CALIFORNIA BUDGET PROJECT

budget brief

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A STATE EITC: MAKING CALIFORNIA'S TAX SYSTEM WORK BETTER FOR WORKING FAMILIES

Executive Summary

Establishing a refundable Earned Income Tax Credit (EITC) in California would reduce economic hardship for millions of people and help them meet basic needs. Half of all states and the District of Columbia have created their own EITCs that build on the federal credit of the same name.

The federal EITC is a refundable tax credit that encourages and rewards work by allowing low- and moderate-income individuals and families to keep more of their earnings and afford the basics. The federal EITC is one of the most effective policy tools for reducing poverty, and it lifts millions of children out of poverty every year. In addition, research shows that the EITC produces long-term benefits for families and children, such as improved health and educational outcomes and higher earnings in subsequent years.

Policymakers must consider a number of factors when designing a state-level EITC. To be effective at reducing economic hardship, a state EITC must be refundable, meaning that even low-income Californians who do not owe income tax – but who do pay other taxes – will still receive the credit. Other issues to consider are the overall cost of the program and the ease of administration.

A traditionally designed, refundable state EITC, which sets the credit as a percentage of the federal EITC and maintains the same eligibility requirements, would give more than 3 million California households an economic boost. The higher the percentage of the federal EITC, the greater the average benefit for working families. A refundable state EITC based on the federal credit would supplement the earnings of working families who have faced decades of wage stagnation, while also helping rebalance the state's tax system and strengthening California's social safety net.

Alternative state EITC designs could offer larger benefits to certain groups of Californians, though these options have notable trade-offs. For example, the state EITC could be expanded for childless workers who receive just a fraction of federal EITC benefits. Another option is to limit the state EITC to families with young children – those age 5 and under – in order to make larger investments in children at a critical stage in their development. These options merit consideration, but policymakers must also consider their drawbacks, which include greater administrative complexity and, in the case of a credit for just families with young children, a policy that reaches fewer Californians.

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PART I: HOW THE FEDERAL EITC WORKS

The federal EITC is a refundable tax credit that allows low- and moderate-income working families and individuals to keep more of their earnings and better meet their basic needs. The EITC reduces the amount of federal income tax owed by a family or individual based primarily on two factors: how much they earn from work and how many children they support. Because the federal EITC is a refundable credit, taxpayers whose EITC exceeds the amount of federal income taxes they owe receive the difference as a tax refund.

The EITC is widely used and helps families make ends meet when they face economic challenges. About half of US taxpayers with children benefited from this federal credit between 1989 and 2006, and most of them (61 percent) used the credit just once or twice during this period.[1] More than 3 million California households – almost one in five tax filers – received the federal EITC in 2012, although estimates suggest that only about 70 percent of eligible Californians claim the credit.[2] Families typically use the EITC to pay bills, reduce debt, or cover the cost of major necessary expenses, such as replacing or repairing a car.[3]

The EITC Is Designed to Encourage Work

The EITC encourages and rewards work by providing a larger credit as workers' earnings increase up to a certain threshold, after which the credit phases out. For example, a single parent with two children who earns $7,500 in 2014 will be eligible for a $3,000 credit, but if she earns twice as much, she will qualify for the maximum credit of $5,460.[4] In other words, she receives a larger credit by working more. However, once her annual earnings reach $17,830, the credit gradually declines, phasing out entirely when her earnings reach $43,756.

The EITC Targets Benefits to Working Families With Children

Low- and moderate-income working families with children receive the overwhelming majority of federal EITC benefits.[5] Families with children are eligible for the EITC up to a higher earnings threshold and can receive larger credits compared to adult workers without children.[6] For example, a married couple with three or more children qualifies for the EITC as long as their annual earnings from work are below $52,427, and a single parent with one child qualifies with earnings below $38,511 (Table 1).[7] Adults without children, on the other hand, qualify only if they have much lower earnings: below $14,590 if unmarried and $20,020 if married. Families with children also are eligible for substantially larger EITC benefits. Families with three or more children can receive a credit of up to $6,143 in 2014, and those with one child can receive a maximum credit of $3,305.[8] In contrast, adults without children can receive a credit of no more than $496 – less than one-seventh the credit for a family with one child.

The Federal EITC Boosts Employment

The federal EITC reduces economic hardship among low-income workers not only by allowing them to keep more of their earnings, but also by providing a major work incentive. Research shows that the EITC creates a strong incentive to work because it provides a larger credit to workers with very low earnings as they work and earn more.[9] Most studies examine the impact of the federal EITC on employment among unmarried mothers. For example, one study concluded that *more than 60 percent* of the employment gains for single mothers, compared to single women without children, was due to the EITC and other tax changes.[10] Another study found that expansions to the federal EITC in the 1990s boosted employment among women who head families far more than any other factor. This includes the strong job market during the latter half of that decade and welfare reform in 1996, which emphasized moving low-income parents into the workforce by instituting strict work requirements and time limits on cash assistance.[11] Similarly, a California-based study found that after the 1990s expansions to the federal EITC, employment among women who received cash assistance through CalWORKs or its predecessor, Aid to Families with Dependent Children (AFDC), increased more for those with multiple children than it did for those with only one child. Most of this differential employment gain is attributed to fact that the EITC expansions benefited multi-child families disproportionately, thereby encouraging work among mothers with more than one child.[12]

Table 1: Families With Children Qualify for a Federal EITC With Higher Earnings and Receive Larger Credits			
Number of Qualifying Children	Earnings to Qualify for Credit, 2014		EITC Amount, 2014
	Single	Married	
No Children	Less Than $14,590	Less Than $20,020	$2 to $496
One Child	Less Than $38,511	Less Than $43,941	$9 to $3,305
Two Children	Less Than $43,756	Less Than $49,186	$10 to $5,460
Three or More Children	Less Than $46,997	Less Than $52,427	$11 to $6,143

Note: "Earnings" includes taxable earnings from work, self-employment income, and certain disability payments. "Qualifying children" must meet certain age, relationship, residency, and other requirements. "Married" refers to taxpayers who file joint returns, while "single" refers to those who file as single, head of household, or qualifying widower.
Source: Internal Revenue Service

The EITC Is the Nation's Most Effective Tool for Reducing Child Poverty

After Social Security, the EITC is the nation's most effective tool for reducing poverty, and it lifts more children out of poverty than any other federal policy.[13] The EITC pulled 6.5 million people – including 3.3 million children – above the poverty line in 2012.[14]

The EITC has also significantly cut poverty in California. The EITC, together with the Child Tax Credit, lifted 1.3 million people, including 629,000 children, out of poverty each year, on average, between 2010 and 2012.[15] Viewed another way, these credits cut California's 2011 child poverty rate by 6 percentage points, from 31.1 percent to 25.1 percent – far more than any other major public support.[16]

The EITC Produces Long-Term Benefits for Families and Children

The EITC produces various long-term benefits for families and children that also contribute to a stronger workforce. For example, a number of studies find that low-income children do better in school when their families' incomes are boosted by the federal EITC, and these gains may even result in increased high school completion and college attendance.[17] In addition, some research suggests that by boosting low-income children's academic achievement and increasing the likelihood that they attend college, the EITC may result in higher lifetime earnings.[18]

Other research suggests that the EITC improves the health and well-being of parents and children. Studies find, for example, that the expansion of the federal EITC in the 1990s was associated with improvements in the mental and physical health of low-income mothers and with reductions in low birth weight among infants.[19] These findings are significant because reducing the incidence of low birth weight has long-term benefits for children. Low birth weight is not only an indicator of poor infant health, but also is associated with an increased risk of health and developmental problems throughout childhood.[20]

PART II: THE BENEFITS OF A CALIFORNIA EITC

A California EITC Based on the Federal Credit Would Benefit Millions of Working Families Struggling to Make Ends Meet

A state EITC based on the federal credit – that is, a traditionally designed EITC – would benefit California in a number of ways. Such a credit would build on the federal credit to further reduce economic hardship among low- and moderate-income working families. In addition, a state EITC would help rebalance California's tax system by reducing the disproportionate share of income that low-income households pay in state and local taxes.

