STATE OF OREGON

Research Report

LEGISLATIVE REVENUE OFFICE
State Capitol Building
900 Court St. NE, Room H-197
Salem, Oregon 97310-1347

(503) 986-1266
FAX 503-986-1770
www.leg.state.or.us/lro/home.htm

Research Report #6-04 **December 2004**

IMPACT OF 1997 LEGISLATION - Earned Income and Working Family Child Care Tax Credits in Oregon

OVERVIEW

The 1997 Oregon legislature adopted SB 388, which created two new personal income tax credits in Oregon, targeted to low and moderate income working families. They were the Earned Income Tax Credit (EIC) and the Working Family Child Care Tax Credit (WFCC). Oregon's EIC is 5% of the federal earned income tax credit. The working family child care tax credit is a percentage of the childcare expenses incurred by working families. 7 years after implementation of these two tax credits in Oregon's personal income tax system, they have grown to be the largest of the personal income tax credits targeted toward low and moderate income families in Oregon.

The federal government has had an EIC since 1975. The purpose of the tax credit is to supplement the wages of low and moderate income families through the personal income tax system. The tax credit goes to households with earnings and the size of the credit rises as earnings increase. The EIC is phased out gradually. In tax years 2004 and beyond, the federal law has specified increases in the maximum income threshold for the EIC. Oregon adopts the same federal earnings and maximum tax credit requirements to qualify for the credit since Oregon's credit is a percentage (5%) of the federal EIC.

Oregon's working family child care tax credit is similar to the federal child care tax credit (CDCTC). The federal tax code first allowed a tax deduction for certain employment-related child/dependent care expenses in 1954. The tax deduction was converted to a tax credit in 1976. The federal CDCTC allows families with child care expenses to claim a credit against federal taxes. Oregon's working family tax credit is similar to the federal CDCTC because the WFCC tax credit is a percentage of the child care expenses eligible for the federal credit.

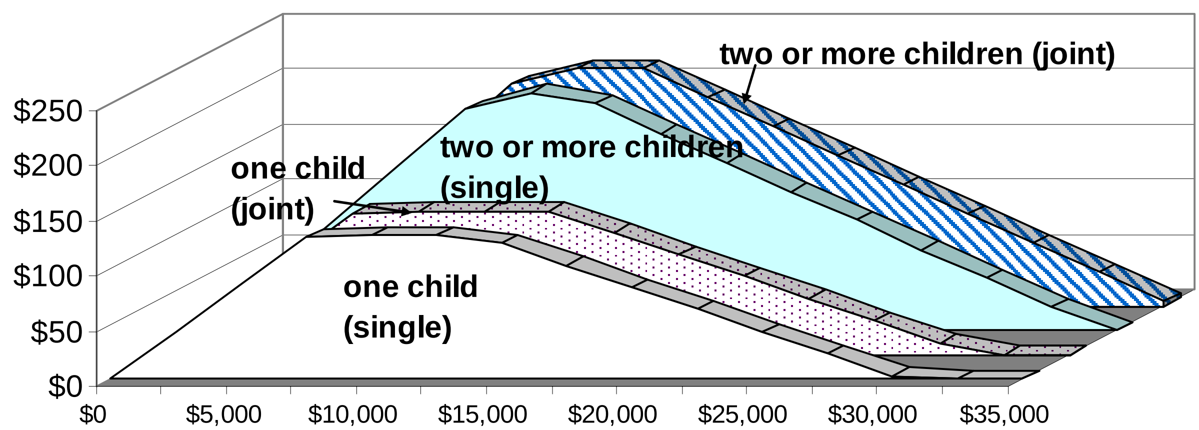
Refundability is a key feature of low income tax credits. A refundable tax credit pays taxpayers the full amount of the tax credit regardless of the taxpayer's annual personal income tax liability. This feature is especially beneficial to low-income taxpayers who may not have enough income tax liability to offset the entire amount of the tax credit. Originally, in 1997, neither the earned income nor working family tax credit was refundable in Oregon. The federal EIC is refundable but the federal CDCTC is not refundable. The 2001 legislature made the working family child care tax credit refundable beginning tax year 2003 but Oregon's EIC is not refundable.

