

A Targeted Economic Boost

An Expanded Working Families Tax Credit in Virginia Would Strengthen Communities and Families



THE
COMMONWEALTH
INSTITUTE

By Chris Wodicka

A targeted working families tax credit can help families earning low wages meet basic needs. For families struggling to make ends meet, these tax credits make a difference in terms of putting food on the table, affording child care, and staying current on utility bills. These tax credits usually take the form of an earned income tax credit (EITC). The federal EITC is one of the biggest success stories we have. The credit lifts 3 million children out of poverty each year. Here in Virginia, it helps to support over 600,000 working households across the commonwealth.

Twenty-nine states and the District of Columbia have enacted their own state EITCs to supplement the federal credit. Virginia's state EITC began in 2006 and is available to workers who claim the federal EITC on their tax returns, equaling 20 percent of the value of the federal EITC. Like the federal credit, Virginia's credit rewards and encourages work, gives a boost to families, and improves the long-term prospects for children.

But the current structure of the state EITC leaves between \$188 and \$260 million in help on the table each year. That's money that would give working people a wage boost at a time when wages are stagnant.

Virginia lawmakers have an opportunity to help Virginia's working families by expanding the state EITC by making it refundable.

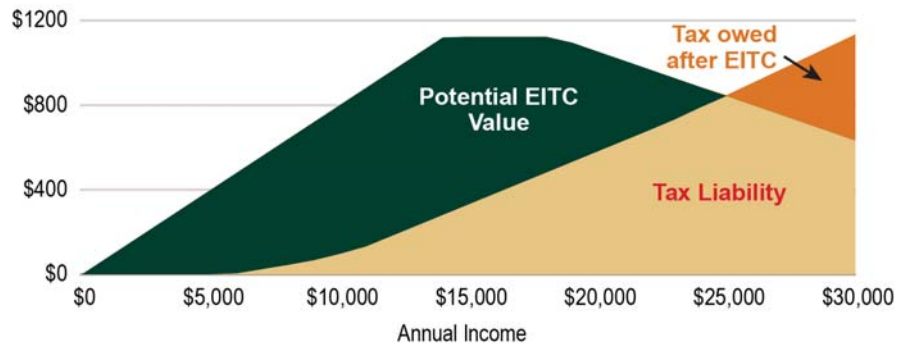
A Pro-Work Tax Credit

The EITC is structured to reward work, particularly for parents of young children. To qualify for the credit, a person must have income from working. The exact amount of a family's credit depends on

EITC is a Pro-Work Credit

The value of the earned income tax credit ramps up as a person earns more and then plateaus and phases down so people don't fall off a cliff. This design encourages people to enter and stay in the labor force and to increase their hours.

Tax liability and credit for a single parent of two at various income levels



Source: TCI calculations based on EITC parameters for tax year 2017

THE COMMONWEALTH INSTITUTE

household income, marital status, and family size. Larger families and married filers are eligible to receive a larger credit. And the value of the credit ramps up as a person earns more and then plateaus and phases down so people don't fall off a cliff. This design encourages people to enter and stay in the labor force and to increase their hours.

The Importance of Refundability

Like the federal credit, the state credit reduces a family's income tax bill, with one key difference. At the federal level, if the value of the credit exceeds the amount of income tax owed, the family receives the difference as a tax refund. This is similar to how refundable tax credits for the state's

Missing Out on the Full Value of the EITC

Earning an income of \$15,080 also earns this mother of two an Earned Income Tax Credit (EITC). The full value of her Virginia EITC is \$1,123. Despite the taxes she pays through everyday purchases, Virginia's non-refundable EITC will only match the taxes she pays on income.



Source: TCI calculations based on EITC parameters for tax year 2017
Note: May not sum due to rounding

THE COMMONWEALTH INSTITUTE

agricultural best management practices, film production companies, and research and development work. For people with low incomes, this refund helps to offset other taxes they pay, such as payroll and gas taxes. However, Virginia’s state EITC is not refundable. This means that if the value of the credit exceeds the amount that a family owes in state income tax, the family misses out on the full value of the credit.

Refundability recognizes that, for low-wage workers, many state and local taxes take a larger share of their incomes than that of high-income and wealthy households. By lowering the relative share of taxes paid by families earning low wages, a refundable EITC would help Virginia’s working families cover basic needs and stimulate local businesses and local economies.

Supporting Our Economy

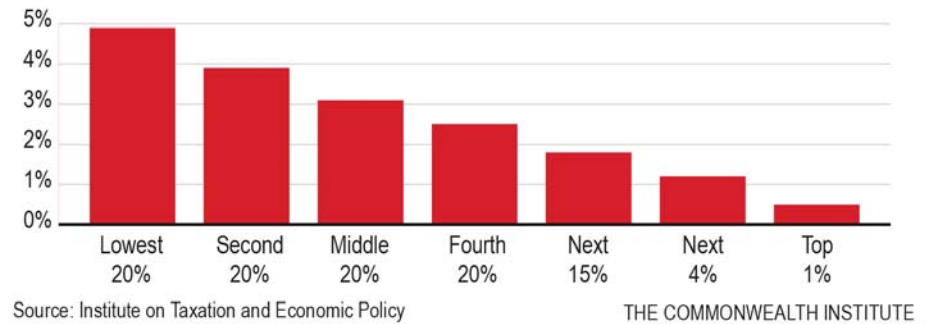
In the 2018 General Assembly session, lawmakers embraced business tax breaks as a strategy to revitalize communities that are facing economic challenges. This is an important goal, but business-centered tax cuts have, at best, a mixed track record of success in boosting the economy. By expanding Virginia’s state EITC through refundability, lawmakers could more directly address persistent poverty and improve the long-term economic outlook for communities by helping working families.

The EITC has strong pro-work features, boosting employment and work hours for low-income families. In addition, because low-income families spend more of their incomes locally on consumer goods, a stronger state EITC would lead to more local spending. For example, low-income families tend to spend a relatively larger

Sales & Excise Tax: Share of Family Income

Families with low or moderate incomes pay a greater share of their income towards sales and excise taxes. This is an example of a regressive tax.

Share of income toward sales and excise taxes per household income quintile



share of their incomes on groceries and other basic needs. The additional disposable income and increase in consumer spending that would result from a refundable EITC would pump millions of dollars into communities throughout Virginia.

Research has documented the downstream and multiplier effects of this additional spending. Additional consumer spending associated with the EITC may spur additional business spending as well as other changes in income and spending patterns.

Long-Term Benefits

Over time, an expanded EITC could help communities address long-standing economic challenges by providing more opportunities for families and the next generation. Studies show the working family tax credits have a range of benefits – from improved infant health to increased college enrollment. Children whose families receive the EITC are shown to earn higher incomes in adulthood compared to similar children whose families did not receive the credit.

Workers earning low wages should be able to make ends meet and support their families. Refundable state EITCs are targeted policies that reward work and strengthen businesses and local economies. Refundability is a key improvement to provide families and communities with a hand up.

The Commonwealth Institute

The Commonwealth Institute for Fiscal Analysis provides credible, independent and accessible information and analyses of state public policies with particular attention to the impacts on low- and moderate-income persons. Our products inform state economic, fiscal, and budget policy debates and contribute to sound decisions that improve the well-being of individuals, communities and Virginia as a whole. Contact 804-396-2051 or go to www.thecommonwealthinstitute.org.

