California Center for Jobs & the Economy

California Business Roundtable

A CLOSER LOOK: THE EARNED INCOME TAX CREDIT

Existing programs to support low income Californians provide a safety net, but do nothing to help those who are trying to get ahead—to build a bridge out of poverty and into the middle class. In both focus groups and subsequent statewide survey of the working poor, participants frequently cited the lack of transitional assistance from being dependent on social welfare programs to financial stability. The participants also stated that, with the exception of Medi-Cal, the current safety net programs are too little, too intermittent, not directed at the primary barriers they face, and too burdened by red tape and restrictions to be of much use in their circumstances.

Frequently, those attempting to climb the economic rungs felt that support was pulled out from underneath them as soon as they began getting ahead. This dramatic reduction in assistance often led to major shifts in their economic conditions, forcing many back onto the same programs they were working to move beyond.

Today's morass of social welfare programs is often bogged down by bureaucracy. Applying for assistance can be complicated and time-consuming—taking workers out of the workplace to navigate an increasingly complex and daunting social welfare system. Many cited instances where they relied on this assistance, only to see it pulled due to minor shifts in their income or household conditions.

Instead of increasing spending on social welfare programs that give recipients no sense of value or place in our economy, California should build its investments in the successful Earned Income Tax Credit. This tax credit provides tax relief and assistance to those in the workforce looking to move up the economic ladder, especially as the cost of living continues to increase in California.

Investing in the EITC is investing in workers and acknowledging their value in our society. This is in sharp contrast to burgeoning ideas like universal basic income, which essentially discards lower-income residents as obsolete resources. Universal basic income is giving up; the EITC is providing Californians with the resources to fight back and secure their place in the changing economy.

This report proposes to enhance and restructure the state's social welfare programs through an Expanded State EITC. Existing federal, state and local resources would be reallocated to the extent practical and used to expand the current state EITC to supplement the federal EITC by another two to four times. This approach would eliminate excessive administrative and transactions costs from the extensive bureaucratic oversight in current programs, and make assistance delivery more predictable and certain. Likewise, as is done in other states, the state EITC should be restructured as a percentage add-on to the federal EITC to simplify calculations and make it easier for beneficiaries to make their budget plans accordingly.

While there have been previous EITC concepts proposed along these lines extending back to the 1970s, they generally have been made as stand-alone measures or oriented more on producing efficiencies in program delivery. However, to be effective as a refocus to economic mobility, the EITC expansion needs to be done in concert with the other recommendations in this report. Investing in the EITC cannot be done in a vacuum. As this report demonstrates, education and housing and other bureaucratic hurdles will continue to be barriers to upward mobility even with increased investments in EITC. We must address the cost of living increases that are suffocating many working-class families. Otherwise, any gains created by an enhanced EITC program will be quickly lost as increasing energy, transportation and housings costs dominate more of families' budgets.

More critically, the EITC restructuring detailed in this report will result in significant administrative cost savings which should be directed to education reforms detailed in the report. In particular, the state should not just be focused on providing two years of free college, but should use the savings made possible by the EITC proposal to reshape the current K-12 orientation, to a shift to K-14 to equip all students with the skills needed to compete in the emerging economy.

The choice is simple—does this state want to support programs designed to keep people in poverty, or does it want to invest in a program that will reward those pulling themselves out?

Background

Federal Earned Income Tax Credit (EITC) provides cash assistance to low and moderate income workers. People filing for the credit must have earned income from an employer or self-employment, meet the income qualifications, and file an income tax return. The EITC is a refundable tax credit applied against the amount of tax owed rather than a deduction against income. The credit is first used to reduce any income tax owed. Any amount left over is then be paid as a tax refund.

The credit varies based on household size. The credit varies with income level, and is designed to phase out as earned income rises rather than stop abruptly at the income cut-off as with most of the other income assistance programs. At first, the amount of the credit grows as earned income rises, reaches the maximum and continues at this point as earned income continues rising to specified levels, then gradually phases out as earned income continues growing. The charts below show the credits available for taxes filed in 2019 for a single parent with 2 children. The upper chart shows the effect on income; the chart below shows the amount of the EITC.

California EITC began in 2015 and was revised in 2017 and 2018. The 2017 revisions incorporated self-employment income along with earned income into the eligibility standards, comparable to the federal rules, along with providing an extension for low levels of assistance into a broader income range. The 2018 revisions expand the amounts. While the state EITC generally follows the eligibility provisions of federal law, the income limits are significantly lower. The amount of the available credit is also determined annually through a direct budget appropriation for this purpose rather than set in statute as a calculated amount.

The charts below show the California EITC based on the 2017 revisions, combined with the federal amounts, for a single parent with 2 children. As indicated, even with the 2017 revisions, the state EITC remains focused on poverty rather than promoting upward mobility.

Both sets of charts show the effects on total income and do not reflect the net effects remaining after payment of any taxes owed, including both income taxes and payroll taxes. Examples incorporating these taxes along with the effect of the report's expanded EITC proposal are contained in the report.