CURRENT LAW

Earned Income Tax Credit (EIC)

Earned Income Tax credits provide supplemental income to low and moderate-income working families. Since the passage of the earned income tax credit in Oregon in 1997, Oregon's tax credit has been 5% of the federal earned income tax credit. Oregon connects to the federal guidelines of the federal earned income tax credit. The federal EIC increases as families earn additional income and have more children and then phases out the tax credit for higher income families. The maximum federal EIC in 2004 is $390 for families with no children. The maximum federal EIC in 2004 is $2,604 for single parents with 1 child with earned income between $7,700 and $12,500. For families with 2 or more children with earned income between $10,750 and $15,000, the maximum federal EIC is $4,300. In 2004, Oregon's maximum EIC is $130 for families with 1 child and $215 for families with 2 or more children. See Figure A, below, for a graphical illustration of the shape of Oregon's EIC structure. The EIC income is based on the taxpayer's wages, salaries, tips, and other employee compensation, plus the amount of self-employment earnings. The EIC income threshold, for the phase-out of the tax credit, is scheduled in federal law to grow annually by $2,000 for tax years 2005 – 2007 and by $3,000 for tax years 2008 and thereafter.

Figure A: Maximum 2004 Earned Income Tax Credit in Oregon



Oregon's EIC benefits a large number of taxpayers each year. See Table B for a historical utilization of the earned income tax credit in Oregon and at the federal level. In 1997, 153,844 taxpayers claimed Oregon's EIC and the number of taxpayers grew by 10.5% over the next 7 years to 170,034 taxpayers in 2003. The average EIC in Oregon has been modest, only $68, compared to the average federal refundable EIC for Oregon residents of $1,609, in 2002. The average annual cost of Oregon's EIC, from 1997-2003, is -$10.3 million. Figure B illustrates the distributional benefit of the tax credit for different income groups for tax year 2003. For taxpayers with gross income between $10,000 and $20,000, these taxpayers comprise 56% of all tax benefits from the EIC credit in 2003. For the lowest income taxpayers, those with income under $15,000, Oregon's earned income tax credit provided more benefit ($4.8 million) than the working family tax credit ($3.1 million) in 2003. Figure B reveals, in 2003 the earned income tax credit does not provide a credit to taxpayers with earned income above $35,000 but the working family tax credit does provide a credit for more moderate income families.

Table C reveals the 16 states that had an EIC in 2003. Most states have designed their tax credit as a percentage of the federal credit and some states have a declining percentage of the federal tax credit depending on family income. Oregon, Oklahoma and Illinois each have a state EIC set at 5% of the federal tax credit which is the lowest percentage of the 16 states which have adopted a state EIC. For example in Minnesota, they have the highest EIC percentage at 46% of the federal tax credit and they make the tax credit refundable for the lowest income families and decrease the EIC percentage to 22% of the federal tax credit for moderate income families. In Wisconsin, the percentage of federal tax credit increases from 4% - 43% depending on the number of children in the family.

In 2003, 13 of the 16 states that had a state EIC, made the tax credit refundable. Oregon is one of 3 states with a non-refundable credit. If an income tax credit is non-refundable, then the amount of the credit to the family can be limited by the family's personal income tax liability. If an income tax credit is refundable, it can benefit low-income taxpayers who would not receive the full benefit from the income tax credit if their personal income tax liability was less than the total credit amount.

Working Family Child Care Tax Credit (WFCC)

The working family tax credit is designed to help low and moderate income families, who have a minimum amount of earned income, pay for their child care costs. The minimum amount of earned income the taxpayer must have to qualify for the WFCC is $6,000 for the tax year and currently the taxpayer's income can not exceed 250% of the federal poverty level. For the lowest income families, those with federal adjusted gross income less than 200% of the federal poverty level, they can claim 40% of their child care expenses. The applicable percentage drops to zero for families with adjusted gross income above 250% of the federal poverty level. See Table A for a complete description of the history of the tax credit schedule of benefits. Currently, the WFCC income threshold phase-out is higher than Oregon's EIC. Oregon's WFCC is a percent of the qualified federal child care expenses each year. Unlike the earned income tax credit, the percentage of qualified child care expenses varies depending on the income of the family.

