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## Making Work Pay in New York: The Earned Income Tax Credit

by Russell Sykes

Low-income working families in New York State receive a significant annual wage supplement through the Earned Income Tax Credit (EITC), which is available to eligible filers of federal, state and New York City income tax returns.

More than 1.6 million households — nearly one out of every five in the Empire State — claimed total EITC payments of \$4.6 billion in 2009, the latest year for which data are available. The combined federal, state and city tax credit in New York averages nearly \$3,000 and provides a 44 percent income boost for a minimum-wage worker with two children.

This paper explores the history and impact of the EITC, compares its effectiveness as a poverty-fighting measure to the minimum wage, and identifies a number of areas where the EITC could be improved.

### History and background

The federal EITC was enacted in 1975 to offset the burden of payroll taxes and provide an incentive to work for low- and moderate-income families. The EITC is refundable — which means that when the tax credit exceeds the amount of taxes owed, the difference becomes a tax refund. As a result, it effectively creates a form of negative income tax.

In 2009 the federal EITC provided over 26 million households with \$58.7 billion in tax credits. Since most low-income working families owe little or no income taxes to begin with, about 87 percent of EITC benefits come in the form of a tax refund. The majority of eligible EITC recipients actually receive the credit because, unlike other benefit programs, it is claimed not through caseworkers and application processes but by filing a tax return. Estimates by the Internal Revenue Service and others such as the Brookings Institution show that 75-80 percent of eligible tax filer households receive the credit, and that in 2007, 87 percent of all available federal EITC credits were claimed.<sup>1</sup>

By design, the EITC provides the greatest help for households with qualifying children<sup>2</sup>, especially three or more children. To minimize any marriage penalty, eligibility ceilings are slightly higher for married families with children than single parent heads of households. Low-income single individuals and childless couples are eligible for a

*continued on page 2*

**Table 1: The EITC—Who Gets How Much?**  
Combined Federal and New York State Credits, 2011 Guidelines

| # Qualifying Children | Filing Status | Maximum Credit Levels (\$) |        | Credit Phase-out Income Range (\$) |
|-----------------------|---------------|----------------------------|--------|------------------------------------|
|                       |               | Income Range               | Credit |                                    |
| 0                     | Single        | 6,070 - 7,590              | 464    | 7,591 - 13,660                     |
|                       | Married       | 6,070 - 12,670             | 464    | 12,671 - 18,740                    |
| 1                     | Single        | 9,100 - 16,690             | 3,094  | 16,691 - 36,052                    |
|                       | Married       | 9,100 - 21,770             | 3,094  | 31,771 - 41,132                    |
| 2                     | Single        | 12,780 - 16,690            | 5,112  | 16,691 - 40,964                    |
|                       | Married       | 12,780 - 21,770            | 5,112  | 21,771 - 46,044                    |
| 3 or more             | Single        | 12,780 - 16,690            | 5,751  | 16,691 - 43,998                    |
|                       | Married       | 12,780 - 21,770            | 5,751  | 21,771 - 49,078                    |

Source: Internal Revenue Service

smaller but still important wage supplement through the EITC.

EITC benefits gradually phase out as income increases. Maximum EITC benefits are effectively targeted, with the highest benefits going to those households with the lowest income and the most children. Households then remain eligible for the maximum benefit along a plateau of income. After the plateau, the EITC begins to phase-out gradually until eligibility ends for different households. This approach maximizes benefits for those most in need and avoids creating a sudden drop off in benefits or a “notch effect.”<sup>3</sup>

Eligibility, maximum benefit levels and phase out ranges for 2011 are outlined in Table 1 on page 1.

The federal EITC has been expanded with bipartisan support five times, including major expansions in 1986 under President Ronald Reagan, 1990 under President George H.W. Bush, and 1993 under President Bill Clinton. Each time, eligibility levels and maximum credit amounts were increased significantly, thereby increasing the wage supplement effect.

The Economic Growth and Tax Relief Reconciliation Act of 2001—the first phase of the tax cuts initiated by President George W. Bush—raised maximum earnings levels for married taxpayers filing jointly. In 2009, President Barack Obama signed into law additional temporary changes establishing a higher EITC amount for families with three or more children and further reducing the marriage penalty.<sup>4</sup>

The EITC, along with the refundable child tax credit, unemployment insurance and food stamps, has significant anti-poverty effects. In 2010, the federal EITC lifted about 6.3 million, including about 3.3 million children, above the poverty line. The number of children living in poverty would have been one-quarter higher without the EITC.<sup>5</sup> However, most official measures of poverty do not account for the effects of the EITC, thereby tending to inflate the number classified as poor.