Half the States Have Created Their Own EITCs to Leverage the Benefits of the Federal Credit

Half of all states and the District of Columbia have established their own state-specific EITCs to leverage the benefits of the federal credit. Nearly all of these states base their credits on the same eligibility rules and earnings thresholds as the federal EITC, and state credits typically are set at a percentage of the federal credit, ranging from 3.5 percent in Louisiana to 40 percent in the District of Columbia.[21] A 40 percent refundable state credit, for example, means that a family receiving $2,000 from the federal EITC would receive an additional $800 from the state EITC (40 percent of $2,000). Nine states and the District of Columbia offer credits equal to 20 percent or more of the federal credit.

The vast majority of states with their own EITCs offer credits that, like the federal EITC, are fully refundable.[22] This means that families whose earnings are so low that they owe no state income tax can still receive as a refund the entire EITC for which they are eligible.

A California EITC Would Further Reduce Economic Hardship by Boosting Workers' Earnings

The federal EITC is a proven tool for reducing economic hardship, and a similarly designed California EITC would provide working families with an additional boost at a time when many are struggling to make ends meet. California workers with hourly wages in the bottom half of the earnings distribution generally experienced steeper declines in the purchasing power of their hourly wages than did higher-wage workers during the Great Recession, and they have regained little of that lost purchasing power during the economic recovery.[23] Moreover, this recent drop in purchasing power has exacerbated a more-than-three-decades-long erosion in wages. For example, California workers with wages at the 20th percentile of the distribution earned 12.2 percent less per hour in 2013 than similar workers did in 1979, after adjusting for inflation. This decline amounts to more than $3,000 in lost annual income for full-time, year-round workers. Additionally, workers earning the median wage were paid 3.9 percent less per hour in 2013 than were similar workers in 1979.[24]

A California EITC would take an important step toward increasing working families' economic security. The additional income from a state credit could help those who live paycheck to paycheck to afford basic necessities, including transportation that parents need to stay employed. A state EITC equal to 15 percent of the federal credit, for example, would have provided a single parent supporting two children on a full-time minimum wage job with up to $806 in 2013 – enough to cover the cost of nearly 11 weeks of transportation expenses or more than five weeks of groceries.[25] Alternatively, this additional boost in income could have helped cover the cost of one-time necessities, such as car maintenance and repair, which studies suggest is one of the most common uses of the federal EITC.[26]

A California EITC Would Strengthen California's Social Safety Net

A California EITC would also help low-income parents make ends meet as they transition off the California Work Opportunity and Responsibility to Kids (CalWORKs) Program, which provides modest cash assistance and job-related services to struggling

A State EITC Works Best in Combination With Continued Increases to the Minimum Wage

Creating a state EITC and boosting the minimum wage are two important strategies for helping working families and individuals to move up the economic ladder, and these policies should be thought of as complements, rather than alternatives, to each other. Together these two policies have the potential to boost financial security for low-income workers to a much greater extent than either policy could on its own.

One reason the EITC and minimum wage work best in combination is because they tend to benefit different groups of workers. The EITC primarily targets families with children, with more than 95 percent of federal EITC dollars going to families with children in 2012.[27] In contrast, minimum wage increases benefit all workers earning that wage regardless of whether they have children. This means that minimum wage policies can fill in gaps where the EITC falls short. At the same time, the EITC can reach workers who have moderate earnings that are well above the minimum wage but who live in poverty due to insufficient work hours. Consider a single parent with two children who earns $12 per hour – above the minimum wage – but works only 30 hours per week due to a lack of child care. This individual would have the same take-home pay as a full-time minimum wage worker who also supports two children on her own ($18,720 per year). This means these two workers would be eligible for the same EITC. Although both workers have pre-tax incomes just below the poverty line, the part-time worker earning $12 per hour would not directly benefit from a minimum wage increase, but she *would* benefit from a state EITC.

There are other ways that a state EITC would work in tandem with increases to California's minimum wage. For instance, some evidence suggests that because the EITC encourages more people to work, it increases the total number of workers in the job market earning low wages. Increased competition among these workers could drive down their wages, thereby offsetting some of the financial gains that workers receive through the state EITC.[28] However, regularly increasing the state's minimum wage would limit the extent to which wages at the low end of the distribution lose purchasing power.[29] Consistently raising the minimum wage is also important for maintaining the EITC's value over time for the lowest earners. As discussed earlier, the EITC is structured such that a reduction in earnings means a lower credit for workers who receive very low wages. Therefore, if the minimum wage is not continually increased to keep up with the cost of living, minimum wage workers' earnings would be gradually eroded by inflation, and lower earnings would result in a smaller, inflation-adjusted EITC.

low-income families with children. As parents work and earn more, the amount of CalWORKs cash assistance they can receive declines, eventually reaching zero. However, the earnings threshold at which parents lose eligibility for this cash assistance is very low – below the poverty line for a single parent with two children. In other words, a full-time working parent may have earnings that are too high for her to qualify for cash assistance, but too low to lift her above the poverty line.[30] A state EITC, along with the federal credit, could help boost the incomes of low-earning parents above the poverty line, helping to fill in the gap where CalWORKs falls short.

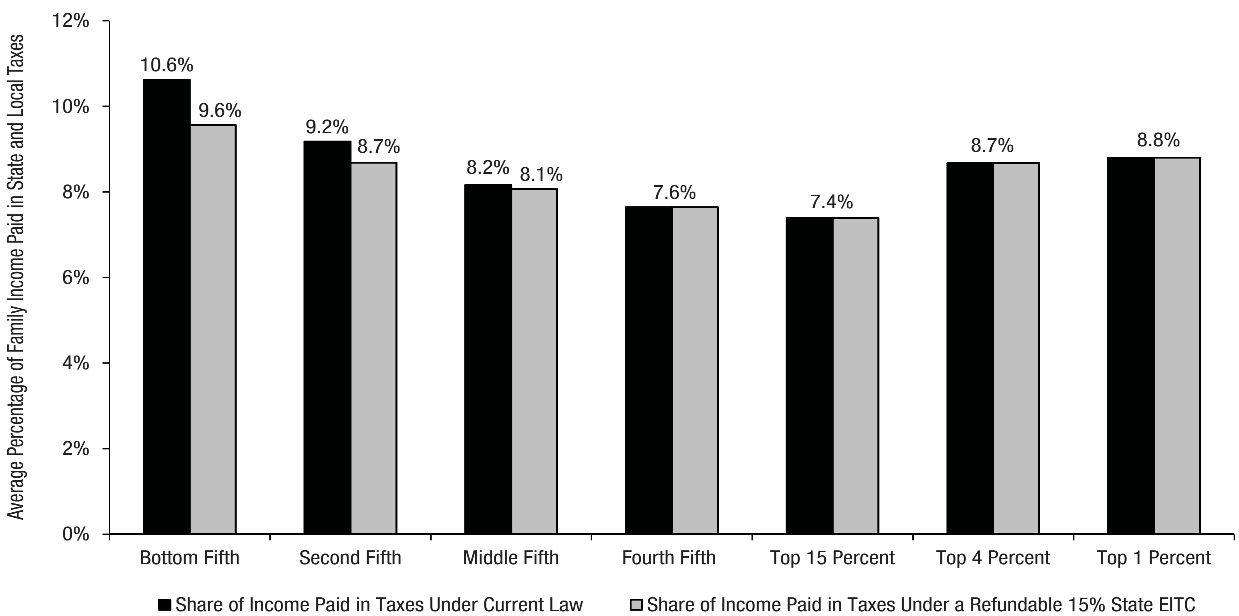
A California EITC Would Help Rebalance the State's Tax System

A state EITC would help rebalance California's tax system, which currently requires lower-earning families to pay a larger share of their annual incomes in state and local taxes, on average, than higher-income families. The bottom fifth of families, with an average annual income of $13,000, pay an estimated 10.6 percent of their incomes in state and local taxes, on average, according to an analysis by the Institute on Taxation and Economic Policy (ITEP).[31] In contrast, the wealthiest 1 percent of families, with an average annual income of $1.6 million, pay an estimated 8.8 percent of their incomes in state and local taxes, on average.[32]

A state EITC would help to offset the state and local taxes that low-income households pay, thereby making California's tax system more balanced across the income distribution. For example, if California established a refundable state EITC equal to 15 percent of the federal credit, the bottom fifth of California's families would pay 9.6 percent of their incomes in state and local taxes, on average, instead of the 10.6 percent that they currently pay (Figure 1). Low-income families would still pay a larger share of their incomes in state and local taxes than the wealthiest 1 percent of Californians – who, unaffected by the state EITC, would continue to pay 8.8 percent of their incomes in these taxes. However, the disparity between these two groups would be smaller.