The number of people benefiting from the WFCC has increased over the past 7 years. In 1997, there were 15,301 taxpayers benefiting from the credit and by 2003, the number of taxpayers claiming the tax credit had increased 68% to 25,763. In tax year 1997, the working family child care tax credit was smaller in total cost than Oregon's earned income tax credit. Initially, the total cost of the WFCC tax credit was $5.2 million versus Oregon's EIC at $9.6 million. The usage of the WFCC first exceeded Oregon's EIC in 2001, see Table B. Over the next 7 years, the WFCC outpaced and surpassed the EIC costs by rising more than 300% to $20.9 million by tax year 2003 when the tax credit first became refundable.

Originally in SB 388, the WFCC tax credit was non-refundable. The 2001 legislature passed HB 2716 which made the WFCC tax credit refundable beginning tax year 2003. On average, the working family child care tax credit provides much more financial support than Oregon's earned income tax credit to low and moderate income families. In 1997, the WFCC was on average $343 which was more than 5 times the size of the Oregon earned income tax credit of $62. By

2003, the preliminary estimates for the average WFCC was $814 which was nearly 12 times the size of the average Oregon earned income tax credit of $70. The distribution of the WFCC tax benefit in 2003 reveals that more moderate income taxpayers benefit from WFCC than Oregon's EIC. The income groups, which received the largest portion of the WFCC in 2003, were between $20,000 and $30,000. 40% of the tax credit benefit was received by taxpayers with income between $20,000 and $30,000.

In 2003, there were 22 states which had a child care tax credit for low and moderate income families. Oregon was one of 13 states with a refundable credit in 2003. There were also 5 states which provided a deduction on taxpayers' income for their eligible child care expenses. Maryland was the only state which provided taxpayers with both a deduction for eligible their child care expenses as well as a personal income tax credit. Vermont had a refundable tax credit with the higher percentage of the federal tax credit for the lowest income families and decreased the percentage of the federal tax credit and made the credit non-refundable for moderate income families.

Utilization of Both Personal Income Tax Credits Together

The changes to the working family child care tax credit to make it refundable beginning tax year 2003 have benefited more than 25,000 families. Some of these low income families are also claiming Oregon's earned income tax credit on their personal income tax returns. In 2002, the taxpayers, who claimed both an earned income tax credit as well as a working family tax credit, had an average tax credit of $562. From the preliminary data in 2003, Oregon's policy change to make the WFCC tax credit refundable increased the cost of the credit by $11.8 million so the total cost of the WFCC tax credit was $20.96 million. This policy change more than doubled the size of the credit and the amount of the benefit to each taxpayer claiming the tax credit. From the preliminary data in 2003, the taxpayers, who claimed both an earned income tax credit as well as a working family tax credit, had an average tax credit of $940 which was an increase of $378 between tax year 2002 and 2003.

Table D provides information on the refundable portion of the WFCC tax credit and the taxpayers who claimed both the WFCC and the EIC tax credits. From the preliminary 2003 data, 17,653 families, or 69% of all WFCC claims, were from taxpayers who claimed both the Oregon EIC and WFCC tax credits. 86% of the refundable tax portion of the WFCC was claimed by taxpayers who had claimed both the Oregon EIC and WFCC. This data reveals that making the working family child care tax credit refundable has helped 10.5% of the low income families that claimed the Oregon EIC in 2003.

Revenue Impact of Expanding the Earned Income Tax Credit

Most legislative proposals in Oregon that expand the earned income tax credit, either make the tax credit refundable or increase the percentage of the federal tax credit or make both policy changes together. Making the EIC tax credit refundable will benefit the lowest income families because they may not have enough tax liability to claim all of the EIC. As the survey of the other U.S. states reveal, that is one of the primary reasons why most other states as well as the federal government have made their earned income tax credits refundable. Increasing the percentage of the federal tax credit above 5% would benefit more moderate income taxpayers who have sufficient tax liability to claim a larger personal income tax credit.

In analyzing the 2003 personal income tax returns, it was revealed that the current 5% EIC eliminated the Oregon personal income tax for 59,392 returns or 35% of all personal income tax returns claiming an EIC. Under the current 5% EIC, 110,642 families used up all their EIC and still paid $56.9 million in Oregon personal income taxes in 2003. If the Oregon EIC had been 10% of the federal EIC, in tax year 2003, an additional 11,303 taxpayers or 42% of all tax returns claiming an EIC would have had their Oregon tax liability eliminated. If the Oregon EIC had been 15% of the federal EIC, in tax year 2003, an additional 20,405 taxpayers or 47% of all tax returns claiming an EIC would have had their Oregon tax liability eliminated.