### **The EITC in NYS**

New York enacted its own EITC in 1994, linking eligibility and credit levels directly to the federal EITC.<sup>6</sup> Benefits were scheduled to phase in over four years, starting at 7.5 percent of the federal credit in 1994, then increasing to 10 percent in 1995, 15 percent in 1996 and 20 percent in 1997. As part of Governor George Pataki’s income tax reform bill in 1995, the phase-in of the EITC was accelerated to produce a credit equal to 20 percent of the federal level as of 1996.

With the enactment of federal welfare reform in 1996, states were allowed to use the new Temporary

Assistance to Needy Families (TANF) block grant program to subsidize the creation or expansion of their own EITCs.<sup>7</sup>

With support from TANF funds, New York’s state EITC was expanded to 25 percent of the federal level in 1998, and to the current level of 30 percent in 2000. (There are slightly more federal than state EITC claimants in New York because of legislative changes to the EITC in 1995 that reduced the state EITC for some eligible higher income filers).<sup>8</sup>

The state EITC has grown from \$77.8 million in 1994 to \$967 million in 2009. New York State’s EITC is -- and has always been -- the largest state EITC in total credits issued. Of the 24 other states with a state EITC, only Vermont at 32 percent of the federal EITC has a higher credit, but the numbers served and aggregate cost is quite small. Several other states such as Minnesota and Wisconsin with nominally higher percentage credits have their own tax structure not linked to the federal

EITC and Maryland’s 50 percent EITC is not refundable – making them less valuable to households than the New York State EITC.

New York City added an EITC to its resident income tax in 2004. While the credit is modest, New York City is one of only three municipalities to establish such an EITC. In 2004 the city EITC provided \$66.3 million to eligible filers. In 2009, it reached

over 888,000 households providing \$94.7 million in EITC credits.<sup>9</sup> Table 2 on page 3 provides a breakdown of credit claimants and total EITC amounts by county of residence in New York.

### **Making work pay**

Workers earning around the minimum wage, especially those supporting children, derive the greatest benefit from the EITC. As illustrated in the chart on page 4, for example, a parent of two children who works full time in a job paying the \$7.25 an hour minimum wage or \$15,080 annually receives a combined state and federal EITC of \$6,646. In effect, such workers get a 44 percent pay boost, raising their total income to \$21,726 – effectively raising their hourly wage to \$10.44.<sup>10</sup> The New York City credit adds \$255 to this total, the equivalent of about 12 cents an hour in added wages. Federal, state and local governments are investing heavily in this wage supplement – a combined total of \$4.6 billion to eligible New York taxpayers in 2009, as noted above.

However, the substantial taxpayer commitment to boosting wages for the working poor through the EITC is overlooked in conventional government measures of poverty levels. It has also been ignored by sponsors of current state legislation that would raise the minimum

***The EITC has been repeatedly expanded with bipartisan support on the federal level. New York’s own EITC dates back to 1994 and now represents the nation’s largest state-level work incentive of its type.***

wage in New York from \$7.25 to \$8.50 an hour, indexing it annually to changes in the Consumer Price Index. Under this plan, if inflation were to rise by a total of 5 percent over the next two years, the minimum wage would hit \$9.37.<sup>11</sup>

Advocates of a higher minimum wage view it as a way to provide a more “livable” income for families mired in poverty. However, there is little question that the EITC is more effectively targeted than a minimum wage to accomplish this goal. Consider:

- Based on a comprehensive analysis of minimum wage studies, economists David Neumark and William Wascher concluded that a higher minimum wage “neither helps low income families

nor reduces poverty.” By contrast, Neumark and Wascher said, the EITC “subsidizes earnings for low-income working families and creates incentives for employment among families with no workers – pursuing much the same goals as suggested by the rhetoric, if not the reality of minimum wages.”<sup>12</sup>