A larger state EITC would reduce the inequity in California's tax system even further. For instance, if California set its state credit at 30 percent of the federal EITC, the bottom fifth of families would pay, on average, 8.5 percent of their incomes in state and local taxes – slightly less than the share paid by the wealthiest 1 percent (8.8 percent).

Figure 1: A Refundable 15 Percent State EITC Would Reduce the Share of Income That Low- and Moderate-Income Families Pay in State and Local Taxes



Note: Analysis is restricted to nonelderly families and includes the impact of Proposition 30 temporary tax rates as well as an offset for federal deductibility of state and local taxes.
Source: Institute on Taxation and Economic Policy

PART III: HOW SHOULD A CALIFORNIA EITC BE STRUCTURED?

California has many options in designing a state EITC, the exact structure of which will determine the credit's impact both in supporting working families and in rebalancing California's tax system. Policymakers could adopt the "traditional design" used by most of the states that have a state credit, which sets the state EITC as a percentage of the federal credit and maintains the same eligibility requirements. Alternatively, policymakers could consider nontraditional designs intended allocate more dollars to specific groups of Californians. For example, the state could provide additional benefits to workers without children or target all of the benefits of a state credit to working families with young children. Additionally, policymakers would need to determine how large a credit to provide, recognizing that a larger credit would provide a larger financial boost to low- and moderate-income Californians, but would reduce state personal income tax revenues to a greater extent.

A State EITC Must Be Refundable in Order to Help Working Families

A critical issue in designing a California EITC is whether to make it refundable like the federal credit and the vast majority of state EITCs. Refundable tax credits provide benefits to households even if they do not owe any income tax; if the credit for which households are eligible is larger than the amount of income taxes they owe, they receive the difference as a tax refund. Nonrefundable tax credits, on the other hand – such as California's child and dependent care tax credit – provide benefits only up to the amount of income taxes owed.

Creating a state EITC that is refundable is especially important in California. This is because many low-income working households pay no state income tax but pay a substantial share of their income in other taxes, such as sales and property taxes. A refundable credit would help to offset those taxes and let low-income working families keep more of what they earn.

Refundability of the credit is central to its broad reach and poverty-reduction power. If California established a traditionally designed, refundable state EITC equal to 15 percent of the federal EITC, more than two out of five households in the bottom fifth of the income distribution (42.8 percent) would receive the credit, compared to just 0.2 percent of these households if the credit were nonrefundable, according to ITEP (Figure 2).[33] In fact, the nonrefundable credit would reach just 0.3 percent of *all California taxpayers,* while the refundable credit would reach almost one-fifth of all taxpayers (19.2 percent).

A refundable state EITC would also provide the lowest-income Californians with substantially larger credits than would a nonrefundable state EITC. Working households in the bottom fifth of the income distribution would receive an average credit of $321 from a refundable state EITC set at 15 percent of the federal credit. This is more than 15 times the average credit they would receive if the state EITC were not refundable ($21).

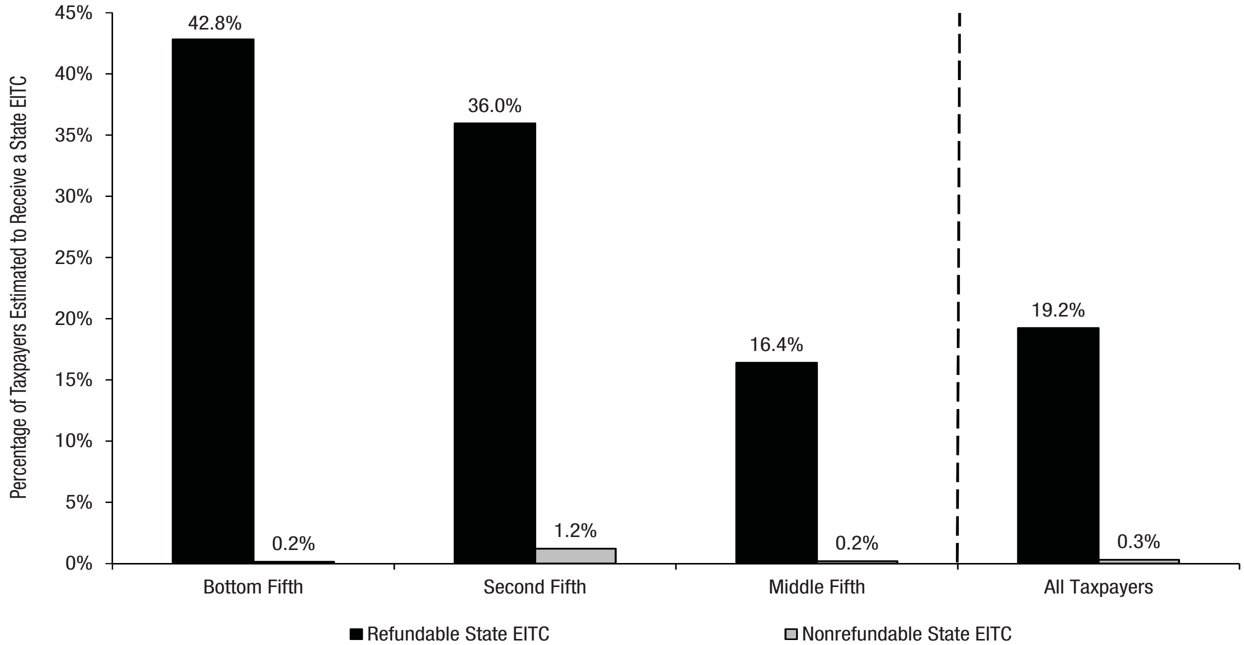
A Traditionally Designed State EITC Would Benefit Millions of Californians, Primarily Families With Children

A traditionally designed, refundable state EITC has a number of advantages. First, while targeted to working families with low and moderate incomes, it would still have broad reach. Given that more than 3 million of the state's households claim the federal EITC, at least this many would benefit from a traditionally designed, refundable California credit, and potentially more since not all eligible workers claim the federal credit.[34] In other words, a traditionally designed state EITC has the potential to help millions of Californians make ends meet.

Families with children would disproportionately benefit under this model. For example, while just 7.1 percent of adults without children would receive benefits if California created a traditionally designed, refundable 15 percent state credit, more than one-third of families with children (35.7 percent) would, according to ITEP (Table 2).[35] An even larger share of families with children age 5 or under would benefit (40.8 percent). Additionally, families with children would receive larger state credits, on average, than taxpayers without children. For instance, those in the bottom fifth of the income distribution would receive a credit of $481, on average – well above the average credit that low-income adults without children would receive ($61).[36]

Another advantage of basing a state EITC on the federal credit is greater simplicity for both taxpayers and tax administrators. A traditionally designed state credit would require adding just one line on state tax forms – a change that would likely incur little administrative cost. In addition, claiming the credit would be straightforward. Californians who are eligible for the federal EITC would simply multiply their federal credit by the specified percentage to determine their state credit.