Table E provides revenue loss estimates for policy changes which expand the earned income tax credit. If Oregon made the 5% earned income tax credit refundable, this policy change would reduce state general fund revenue by on average -$6.1 million annually over the next 3 bienniums. If the earned income tax credit was increased to 10% of the federal tax credit, that policy change would reduce state general fund revenue by approximately -$6.3 million annually and combining the higher percentage with a refundable provision would reduce the state general fund by -$20 million, on average, annually over the next 3 bienniums.

TABLE A: Child and Dependent Care, Working Family Child Care and Earned Income Tax Credits - Table of Oregon Legislative Changes

Year	Legislation	Oregon Laws	Description of Changes
1997	SB 388	ORS 315.262 Ch. 692 § 2	Oregon Working Family Child Care Tax Credit established. Credit calculation based on % of allowable expenses. Phase-out based on Federal Adjusted Gross Income as % of Federal Poverty Level (FPL) AGI not more than 150% of FPL 40% of eligible expenses 150% to 160% 36% of eligible expenses 160% to 170% 32% of eligible expenses 170% to 180% 24% of eligible expenses 180% to 190% 16% of eligible expenses 190% to 200% 8% of eligible expenses Greater than 200% of FPL not eligible for credit
1997	SB 388	ORS 315.266 Ch. 692 § 3	Oregon Earned Income Tax Credit established. Credit is 5% of the federal earned income tax credit allowed under IRC § 32. Tax credit is non-refundable and can not exceed the tax liability of the taxpayer and can not be carried forward to a succeeding tax year.
1999	SB 2	ORS 315.262	Increases the maximum income threshold to qualify for the Working Family Child Care Tax Credit. Phase-out based on Federal Adjusted Gross Income as % of Federal Poverty Level (FPL) AGI not more than 200% of FPL 40% of eligible expenses 200% to 210% 36% of eligible expenses 210% to 220% 32% of eligible expenses 220% to 230% 24% of eligible expenses 230% to 240% 16% of eligible expenses 240% to 250% 8% of eligible expenses Greater than 250% of FPL not eligible for credit
2001	HB 2716	Ch. 867 § 1	Oregon Working Family Child Care Tax Credit amended by making the tax credit refundable beginning tax year 2003.

TABLE B: HISTORICAL UTILIZATION OF EIC AND WFCC & FEDERAL EIC

TAX YEAR	OREGON – TOTAL TAX		FEDERAL – TOTAL TAX	OREGON # OF CLAIMS		OREGON AVERAGE TAX		FEDERAL AVERAGE TAX
Tax ($ 000)	WFCC	EIC	EIC	WFCC	EIC	WFCC	EIC	EIC
1997	5,242	9,575	131,016	15,301	153,844	343	62	1,468
1998	6,008	10,056	139,725	16,758	165,720	359	61	1,510
1999	6,956	9,771	142,414	18,356	148,775	379	66	1,516
2000	7,050	9,766	148,917	18,161	148,106	388	66	1,529
2001	13,195	10,038	173,285	25,758	150,190	512	67	1,559
2002	13,956	11,325	211,004	26,171	166,472	533	68	1,609
2003*	20,962	11,879		25,763	170,034	814	70	