- A 2007 study by economists Richard V. Burkhauser and Joseph J. Sabia found that only 13.2 percent of workers earning a wage of \$7.25 or less were the primary earner in a household, while 46.3 percent were in families with incomes at or above three times the poverty line. The study concluded that “the majority of low wage workers are not household heads... and an even greater share are

**Table 2: EITC Claims by Place of Residence, 2009**

| County*     | Number | Amount (\$000) | Avg. Credit (\$) | County*      | Number    | Amount (\$0) | Avg. Credit (\$) |
|-------------|--------|----------------|------------------|--------------|-----------|--------------|------------------|
| Albany      | 18,166 | 10,610         | 584              | Orleans      | 3,323     | 2,069        | 623              |
| Allegany    | 3,640  | 2,241          | 616              | Oswego       | 9,925     | 6,123        | 617              |
| Broome      | 14,473 | 8,785          | 607              | Otsego       | 4,281     | 2,493        | 582              |
| Cattaraugus | 6,765  | 4,273          | 632              | Putnam       | 3,045     | 1,442        | 474              |
| Cayuga      | 5,537  | 3,322          | 600              | Rensselaer   | 10,162    | 5,916        | 582              |
| Chautauqua  | 11,140 | 7,029          | 631              | Rockland     | 16,650    | 12,509       | 751              |
| Chemung     | 7,306  | 4,470          | 612              | St. Lawrence | 8,094     | 5,079        | 627              |
| Chenango    | 4,407  | 2,791          | 633              | Saratoga     | 10,471    | 5,799        | 554              |
| Clinton     | 5,661  | 3,251          | 574              | Schenectady  | 11,333    | 6,999        | 618              |
| Columbia    | 4,002  | 2,260          | 565              | Schoharie    | 1,968     | 1,128        | 573              |
| Cortland    | 3,693  | 2,236          | 605              | Schuyler     | 1,492     | 866          | 580              |
| Delaware    | 3,467  | 2,056          | 593              | Seneca       | 2,477     | 1,488        | 601              |
| Dutchess    | 13,520 | 7,507          | 555              | Steuben      | 7,691     | 4,757        | 618              |
| Erie        | 61,708 | 37,748         | 612              | Suffolk      | 78,635    | 46,564       | 592              |
| Essex       | 2,591  | 1,484          | 573              | Sullivan     | 6,197     | 3,952        | 638              |
| Franklin    | 3,867  | 2,439          | 631              | Tioga        | 3,763     | 2,294        | 610              |
| Fulton      | 4,798  | 2,934          | 612              | Tompkins     | 5,061     | 2,761        | 546              |
| Genesee     | 4,174  | 2,510          | 601              | Ulster       | 11,591    | 6,423        | 554              |
| Greene      | 3,305  | 1,827          | 553              | Warren       | 4,944     | 2,795        | 565              |
| Hamilton    | 330    | 172            | 520              | Washington   | 4,749     | 2,848        | 600              |
| Herkimer    | 5,055  | 3,134          | 620              | Wayne        | 7,105     | 4,322        | 608              |
| Jefferson   | 8,384  | 5,278          | 630              | Westchester  | 46,640    | 27,980       | 600              |
| Lewis       | 1,810  | 1,096          | 606              | Wyoming      | 2,621     | 1,514        | 577              |
| Livingston  | 3,871  | 2,289          | 591              | Yates        | 1,914     | 1,186        | 620              |
| Madison     | 4,587  | 2,783          | 607              |              |           |              |                  |
| Monroe      | 53,086 | 32,985         | 621              | Bronx        | 196,179   | 134,899      | 688              |
| Montgomery  | 4,832  | 3,041          | 629              | Kings        | 284,926   | 187,960      | 660              |
| Nassau      | 63,073 | 36,875         | 585              | New York     | 121,894   | 66,932       | 549              |
| Niagara     | 15,779 | 9,511          | 603              | Queens       | 227,988   | 136,421      | 598              |
| Oneida      | 18,335 | 11,711         | 639              | Richmond     | 27,209    | 16,728       | 615              |
| Onondaga    | 33,016 | 20,322         | 616              |              |           |              |                  |
| Ontario     | 6,700  | 3,955          | 590              | All Other*   | 30,748    | 7,157        | 233              |
| Orange      | 21,578 | 14,588         | 676              | Grand Total  | 1,575,732 | 966,912      | 614              |

\* Includes nonresidents and part-year residents who moved out of New York. Part-year residents moving into New York are counted in the county into which they moved.

