percent state EITC would yield a maximum credit of \$472.

An analysis of sample taxpayers shows that at a minimum, a North Carolina state EITC would need to be set at 11- percent for married couples with two children and 23-percent for single filers with at least one child to offset state income and sales taxes paid by the lowest paid workers (Figure 1).

For example, a married couple with two children who earn \$20,650 a year in 2007 (the 2007 federal poverty guideline earnings for a family of four) would owe \$79 in state income taxes and pay an estimated \$1,015 in state and local sales taxes. They would qualify for \$4,029 from the federal EITC, and would therefore receive a state EITC of \$201 at 5-percent or \$403 at 10-percent. After deducting their \$79 income tax payment, this family would receive a check from the state in the amount of \$122 assuming a 5% credit or \$324 assuming a 10% credit. To refund this working family for state income taxes plus the estimated amount of sales taxes they pay, their state EITC would need to be \$1,094, or 27 percent of the federal credit.

**Figure 1: Level of State EITC Needed to Offset State and Local Income and Sales Taxes**

Filing Status	Annual Earnings	* NC Income Taxes Owed	Average Sales Taxes Paid in Income Bracket	Total State Income and Sales Taxes Paid	5% State EITC credit	10% State EITC credit	% of Fed EITC Needed to Refund State Income and Sales Taxes	% of Fed EITC Needed to Reimburse Income and Sales- with average Child & Dep Care Credit
<b><u>Single-parent with one child</u></b>	\$6,396	\$0	\$500	\$500	\$109	\$218	23%	23%
	\$12,792	\$188	\$500	\$688	\$143	\$285	24%	18%
	\$13,690	\$241	\$500	\$741	\$143	\$285	26%	18%
	\$17,000	\$440	\$500	\$940	\$130	\$260	36%	25%
	\$23,000	\$823	\$1,015	\$1,838	\$82	\$164	112%	94%
	\$27,380	\$1,129	\$1,015	\$2,144	\$47	\$94	229%	202%
<b><u>Married Couple with 2 children</u></b>	\$12,792	\$0	\$500	\$500	\$236	\$472	11%	11%
	\$17,000	\$0	\$500	\$500	\$236	\$472	11%	11%
	\$20,650	\$79	\$1,015	\$1,094	\$201	\$403	27%	25%
	\$23,000	\$220	\$1,015	\$1,235	\$177	\$354	35%	29%
	\$25,584	\$375	\$1,015	\$1,390	\$150	\$299	46%	34%
	\$30,975	\$699	\$1,015	\$1,714	\$93	\$186	92%	61%

\* Includes Child Tax Credit, but not the Child and Dependent Care Credit.

\*\*The minimum state EITC needed to offset state income and sales taxes, 11% and 23 %, would remain constant even with the Child and Dependent Care Credit. If the average Child and Dependent Care Credit is applied to each scenario,

## Conclusion

As lawmakers continue to debate the merits of enacting a state earned income tax credit in North Carolina, they must understand that reimbursing low- and moderate-income workers for income taxes paid is but one very small goal of a state EITC. Just as the federal EITC is meant to reimburse workers primarily for payroll taxes, and not federal income taxes, a state credit would primarily seek to offset state sales and property taxes and not state income taxes, which represent relatively little of these families' tax bills.

**Contact Meg Gray, Policy Analyst: (919) 856-3192**