* preliminary 2003 data

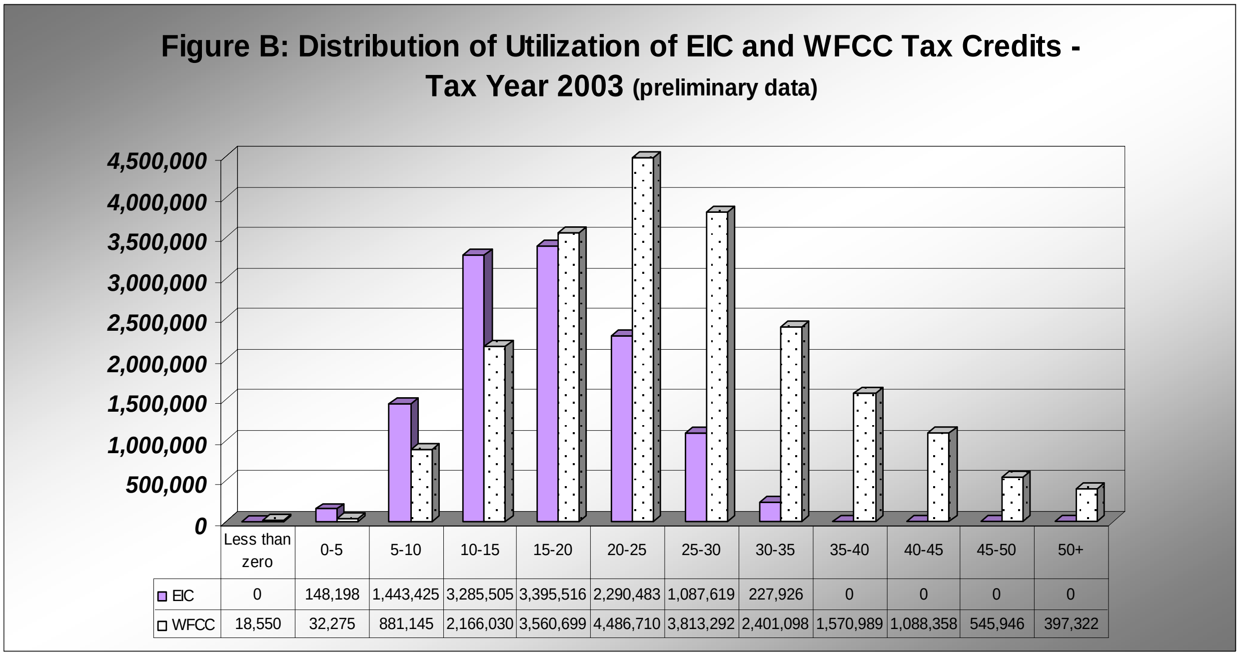


Figure B: Distribution of Utilization of EIC and WFCC Tax Credits - Tax Year 2003 (preliminary data)

	Less than zero	0-5	5-10	10-15	15-20	20-25	25-30	30-35	35-40	40-45	45-50	50+
EIC	0	148,198	1,443,425	3,285,505	3,395,516	2,290,483	1,087,619	227,926	0	0	0	0
WFCC	18,550	32,275	881,145	2,166,030	3,560,699	4,486,710	3,813,292	2,401,098	1,570,989	1,088,358	545,946	397,322

TABLE C: State Child and Dependent Care and Earned Income Tax Credits By State - 2003

	Child and Dependent Care Tax Credit		Earned Income Tax Credit	
State	**Refundable**	**Benefit Structure (% of federal credit)**	**Refundable**	**Benefit Structure (% of federal credit)**
AL	No	No state credit	No	No state credit
AK	No	No state credit	No	No state credit
AZ	No	No state credit	No	No state credit
AR	Yes	20%	No	No state credit
CA	Yes	34-50%	No	No state credit
CO	Yes	10-50%	Credit suspended this year	
CN	No	No state credit	No	No state credit
DE	No	50%	No	No state credit
DC	No	32%	Yes	25%
FL	No	No state credit	No	No state credit
GA	No	No state credit	No	No state credit
HI	Yes	15-25%	No	No state credit
ID	No	Deduction of eligible expenses	No	No state credit
IL	No	No state credit	Yes	5%
IN	No	No state credit	Yes	6%
IA	Yes	40-75%	No	6.5%
KS	No	25%	Yes	15%
KT	No	20%	No	No state credit
LS	Yes	10-50% (if income > $60K max benefit = $25	No	No state credit
ME	Yes	21.5 – 43%	No	5%

TABLE C: State Child and Dependent Care and Earned Income Tax Credits By State - 2003