Source: NYS Department of Taxation and Finance



not poor household heads.”<sup>13</sup> In another study, the same researchers concluded that raising New York’s minimum wage, from the \$7.15 rate in effect in 2008 to \$8.25, would result in the loss of 29,000 jobs.<sup>14</sup> They cited “substantial evidence ... that unlike minimum wage increases, expansions in the EITC attract low-skilled workers to the labor market, particularly single mothers.”<sup>15</sup>

- A Congressional Budget Office study in 2007 found that only 15 percent of the benefits flowing from a then-theoretical minimum wage increase to \$7.25 hour would go to households with income under the poverty level (56 percent went to households with overall earnings two to three times the poverty level) while 60 percent of expanded EITC benefits would reach poverty level earners.<sup>16</sup>

The EITC also contributes to the overall progressivity

of New York’s income tax structure, giving the state the highest tax threshold – the income level where low income earners actually begin to pay state income taxes – among the 42 states with income taxes. In 2010, New York’s tax thresholds were \$34,600 for a family of three and \$40,300 for a family of four.<sup>17</sup>

### Collecting the credit

Of course, from a worker’s standpoint, the difference between a refundable tax credit and a mandated pay increase is that the credit is collected in a single annual lump sum, while an hourly pay increase flows through weekly or biweekly paychecks.<sup>18</sup>

However, a 2005 survey by the Brookings Institute suggested that EITC recipients were spending the refund in the same way that they would spend a wage increase, with 82 percent of all EITC benefits being used to pay household expenses (including auto, medical, educational and other general expenses), and the remainder divided evenly between debt repayment and savings.

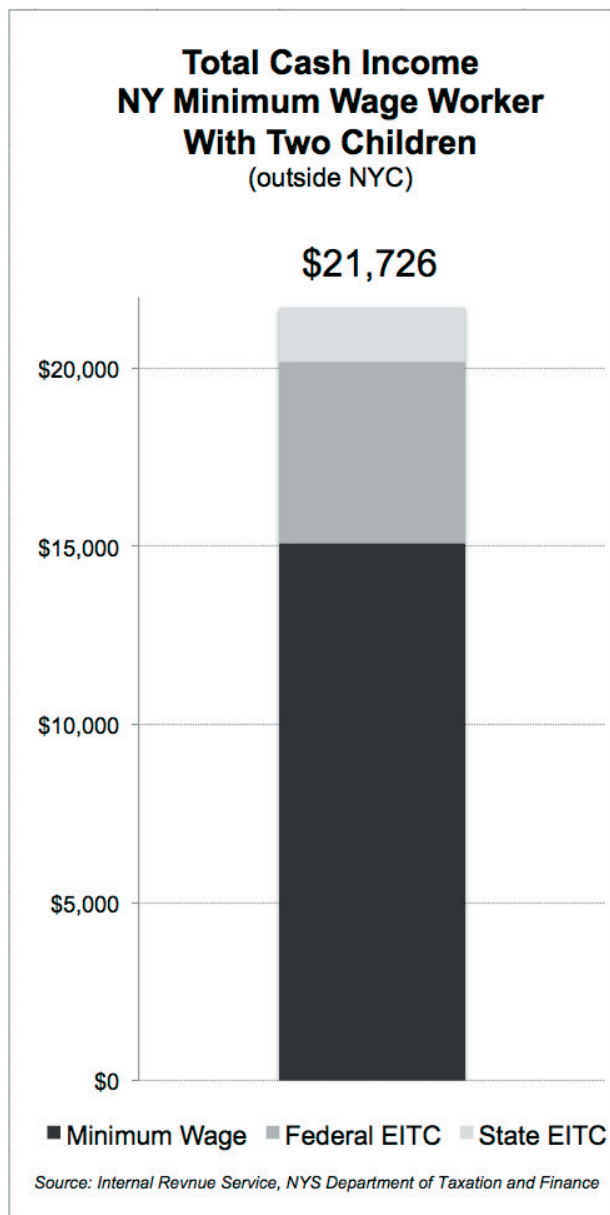
While the EITC provides a generous wage supplement to working families with children, it provides only a meager benefit to working individuals and couples not raising qualifying children, “too small even to fully offset federal taxes for workers at the poverty line.”<sup>19</sup>

Eligibility for the federal EITC for single workers not raising children is capped at \$13,660 annually and married couples not raising children at \$17,000. The credit is only available to those between the ages of 25 and 64 and therefore does not help younger workers. The maximum federal credit available for these workers is \$464, which combined with New York’s maximum of \$139 provides \$603 to a household eligible for the maximum credit. Clearly the EITC for childless individuals and couples does not provide nearly the same work incentive or wage supplement effect.