Figure 2: A Nonrefundable State EITC Would Reach Very Few Californians



Note: Analysis compares a refundable and nonrefundable state EITC equal to 15 percent of the federal EITC. Analysis is restricted to nonelderly families and includes the impact of Proposition 30 temporary tax rates as well as an offset for federal deductibility of state and local taxes.
Source: Institute on Taxation and Economic Policy

Setting a State EITC as a Higher Percentage of the Federal Credit Would Provide Larger Benefits, But Would Cost More

Policymakers have flexibility in determining the size of a state EITC, and setting it as a larger percentage of the federal credit would provide greater benefits to California families. For example, a traditionally designed, refundable state EITC equal to 5 percent of the federal credit would provide a single parent with two children a maximum benefit of $273 in 2014 (Table 3). Tripling this state credit to 15 percent of the federal EITC would bring the maximum credit to $819. Setting the state EITC even higher – at 30 percent of the federal credit – would allow this family to receive a maximum credit of $1,638.

Although a larger state EITC would provide greater benefits, it would also reduce state personal income tax revenues by a larger amount. A traditionally designed, refundable 15 percent state credit would cost an estimated $1 billion in 2014 – approximately 1 percent of total state General Fund revenues. A refundable *30 percent* state credit would cost around $2.1 billion, or about 2 percent of General Fund revenues.[37]

Table 2: A Traditionally Designed, Refundable 15 Percent State EITC Would Provide a Larger Tax Credit to Families With Children

Taxpayer Type	Percentage of all Taxpayers Receiving Tax Credit	Average Tax Credit for Taxpayers in the Bottom Fifth of the Income Distribution
All	19.2%	$321
Families With At Least One Qualifying Child	35.7%	$481
Families With At Least One Qualifying Child Age 5 or Under	40.8%	$486
Adults Without Qualifying Children	7.1%	$61

Note: A traditionally designed state EITC is one that is set as a percentage of the federal credit and maintains the same eligibility requirements. "Qualifying children" must meet certain age, relationship, residency, and other requirements. "Adults without qualifying children" includes taxpayers who have children, but whose children do not meet these requirements. This analysis incorporates California's participation rate – 71 percent – for the federal EITC in 2010, the most recent year for which Internal Revenue Service estimates are available.
Source: Institute on Taxation and Economic Policy

Table 3: Setting a Traditionally Designed, Refundable State EITC at a Higher Percentage of the Federal EITC Would Provide Greater Benefits to California Families						
Number of Qualifying Children	Maximum State EITC at Different Percentages of 2014 Maximum Federal EITC					
	5 Percent	10 Percent	15 Percent	20 Percent	25 Percent	30 Percent
No Children	$25	$50	$74	$99	$124	$149
One Child	$165	$331	$496	$661	$826	$992
Two Children	$273	$546	$819	$1,092	$1,365	$1,638
Three or More Children	$307	$614	$921	$1,229	$1,536	$1,843

Note: A traditionally designed state EITC is one that is set as a percentage of the federal credit and maintains the same eligibility requirements. “Qualifying children” must meet certain age, relationship, residency, and other requirements.
Source: CBP analysis of Internal Revenue Service data

Policymakers Could Target the Benefits of a State EITC to Certain Groups of Californians

Implementing a traditionally designed, refundable state EITC would benefit millions of low- and moderate-income Californians and would rebalance California’s tax system. Nonetheless, policymakers could modify the traditional design. For example, they could build on the standard EITC model by providing a larger state credit to some workers or limit eligibility for a state credit to certain types of families, as a few states have done.[38] Policymakers would need to weigh the advantages of these types of modifications against potential drawbacks, which could include increased administrative complexity, larger costs to the state, or the exclusion of some workers who would otherwise be eligible for a credit under a traditionally designed state EITC.

Two alternative state EITC designs – which target different groups of workers in different ways – are discussed below. These two examples of design options are meant to illustrate the different strategies that policymakers could use to change the traditional state EITC to achieve desired public policy outcomes.

California Could Provide a Larger State EITC to Childless Workers

One state option is to expand a traditionally designed EITC to better reach workers who do not have children and provide these childless adults with larger benefits. As discussed earlier, childless adults are less likely to be eligible for the federal EITC, and those who are eligible receive an average credit that is less than one-tenth the average credit received by families with children.[39] In addition, low-income adults without children often do not qualify for assistance from other public supports that could help supplement their wages, or they may qualify for only limited benefits.[40] Moreover, men who work in low-wage jobs, and who would be expected to account for a disproportionate share of childless workers, have seen their earnings erode substantially in recent decades and therefore stand to benefit greatly from a more robust state EITC.[41]

State policymakers have a number of options for increasing the benefits of a state EITC for adults without children. The simplest approach would be to set the state credit for these workers at a larger percentage of the federal credit. For example, if California created a 45 percent state EITC for childless adults and a 15 percent state EITC for families, then adults without children could receive a maximum state credit of $223 – almost half the maximum state credit for adults with one child (Table 4). Raising the state credit for childless adults even higher, while maintaining a 15 percent credit for families, would bring the maximum benefit for childless adults even closer to the benefit for adults with children.

State policymakers could also consider changing the earnings thresholds for childless adults so that more of these workers would qualify for a state EITC. As described earlier, the *federal* EITC phases out after a worker’s earnings reach a certain threshold. This threshold – and the *rate* at which the federal credit phases out – determine the maximum earnings that a worker can have while remaining eligible for a credit. Currently, unmarried childless workers only receive a federal credit if their earnings are below $14,590. This earnings limit falls far short of what a single

Table 4: California Could Increase the State EITC for Adults Without Children to Bring It Closer to the Credit for Families With Children	
State EITC as a Percentage of 2014 Federal EITC	Maximum State Credit
Adults Without Qualifying Children	
15%	$74
30%	$149
45%	$223
60%	$298
Adults With One Qualifying Child	
15%	$496

Note: “Qualifying children” must meet certain age, relationship, residency, and other requirements. “Adults without qualifying children” includes taxpayers who have children, but whose children do not meet these requirements.
Source: CBP analysis of Internal Revenue Service data

adult needs to achieve a modest standard of living in California.[42] Yet, a traditionally designed *state* EITC would follow the same eligibility rules as the federal credit, resulting in the same low earnings threshold. In order to reach more childless adults, state policymakers could change the eligibility rules to boost the earnings threshold for a state credit – for instance, to $18,720, the annual earnings of a full-time minimum wage worker.

Expanding a traditionally designed state EITC to reach more childless workers or allow them to receive a larger credit would provide an economic boost to a group of workers who are often excluded from other social programs. However, this approach would have a number of drawbacks compared to a traditional design. First, it would increase the cost of a state EITC since it would expand on the traditional state EITC model. Second, higher earnings thresholds for adults without children would decouple their state credit from the federal credit, making it more complex to determine eligibility for both the federal and state credits. Third, administering such a credit could be more challenging than implementing a traditionally designed credit.

