BTC Brief
BUDGET & TAX CENTER

May 2013

State EITC is the best tool to reduce an increased tax load on low-income taxpayers

BY ALEXANDRA FORTER SIROTA

THE STATE EARNED INCOME TAX CREDIT is the best way to make sure that low-income North Carolinians are not paying more than their fair share of taxes, while also helping low-income families stay out of poverty and create a better future for their children. Unless lawmakers reverse course, close to one million working families in North Carolina will face a tax increase beginning in tax year 2014 due to lawmakers' decision to allow this tax credit to expire.[1] Even with the state EITC, low-income households already pay a higher share of their income in state and local taxes than wealthy households.[2] The EITC is the best way to right that wrong.

EITC Best Tool for Fixing Upside-Down Tax Code

This tax credit helps families that work but earn low wages and it is the best tool for addressing the fact that our tax system asks more of those with less. By offsetting the full range of taxes that working families pay (income, sales, property, and excise taxes), it lets them keep more of what they earn so that they can stay in the workforce despite low wages, better support their children, and avoid poverty.[3] In doing so, the EITC reduces use of public assistance and can actually improve children's educational achievement, educational attainment, and earnings later on in life.[4]

The EITC is mostly used as a temporary support. Research shows that three out of five recipients claim this tax credit for short periods—only one or two years.[5] As such, this tax credit is an effective way to help families stay on their feet by offsetting short-term struggles resulting from job loss, reduced hours, or reduced pay. Additional research finds that the EITC also goes some way towards lessening the inequality of income because it offsets the income decline experienced over the past twenty years by the lowest income households with children relative to higher-income households.[6]

MEDIA CONTACT:

ALEXANDRA FORTER SIROTA
Project Director
919/861-1468
alexandra@ncjustice.org

Budget & Tax Center

a project of the

north carolina
JUSTICE CENTER

P.O. Box 28068
Raleigh, NC
27611-8068

www.ncjustice.org

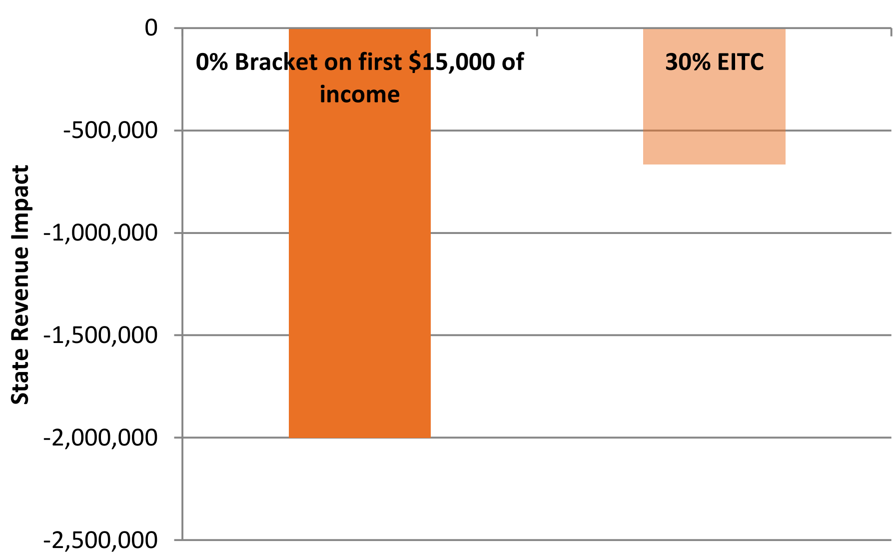
Zero Percent Bracket Not a Good Substitute for EITC

Some policymakers claim that the zero percent income tax brackets in their tax cut plans address the negative impact their proposals have on low-income families, but that is not the case. In reality, a zero percent income tax bracket is more costly than the EITC, poorly targeted, and offers none of the additional benefits like support of work, reduction of child poverty, and improvement in children's educational outcomes.

A zero percent tax bracket reduces taxes for everyone, not just low-income people, so it's ineffective in fixing the disparity between the tax burdens of the rich and poor. For example, a zero percent tax bracket on the first $15,000 of income, applies to the first $15,000 of income earned for everyone, even millionaires.

This means that a zero percent tax bracket is helping people who don't need help, making it much more expensive. While the state would spend $2 billion on this, increasing the state EITC to 30 percent of the federal credit would only cost one-third of that.[7]

Figure 1. The Cost of the Zero Tax Bracket in Senator Berger's Plan Would be Better Spent on the State EITC



Source: Special Data Request to Institute on Taxation and Economic Policy, May, 2013.

In contrast, an Earned Income Tax Credit (EITC) is targeted to only low-income taxpayers who work, specifically, and it addresses the fact that they are paying a higher percent of their income in sales and property taxes than the wealthy.

Budget & Tax Center

a project of the

north carolina
JUSTICE CENTER

P.O. Box 28068
Raleigh, NC
27611-8068

www.ncjustice.org

BTC Brief

north carolina JUSTICE CENTER

In addition, unlike a zero percent income tax bracket, the EITC adjusts based on a family's size and income, so those who get a raise, a better paying job, or otherwise see their earnings picture improve (as most do within a year or two) no longer receive it. A zero tax bracket is ongoing, regardless of need.

It's clear that the EITC, not a zero percent tax bracket, is the better policy choice to minimize the upside-down nature of the state's tax system.

If lawmakers want to create a fair tax system that helps everyone – including low-income people – prosper, they should reinstate and expand the state EITC and leave behind the idea of a zero-tax bracket.

---

[1] House Bill 82, entitled IRC Update, became law in March 2013, allowing the state EITC to sunset in tax year 2014. During the floor debate for House Bill 82, legislators in both chambers voted down measures to extend the sunset date for the state EITC. The official legislative record of House Bill 82 is available at: http://ncleg.net/gascripts/BillLookUp/BillLookUp.pl?Session=2013&BillID=hb82&submitButton=Go

[2] Institute on Taxation and Economic Policy, "Who Pays? A Distributional Analysis of the Tax Systems in All 50 States." January 2013.

[3] Mitchell, Tazra. "North Carolina's Earned Income Tax Credit: A Modest but Vital Boost to Low-Paid Workers across the State." North Carolina Budget and Tax Center. February 2013.

[4] Mitchell, Tazra. "North Carolina's Earned Income Tax Credit: A Modest but Vital Boost to Low-Paid Workers across the State." North Carolina Budget and Tax Center. February 2013.

[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] Liebman, Jeffrey, 1998. "The Impact of the Earned Income Tax Credit on Incentives and Income Distribution," in James M. Poterba, ed., *Tax Policy and the Economy,* Vol. 12, MIT Press.

[7] Special Data Request to the Institute on Taxation and Economic Policy, May 2013.

Budget & Tax Center

a project of the

north carolina
JUSTICE CENTER

P.O. Box 28068
Raleigh, NC
27611-8068

www.ncjustice.org