	Child and Dependent Care Tax Credit		Earned Income Tax Credit	
State	**Refundable**	**Benefit Structure (% of federal credit)**	**Refundable**	**Benefit Structure (% of federal credit)**
MD	No	Deduction of eligible expenses + 3.25-32.5% of federal credit	Yes	18%
MA	No	Deduction of eligible expenses	Yes	15%
MI	No	No state credit	No	No state credit
MN	Yes	0-100%	Yes	22-46%
MS	No	No state credit	No	No state credit
MO	No	No state credit	No	No state credit
MT	No	Deduction of eligible expenses	No	No state credit
NE	Yes	25-100%	No	No state credit
NV	No	No state credit	No	No state credit
NH	No	No state credit	No	No state credit
NJ	No	No state credit	Yes	20%
NM	Yes	40% of eligible expenses, reduced by the amount of federal credit	Yes	Not structured as % of federal credit
NY	Yes	20-110%	Yes	30%
NC	No	7-13% of eligible expenses	No	No state credit
ND	No	No state credit	No	No state credit
OH	No	25 or 100%	No	No state credit
OK	No	20%	Yes	5%
OR	Yes	4-30% of eligible expenses	No	5%
PA	No	No state credit	No	No state credit
RI	No	25%	No	25%
SC	No	7% of eligible expenses	No	No state credit
SD	No	No state credit	No	No state credit
TN	No	No state credit	No	No state credit
TX	No	No state credit	No	No state credit
UT	No	No state credit	No	No state credit
VT	Yes	Refundable: 50% of federal credit (income limit $40K joint and $30K single) Nonrefundable: 24% of federal credit	Yes	32%
VA	No	Deduction of eligible expenses	No	No state credit
WA	No	No state credit	No	No state credit
WV	No	No state credit	No	No state credit
WI	No	No state credit	Yes	4% (1 child), 14% (2 children), 43% (3 or more children)
WY	No	No state credit	No	No state credit

TABLE D: Amount of Refundable WFCC Claimed by Taxpayers Who Claimed Both the OR Earned Income Credit and the WFCC Tax Credit – Tax Year 2003

	Refundable WFCC		Refundable Portion of WFCC		
AGI income ($000)	Number of Tax Returns Claiming WFCC	Tax Returns Claiming Both Credits (% total WFCC claims)	Refundable Portion of WFCC - Total Tax	Refundable Portion of WFCC - Total Tax - Those who claim both Credits	Those that claim both credits - % of total refundable portion of WFCC
Less than zero	16	0	18,550	18,550	100%
0-5	43	32.6%	32,274	9,231	29%
5-10	1,421	90.3%	877,703	769,182	88%
10-15	3,152	93.3%	2,098,177	1,934,465	92%
15-20	4,171	93.0%	3,023,155	2,813,054	93%
20-25	4,507	93.0%	2,779,570	2,605,310	94%
25-30	4,345	87.8%	1,588,288	1,404,309	88%
30-35	2,638	58.0%	768,335	550,061	72%
Total	**25,763**	**68.5%**	**11,746,678**	**10,085,612**	**86%**

TABLE E: Revenue Impact of Expanding Oregon's Earned Income Tax Credits

($ millions)	**Non-Refundable EIC**				**Refundable EIC**				
Fiscal Year	**10%**	**15%**	**20%**	**25%**	**5%**	**10%**	**15%**	**20%**	**25%**
2005-06	-$6.9	-$12.4	-$16.9	-$20.8	-$5.9	-$20.4	-$34.8	-$49.2	-$63.7
2006-07	-$6.7	-$12.0	-$16.4	-$20.1	-$6.0	-$20.2	-$34.4	-$48.6	-$62.9
2007-08	-$6.5	-$11.6	-$15.8	-$19.5	-$6.1	-$20.1	-$34.2	-$48.2	-$62.2
2008-09	-$6.2	-$11.2	-$15.3	-$18.8	-$6.4	-$19.8	-$33.5	-$47.3	-$61.1
2009-10	-$5.9	-$10.6	-$14.4	-$17.8	-$6.1	-$19.6	-$33.1	-$46.5	-$60.0
2010-11	-$5.6	-$10.1	-$13.8	-$17.0	-$6.2	-$19.4	-$32.5	-$45.7	-$58.8
Average over the next 3 bienniums	**-$6.3**	**-$11.3**	**-$15.4**	**-$19.0**	**-$6.1**	**-$19.9**	**-$33.8**	**-$47.6**	**-$61.5**

Beginning tax year 2005