California Could Target a State EITC to Low- and Moderate-Income Working Families With Young Children

Another option is to *limit* eligibility for a state EITC to certain types of working families, while increasing the size of the credit that those families may receive. For instance, California policymakers could target the credit in a way that might provide the greatest long-term benefit to low-income children. Specifically, California could restrict eligibility for a state EITC to working families with at least one child age 5 or under – an age range during which poverty is potentially most detrimental and interventions to reduce poverty appear more likely to produce a long-term payoff.[43] Research suggests that boosting the incomes of low-income families when their children are young is most likely to improve children's academic achievement and earnings prospects as adults.[44] One highly regarded study, for example, found that a $3,000 boost in annual earnings for a low-income family – with an average income of less than $25,000 – was associated with a 17 percent increase in adult earnings for the children in that family.[45]

A state EITC targeted to low- and moderate-income working families with young children would allow California to provide a much larger credit than would a traditionally designed state EITC, which would be available to all those who claim the federal credit. For example, for approximately the same cost as a traditionally designed, refundable *15 percent* credit, California could provide a *35 percent* refundable state credit to low- and moderate-income families with at least one child age 5 or under.[46] A credit of this size would provide a significant income boost to eligible families. Those with incomes in the bottom fifth of the distribution would receive an average state credit of $1,045 – more than three times the average credit that they would receive from a traditionally designed 15 percent EITC ($321) (Table 5). A $1,045 state credit could cover the cost of 10 weeks of child care for an infant.[47] A state EITC targeted to families with young children would also provide sizeable benefits to moderate-income families: an average of $956 for those in the second fifth of the distribution and an average of $651 for those in the middle fifth.

Limiting a state EITC to families with young children would mean a substantial investment in the economic future of many low-income Californians. However, narrowing the reach of a state EITC also would have a number of drawbacks. For example, far fewer low- and moderate-income Californians would benefit overall. If a state EITC were limited to families with children 5 or younger, only 7.8 percent of all California taxpayers would receive the credit, compared to 19.2 percent of taxpayers under a traditionally designed state EITC. This difference would be even greater among the lowest-income households. Just 12.2 percent of taxpayers in the bottom fifth would receive a credit from a targeted state EITC, compared to 42.8 percent under a traditional design. Moreover, narrowing eligibility for a state EITC only to families with young children would limit the EITC's effectiveness at rebalancing California's tax system.

Table 5: A 35 Percent Refundable State EITC Targeted to Families With Young Children Would Provide Larger Credits Than a Traditionally Designed 15 Percent Refundable State EITC

	EITC Targeted to Families With Children Age 5 and Under	Traditionally Designed EITC
Income Group	Average Credit	
Bottom Fifth	$1,045	$321
Second Fifth	$956	$397
Middle Fifth	$651	$257
	Percentage of Taxpayers Receiving a Credit	
Bottom Fifth	12.2%	42.8%
Second Fifth	16.9%	36.0%
Middle Fifth	12.2%	16.4%

Note: A traditionally designed state EITC is one that is set as a percentage of the federal credit and maintains the same eligibility requirements. This analysis incorporates California's participation rate – 71 percent – for the federal EITC in 2010, the most recent year for which Internal Revenue Service estimates are available.
Source: Institute on Taxation and Economic Policy

Another potential drawback of a targeted state EITC is that it would likely be more challenging to administer and claim compared to a traditionally designed credit since it would not be linked to the federal credit. Families would have to follow a more complicated set of instructions for claiming the federal and state EITCs because the eligibility rules for each would differ.

PART IV: ISSUES TO CONSIDER IN IMPLEMENTING A STATE EITC

California Could Implement Measures to Increase the Share of Working Families Who Benefit From a State EITC

The share of eligible Californians who claim a newly created state EITC could be low at first, given that workers with very low incomes are not required to file state income tax returns. Moreover, many eligible Californians do not claim the *federal* EITC, which suggests that many households are currently unaware that this benefit is available to them. If California establishes a state EITC, policymakers should consider adopting measures to help all eligible families and individuals learn about the new credit. For example, policymakers could:

- Require employers to notify employees of their potential eligibility for the state EITC – a requirement that currently applies to the federal EITC;[48]
- Launch a public information campaign to increase awareness of the state EITC;
- Expand free tax preparation services for low-income working families, as a number of states have done;[49] or
- Encourage counties to provide information about the federal and state EITCs when Californians apply for other public benefits, such as CalWORKs.

Extending the credit's reach would broaden its impact, reducing economic hardship among a larger number of families and individuals. Additionally, increasing the share of eligible Californians who participate in a state EITC could also lead to more eligible Californians claiming the *federal* credit, which would result in an even larger boost in economic security for low- and middle-income families in California. Also, this boost in federal EITC use would be supported by federal dollars instead of state dollars, making it a cost-effective way to provide extra support to California families.

How Could California Offset the Cost of a State EITC?

California spends billions of dollars each year through the tax code in the form of foregone revenues. These "tax expenditures" – which include various exemptions, deductions, and credits – receive far less scrutiny than spending that happens through the state budget. While some tax expenditures are worthwhile, others are of questionable merit and should be revisited, potentially presenting ways of offsetting – at least in part – the cost of a state EITC. For example, California policymakers could offset some of the cost of a state EITC by:

- **Scaling back or eliminating costly or ineffective tax expenditures, such as tax credits that target specific businesses or industries.** Such credits are generally "inappropriate public policy," according to the Legislative Analyst's Office (LAO), because "they (1) give an unequal advantage to some businesses at the expense of others and (2) promote unhealthy competition among states."[50] Moreover, research shows that tax incentives intended to encourage businesses to create jobs in a particular state, either by expanding in or relocating to that state, typically fail to do so.[51]

  California's recently expanded film tax credit, which will reduce state revenues by up to $330 million each year between 2015-16 and 2019-20, is a prime example of a business tax incentive that state policymakers could scale back or eliminate in order to offset some of the cost of providing a state EITC.[52] Similar credits in other states have been ineffective at maintaining or increasing film production, and it is unlikely that California's expanded tax credit would do so either, particularly given that recent declines in film production jobs appear to be partly driven by technology changes and international competition.[53]

- **Evaluating the state's new California Competes Tax Credit to determine whether it is an appropriate use of state revenues.** This credit, established through the 2013-14 budget, will provide $200 million in tax credits to businesses each year between 2015-16 and 2018-19 in exchange for investments and employment expansion in California. If early evaluations of this credit show that it fails to spur overall job creation, then these dollars would be better spent on a state EITC, a policy option that could boost the employment of low-income workers by rewarding work.

- **Reducing or eliminating tax expenditures that disproportionately benefit the state's wealthiest**

residents. For example, California could save tens of millions of dollars each year by limiting the state's mortgage interest deduction to owners' primary residences. In essence, this policy would shift state resources currently being used to reduce the cost of vacation homes and boats to boost the incomes of low- and moderate-income working families.

CONCLUSION AND KEY POLICY CONSIDERATIONS

Decades of research have shown that the federal EITC is one of the most effective tools for reducing poverty and expanding economic opportunities for individuals and families. Given the success of the federal EITC, California should consider establishing a state version to supplement the federal credit, as 25 other states have done. A traditionally designed, refundable California EITC would reduce economic hardship for millions of families while also rebalancing California's tax system, which now requires low-income families to pay a larger share of their incomes in taxes than high-income families. Alternative state EITC designs – such as expanding the traditionally designed credit to better reach childless workers or narrowing the traditional credit to focus only on families with young children – could also merit consideration.

As this report explains, policymakers have many options in designing a state EITC, and the Institute on Taxation and Economic Policy analyses presented throughout this report indicate how various policy options would impact California's low- and moderate-income taxpayers. In particular, this report suggests that policymakers consider these key issues:

- **A state EITC must be refundable in order to help working families, and a larger state credit would do far more to reduce economic hardship.** However, refundable and larger credits would reduce state revenues to a greater extent than nonrefundable and smaller credits would, raising the overall cost to the state.
- **A traditionally designed state EITC – the simplest model – would reach millions of Californians and rebalance California's system of state and local taxes.** A traditionally designed, refundable state EITC – which is set as a percentage of the federal EITC – would be easier for the state to administer and simpler for families to claim compared with nontraditional designs.
- **Alternative state EITC designs could target the benefits of the state credit to specific groups of Californians, but involve certain trade-offs.** For example, California could build on the standard EITC model by providing a larger credit to workers without children – a group that currently receives just a fraction of federal EITC benefits. Trade-offs of such an approach would be include increased costs and administrative complexity. Alternatively, California could limit eligibility for a state credit to families with young children – those age 5 and under – in order to make larger investments in children at a critical stage in their development. This policy, by narrowly restricting eligibility, would mean additional administrative complexity and a credit that reaches fewer Californians.
- **California could scale back or eliminate costly or ineffective tax expenditures to help offset the cost of an EITC.** The state could reduce or eliminate tax expenditures that target specific businesses or industries or disproportionately benefit the state's wealthiest residents.

The policy choices California makes today can lay the groundwork for a more prosperous future. By choosing to invest in policies, like a state EITC, that foster the well-being of millions of individuals and families, policymakers can strengthen the state's communities and economy, helping to ensure a more vibrant future for all Californians.

Alissa Anderson and Luke Reidenbach prepared this Budget Brief*. The CBP was established in 1995 to provide Californians with a source of timely, objective, and accessible expertise on state fiscal and economic policy issues. The CBP engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low- and middle-income Californians. Support for the CBP is provided by foundation grants, subscriptions, and individual contributions. Please visit the CBP's website at www.cbp.org.*

ENDNOTES

1 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* 39:5 (2011), pp. 619-652.

2 Internal Revenue Service. The most recent estimate produced by the federal government indicates that 71 percent of eligible California taxpayers claimed the federal EITC in 2010.

3 Andrew Goodman-Bacon and Leslie McGranahan, "How Do EITC Recipients Spend Their Refunds?" *Economic Perspectives* (Federal Reserve Bank of Chicago: Second Quarter 2008) and Timothy M. Smeeding, Katherin Ross Phillips, and Michael O'Connor, "The EITC: Expectation, Knowledge, Use, and Economic and Social Mobility," *National Tax Journal* 53:4 (2000), pp. 1187-1210.

[4] Tax Policy Center, "Earned Income Tax Credit Parameters, 1975-2014," downloaded from http://www.taxpolicycenter.org/taxfacts/Content/PDF/historical_eitc_parameters.pdf on September 17, 2014.

[5] In 2012, for instance, more than 95 percent of federal EITC spending went to low- and moderate-income families with children. Internal Revenue Service, *Table 2.5 – Returns with Earned Income Credit, by Size of Adjusted Gross Income, Tax Year 2012*. Workers younger than 25 or older than 64 are not eligible for the federal EITC.

[6] For taxpayers to qualify for the federal EITC for families, their children must meet certain age, relationship, residency, and other requirements. For example, children must be under age 19, or be a full-time student under age 24, or be "permanently and totally" disabled. Unless otherwise specified, "families with children" means families with children who qualify under federal EITC eligibility requirements and "adults without children" means adults who do not have children who qualify under these requirements. In other words, "adults without children" includes adults who have children, but whose children do not meet the federal EITC eligibility requirements. "Earnings" includes taxable earnings from wages and salaries, self-employment income, and certain disability payments.

[7] The size of the credit does not vary based on marital status. Credit amounts and earnings thresholds are adjusted annually for inflation. Unless otherwise noted, "married" refers to taxpayers who file joint income tax returns, while "single" refers to taxpayers who file as single, head of household, or qualifying widower. Taxpayers whose filing status is "married, filing separately" are not eligible to claim the federal EITC.

[8] The American Recovery and Reinvestment Act of 2009 temporarily provided a larger EITC for families with three or more children. This provision was extended through 2017 by the 2012 Taxpayer Relief Act.

[9] Although in theory the EITC would also be expected to cause some workers to work fewer hours as the credit phases out, there is no strong evidence that this occurs in practice. This lack of strong evidence may reflect workers' limited ability to adjust their work hours or their lack of understanding of how the EITC works. Additionally, some research shows that another impact of the federal EITC's work incentive is an increase in the overall supply of workers, which could reduce earnings for some low-income workers. This downward wage pressure disproportionately affects childless workers because they receive a smaller credit that is less effective at offsetting any reduction in wages. See Andrew Leigh, *Who Benefits From the Earned Income Tax Credit? Incidence Among Recipients, Coworkers and Firms,* Institute for the Study of Labor Working Paper No. 4960 (May 2010).

[10] Bruce D. Meyer and Dan T. Rosenbaum, "Welfare, the Earned Income Tax Credit, and the Labor Supply of Single Mothers," *The Quarterly Journal of Economics* 116:3 (2001), pp. 1063-1114. This study examined the impact of the EITC on employment between 1984 and 1996. The "other tax changes" included an increase in the personal exemption in 1987 and an increase in the standard deduction for heads of households in 1988. However, the study's authors note that the EITC played the dominant role in boosting single mothers' employment.

[11] Jeffrey Grogger, "The Effects of Time Limits, the EITC, and Other Policy Changes on Welfare Use, Work, and Income Among Female-Headed Families," *Review of Economics and Statistics* 85:2 (2003), pp. 394-408. This study examined the impact of the EITC on employment between 1993 and 1999. Numerous other studies have similarly documented the significant role of the EITC in boosting employment.

[12] V. Joseph Hotz, Charles H. Mullin, and John Karl Scholz, *Examining the Effect of the Earned Income Tax Credit on the Labor Market Participation of Families on Welfare,* National Bureau of Economic Research Working Paper No. 11968 (December 2005). Specifically, this study examined employment among California women who received cash assistance at some point between 1987 and 2000 and found that more than three-quarters of the employment gains between 1991 and 2000 for women with multiple children relative to those with only one child was attributable to the expansion of the EITC.

[13] Chuck Mar, Chye-Ching Huang, and Arloc Sherman, *Earned Income Tax Credit Promotes Work, Encourages Children's Success at School, Research Finds: For Children, Research Indicates That Work, Income, and Health Benefits Extend Into Adulthood* (Center on Budget and Policy Priorities: April 15, 2014).

[14] Center on Budget and Policy Priorities, *Policy Basics: The Earned Income Tax Credit* (Updated January 31, 2014). These estimates are based on the US Census Bureau's Supplemental Poverty Measure.

[15] Center on Budget and Policy Priorities, *California Fact Sheet: Tax Credits Promote Work and Fight Poverty* (March 5, 2014). The federal Child Tax Credit provides a credit up to $1,000 for each dependent child under age 17. Unlike the EITC, the Child Tax Credit is not restricted to low- and moderate-income families. See Chuck Mar, Chye-Ching Huang, and Arloc Sherman, *Earned Income Tax Credit Promotes Work, Encourages Children's Success at School, Research Finds: For Children, Research Indicates That Work, Income, and Health Benefits Extend Into Adulthood* (Center on Budget and Policy Priorities: April 15, 2014).

[16] Sarah Bohn, et al., *The California Poverty Measure: A New Look at the Social Safety Net* (Public Policy Institute of California: October 2013). This analysis is based on the California Poverty Measure (CPM), an alternative and more accurate measure of poverty. The CPM better accounts for the cost of basic necessities and factors in a broader array of economic resources available to families and individuals than does the official poverty measure produced by the US Census Bureau. The Child Tax Credit is partially refundable, but this CPM analysis examined only the impact of the refundable portion of the credit.

[17] See, for example, Gordon B. Dahl and Lance Lochner, "The Impact of Family Income on Child Achievement: Evidence From the Earned Income Tax Credit" *American Economic Review* 102:5 (2012), pp. 1927–1956. This study linked the expansions to the federal EITC in the late 1980s and 1990s to significant gains in low-income children's math and reading achievement. Specifically, the study found that the median EITC for eligible families with two children increased by $1,670 (in 2000 dollars) between 1987 and 1999, implying an average test score increase of 10 percent of a standard deviation for the children in these families. Other studies that have linked the EITC to gains in children's academic achievement estimate that these gains increase the probability that children graduate from high school or receive a GED and attend college. See, for example, Michelle Maxfield, *The Effects of the Earned Income Tax Credit on Child Achievement and Long-Term Educational Attainment,* Michigan State University Job Market Paper (November 14, 2013) and Raj Chetty, John N. Friedman, and Jonah Rockoff, *New Evidence on the Long-Term Impacts of Tax Credits,* Statistics of Income Paper Series (Internal Revenue Service: November 2011).

[18] Raj Chetty, John N. Friedman, and Jonah Rockoff, *New Evidence on the Long-Term Impacts of Tax Credits, Statistics of Income Paper Series* (Internal Revenue Service: November 2011).

[19] Hilary W. Hoynes, Douglas L. Miller, and David Simon, *Income, the Earned Income Tax Credit, and Infant Health,* National Bureau of Economic Research Working Paper No. 18206 (July 2012) and William N. Evans and Craig L. Garthwaite, *Giving Mom a Break: The Impact of Higher EITC Payments on Maternal Health,* National Bureau of Economic Research Working Paper No. 16296 (August 2010).

[20] See, for example, Jeanne Brooks-Gunn and Greg J. Duncan, "The Effects of Poverty on Children," *The Future of Children* 7:2 (Summer/Fall 1997), pp. 57 and 60.

[21] Erica Williams and Michael Leachman, *States Can Adopt or Expand Earned Income Tax Credits to Build a Stronger Future Economy* (Center on Budget and Policy Priorities: January 30, 2014).

[22] Erica Williams and Michael Leachman, *States Can Adopt or Expand Earned Income Tax Credits to Build a Stronger Future Economy* (Center on Budget and Policy Priorities: January 30, 2014). By 2015, 22 of the 25 states that offer a state EITC will provide refundable state EITCs. Taxpayers in Maryland can choose between a refundable state EITC or a non-refundable EITC set at 50 percent of the federal credit. Ohio's EITC is limited to half of income taxes owed on income above $20,000.

23 The inflation-adjusted hourly wage of workers with earnings at the 20th percentile of the distribution declined by 5.9 percent between 2006 and 2011, then rose by just 0.6 percent between 2011 and 2013. In addition, the inflation-adjusted hourly wage of workers earning the median wage declined by 4.5 percent between 2006 and 2011 and by another 0.6 percent between 2011 and 2013. See California Budget Project, *Where Is the Wage Growth?* (May 2014) for additional information on wage trends in California.

24 The long-term erosion in the purchasing power of low- and mid-wage workers' earnings reflects changes in the job market such as the diminishing share of the workforce represented by labor unions and the deterioration in the purchasing power of the state's minimum wage.

25 A full-time, year-round worker with two children earning the minimum wage in 2013 would have had annual earnings of $16,640 and would have been eligible for the maximum federal EITC of $5,372. Estimates of the cost of transportation and food are from California Budget Project, *Making Ends Meet: How Much Does It Cost to Raise a Family in California?* (December 2013).

26 Andrew Goodman-Bacon and Leslie McGranahan, "How Do EITC Recipients Spend Their Refunds?" *Economic Perspectives* (Federal Reserve Bank of Chicago: Second Quarter 2008).

27 Internal Revenue Service, *Table 2.5 – Returns with Earned Income Credit, by Size of Adjusted Gross Income, Tax Year 2012.*

28 In other words, some of the benefit of an EITC may go to employers rather than to workers. See Jesse Rothstein, *Is the EITC Equivalent to an NIT? Conditional Cash Transfers and Tax Incidence,* National Bureau of Economic Research Working Paper No. 14966 (May 2009). However, the evidence for this effect is mixed. See Steve Holt, *The Earned Income Tax Credit at Age 30: What We Know* (The Brookings Institution: February 2006), p. 15.

29 Maintaining a steady wage floor is particularly important given that some low-wage workers, such as those younger than 25 or older than 64, are not eligible for the EITC. These workers could face lower wages if the EITC increases competition among low-wage workers and they would not be able to benefit from the EITC, which otherwise might help offset their lower wages.

30 The jobs that CalWORKs parents typically find tend to pay at or only slightly above the minimum wage. California Budget Project, *Moving Beyond Welfare: What Do We Know About Former CalWORKs Recipients?* (December 2003) and Nicolas Johnson and Erica Williams, *A Hand Up: How State Earned Income Tax Credits Help Working Families Escape Poverty in 2011* (Center on Budget and Policy Priorities: April 2011).

31 ITEP used its Microsimulation Tax Model to develop many of the estimates in this report. This model is capable of calculating the impact of tax code changes – such as the implementation of a state EITC – on taxpayers and on revenues. Moreover, this model provides estimates of the impact of tax code changes on taxpayers at different income levels, making it a useful tool for assessing the potential impact of a state EITC on low-income households. The ITEP estimates in this report apply current tax rates, including the temporary rate changes under Proposition 30, to 2010 income levels. (Proposition 30 – approved by California voters in 2012 – increased state personal income tax rates for high-income taxpayers for tax years 2012 through 2018 and raised the state's sales tax rate by one-quarter cent between January 1, 2013 and December 31, 2016.) ITEP's estimates also account for the federal deductibility of state and local taxes and are for nonelderly taxpayers only, which includes singles and couples, with and without qualifying children, who are under the age 65. "Qualifying children" are children who qualify under federal EITC eligibility requirements. In addition, ITEP's estimates of the impact of a state EITC assume that some eligible California taxpayers would not claim such a credit. Specifically, the ITEP Microsimulation Tax Model incorporates California's participation rate – 71 percent – for the federal EITC in 2010, the most recent year for which Internal Revenue Service estimates are available. For more information on the methodology behind the ITEP Microsimulation Tax Model, see http://www.itep.org/about/itep_tax_model_full.php.

32 The imbalance of California's state and local tax system is a function of the types of taxes that Californians pay and how these taxes affect families across the income spectrum. While the state's income tax and corporate tax are progressive – meaning that Californians at higher incomes pay a larger share of their incomes in those taxes – other state and local taxes, including sales and excise taxes as well as property taxes, are regressive and disproportionately impact households with low incomes.

33 Institute on Taxation and Economic Policy.

34 In 2010, an estimated 71 percent of California tax filers who were eligible for the federal EITC actually claimed it, according to the Internal Revenue Service.

35 In this analysis, "families with children" means families with children who qualify under federal EITC eligibility requirements and "adults without children" means adults who do not have children who qualify under these requirements. In other words, "adults without children" includes adults who have children, but whose children do not meet the federal EITC eligibility requirements.

36 Income distribution segments are for each population analyzed. For example, the bottom fifth of the income distribution for adults without children reflects the bottom fifth of the income distribution for just adults without children, whereas the bottom fifth for all taxpayers reflects the bottom fifth of the income distribution among all taxpayers.

37 Institute on Taxation and Economic Policy.

38 The District of Columbia, for example, recently approved a modification to its EITC to provide a larger benefit to low-income adults without children because the federal credit provides limited support to such workers. Beginning in 2015, the DC EITC for low-income workers without children will be set at 100 percent of the federal credit for single adults with incomes up to 150 percent of the federal poverty line – compared to 40 percent for other families. The credit amount will gradually decline as workers' income goes up, phasing out entirely when income reaches twice the poverty line. New York City has also begun to pilot its own version of an enhanced EITC for childless workers called Paycheck Plus. See Rachel Pardoe and Dan Bloom, *Paycheck Plus: A New Antipoverty Strategy for Single Adults* (MDRC: May 2014). Wisconsin, on the other hand, provides no credit for low-income workers without children and instead provides a larger credit for working families with multiple children. Wisconsin's EITC equals 34 percent of the federal credit for families with three children, 11 percent of the federal credit for families with two children, and 4 percent of the federal credit for families with one child.

39 Chuck Marr and Chye-Ching Huang, *Strengthening the EITC for Childless Workers Would Promote Work and Reduce Poverty* (Center on Budget and Policy Priorities: Updated July 30, 2014). "Childless adults" refers to those without dependent children. In other words, adults who are parents, but who do not have custody of their children, are considered "childless adults." Research indicates that childless workers are more affected by the wage effects of the federal EITC. Specifically, the increase in the labor supply can lead to downward wage pressures, but the federal credit for childless workers is too small to offset this reduction in earnings. See Andrew Leigh, *Who Benefits From the Earned Income Tax Credit? Incidence Among Recipients, Coworkers, and Firms,* Institute for the Study of Labor Working Paper 4960 (May 2010).

40 For example, adults without children are not eligible to receive CalWORKs cash assistance or job-related services. In addition, those ages 18 to 49 who are "able-bodied" can only receive CalFresh food assistance for three months in a 36-month period unless they work or participate in certain work-related activities for at least 20 hours per week. However, states can receive a waiver of this requirement at times of high unemployment.

[41] California men with hourly wages at the 20th percentile of the wage distribution earned 27.2 percent less per hour in 2013 than did similar men in 1979, after adjusting for inflation – amounting to a loss of around $8,700 in annual income for full-time, year-round workers. CBP analysis of US Census Bureau, Current Population Survey data.

[42] A single adult in California needs to earn an estimated $32,625 per year to cover the cost of basic expenses, such as housing, food, and transportation. California Budget Project, *Making Ends Meet: How Much Does It Cost to Raise a Family in California?* (December 2013).

[43] Research suggesting that poverty is potentially most detrimental to young children includes: Eric I. Knudsen, et al., "Economic, Neurobiological, and Behavioral Perspectives on Building America's Future Workforce," *Proceedings of the National Academy of Sciences of the United States of America* 103:27 (2006); Jack P. Shonkoff, et al., "The Lifelong Effects of Early Childhood Adversity and Toxic Stress" *Pediatrics* 129:1 (2012); Katherine Magnuson, "Reducing the Effects of Poverty Through Early Childhood Interventions," *Fast Focus* 17-2013 (Institute for Research on Poverty: August 2013); and National Scientific Council on the Developing Child, *Excessive Stress Disrupts the Architecture of the Developing Brain,* Working Paper 3 (2014). Research suggesting that interventions to reduce poverty may be more likely to produce a long-term payoff includes: Greg J. Duncan, Kathleen M. Ziol-Guest, and Ariel Kalil, "Early Childhood Poverty and Adult Attainment, Behavior and Health" *Child Development* 81:1 (2010), pp. 306-325; Greg J. Duncan and Jeanne Brooks-Gunn, "Income Effects Across the Life Span: Integration and Interpretation," in *Consequences of Growing Up Poor,* Greg J. Duncan and Jeanne Brooks-Gunn, Eds. (New York: Russell Sage Foundation, 1997); and James J. Heckman, et al. "The Rate of Return to the High/Scope Perry Preschool Program," *Journal of Public Economics* 94:1-2 (2010), pp. 114-128.

[44] Greg J. Duncan, Kathleen M. Ziol-Guest, and Ariel Kalil, "Early Childhood Poverty and Adult Attainment, Behavior and Health" *Child Development* 81:1 (2010), pp. 306-325; Greg J. Duncan and Jeanne Brooks-Gunn, "Income Effects Across the Life Span: Integration and Interpretation," in *Consequences of Growing Up Poor,* Greg J. Duncan and Jeanne Brooks-Gunn, Eds. (New York: Russell Sage Foundation, 1997); and Gordon B. Dahl and Lance Lochner, "The Impact of Family Income on Child Achievement: Evidence From the Earned Income Tax Credit," *American Economic Review* 102:5 (2012), pp. 1927-1956.

[45] Specifically, annual earnings increased by 17 percent between ages 25 and 37. Greg J. Duncan, Kathleen M. Ziol-Guest, and Ariel Kalil, "Early Childhood Poverty and Adult Attainment, Behavior and Health" *Child Development* 81:1 (January/February 2010), pp. 306-325.

[46] ITEP Microsimulation Tax Model. ITEP estimates that a traditionally designed, refundable 15 percent state EITC would reduce state personal income tax revenues by approximately $1 billion. By limiting eligibility for a state EITC to families with at least one child age 5 or under, ITEP estimates that approximately $1 billion could be used to provide those eligible with a refundable 35 percent state credit. ITEP's estimates assume that the credit amount under this targeted EITC would be determined based on the number of children age 5 and under rather than on the total number of children in the household. For example, the federal EITC provides a maximum credit of $5,460 to married couples with two children and a maximum of $3,305 to married couples with one child. Under the targeted state EITC, a married couple with two children, one age 4 and one age 7, would qualify for a maximum state credit equal to 35 percent of $3,305 – the maximum federal credit available to a married couple with *one child* – because only one child in this family is under age 6. California policymakers have flexibility in deciding how much they are willing to reduce personal income tax revenues in order to provide a state EITC. This hypothetical example simply illustrates that the state could provide a much larger credit by limiting eligibility for the credit to certain families, using the cost of a traditionally designed, refundable 15 percent state EITC as a baseline comparison.

[47] CBP analysis of 2009 Regional Market Rate Survey data. This analysis is based on the estimated cost of full-time, license-exempt care for an infant because workers who earn low wages are more likely to use license-exempt care than other forms of care. Additionally, this analysis assumes that the family does not receive subsidies through the state's subsidized child care system to offset the cost of this care. The cost of license-exempt child care is estimated to be 60 percent of the Regional Market Rate (RMR) for licensed family child care homes because California currently uses this 60 percent threshold to reimburse license-exempt providers through the state's subsidized child care system. The RMR is derived from a survey of provider rates and is used to determine the value of vouchers the state provides to families who are eligible for subsidized child care.

[48] AB 650 (Lieu, Chapter 606 of 2007) requires employers who are subject to and required to provide Unemployment Insurance to notify all of their employees of their potential eligibility for the federal EITC.

[49] Iowa, for example, used state dollars to support the efforts of a private, asset-development organization – the Institute for Social Economic Development Ventures – which provides free tax preparation services and conducts statewide outreach to promote the EITC. Similarly, Virginia allocated state funds to support the Virginia Creating Assets, Savings, and Hope Campaign as well as a number of other coalitions that provide free taxpayer preparation services to people who may be eligible for the EITC. See Qiana Torres Flores, *Tax Credits for Working Families: Earned Income Tax Credit* (National Conference of State Legislatures: July 31, 2014). California's Department of Community Services and Development, which works with local Community Services Block Grant agencies to increase awareness of the federal EITC and to assist low-income Californians in claiming the credit, could potentially expand its efforts to promote a state EITC.

[50] Legislative Analyst's Office, *Overview of Motion Picture Industry and State Tax Credits* (April 30, 2014), p. 19.

[51] According to one in-depth review of the research, "[s]tatistical and econometric studies are nearly unanimous in concluding that state and local tax incentives fail to attract a significant number of new businesses, create numerous jobs, or substantially enhance state economic performance." Robert G. Lynch, *Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development* (Economic Policy Institute: 2004), p. 25.

[52] AB 1839 (Gatto, Chapter 413 of 2014) will provide up to $330 million per year to businesses engaged in certain motion picture activities beginning in 2015-16, more than tripling the amount previously provided.

[53] In fact the LAO concludes, "[a]fter reviewing all of the available data, we find it difficult to arrive at a strong conclusion regarding the extent to which runaway production has harmed the California motion picture industry." Additionally, the LAO argues that "even in the absence of other states' and countries' subsidies, the level of film and television production activity in California might decline or grow slowly." The LAO warned policymakers wishing to pursue an expansion of the film tax credit to do so "cautiously." Increasing California's credit, they argued, could spur a "race to the bottom," in which other states respond to California's higher credit by further increasing their film industry incentives, thereby requiring California to raise its own credit even higher to remain competitive. Such competition would likely prevent California from "making any real headway in terms of increasing its share of film and television productions" and would be extremely costly. Legislative Analyst's Office, *Overview of Motion Picture Industry and State Tax Credits* (April 30, 2014), pp. 2, 3, 14, 21, and 22.