However, New York made a unique foray into addressing these concerns for non-custodial parents. In 2006, New York became the only state in the nation to establish a refundable non-custodial EITC for income eligible tax filers who have a registered child support order and are current in their payments for the Tax Year in which they are claiming the non-custodial EITC.

Without legislative action, New York’s non-custodial EITC, currently claimed by nearly 10,000 state residents, will sunset after 2013.<sup>20</sup> A 2010 preliminary evaluation by the Urban Institute found that relatively few non-custodial parents had been claiming the credit, and recommended steps for boosting awareness of the incentive.<sup>21</sup>

About two-thirds of EITC-claiming households complete their tax returns with the help of commercial tax preparers including volunteer income tax assistance sites sponsored by the Internal Revenue Service.<sup>22</sup> But many others within that two-thirds use paid preparers who spring up during the annual tax-filing season,



offering high interest advances on anticipated EITC credits through refund anticipation loans and refund anticipation checks. The costs of commercial tax preparation fees and loans erode the value of the EITC. Some preparers submit erroneous and incomplete returns, or file fraudulent EITC claims.<sup>23</sup>

To address such problems, a state Department of Taxation and Finance task force has recommended reforms including minimum age and education requirements for tax preparers, competency examinations, continuing professional education, conduct standards for those who prepare returns for compensation, and increased consumer education about the benefits of free tax preparation.<sup>24</sup>

The IRS has also taken a harder stance on tax preparers and refund anticipation loans and larger banks such as JP Morgan Chase and HSBC are ending their use of refund anticipation loans.<sup>25</sup>

### Conclusion

The EITC is an example of a program that works, insofar as it subsidizes low-paid employment and creates an incentive to work.

However, some groups have called for further expansion or enhancement of the credit on a nationwide level, including permanent enactment of the marriage penalty relief that expires in 2013<sup>26</sup> and mitigation of the EITC marriage penalty by expanding income phase-out

rates for married couples with young children.<sup>27</sup> There is also organized support for increasing the credit, raising income eligibility thresholds and lowering the eligibility entry age from 24 to 21 for workers not supporting children.<sup>28</sup> The US Conference of Mayors also has backed further efforts to assist married families and expansion of the childless workers EITC.<sup>29</sup>

In New York, Assemblyman Robin Schimminger has introduced a bill (A.9542) that would expand the EITC to 35 percent of the federal credit by 2013.

These ideas are worthy of consideration, but given the pressures to hold down spending at every level, proposals to expand the EITC need to be subjected to more stringent cost-benefit analysis than ever. In the meantime, further regulation of tax preparers including requiring minimum qualifications would improve the program, guard against households losing significant portions of the EITC in preparer fees, and further enhance program integrity.

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## ENDNOTES

<sup>1</sup> Steve Holt, “Ten Years of EITC Movement: Making Work Pay Then and Now”, Brookings Institution Metropolitan Opportunity Series, April 2011, page 7

<sup>2</sup> A child must have a valid Social Security number and meet all other IRS tests to qualify as a child for EITC, outlined at <http://www.irs.gov/individuals/article/0,,id=218779,00.html>

<sup>3</sup> Maximum EITC benefit ranges and phase-out schedules differ by household types as outlined in [http://eitcoutreach.org/wp-content/uploads/2008/03/Final\\_Benefits1-12-13-11.pdf](http://eitcoutreach.org/wp-content/uploads/2008/03/Final_Benefits1-12-13-11.pdf)

<sup>4</sup> The three or more children and the higher phase-outs for married joint filer provisions are temporary, enacted federally for TYs 2009 and 2010 and subsequently extended for 2011 and 2012. Unless extended again, they will expire after 2012.

<sup>5</sup> Center on Budget and Policy Priorities, “Policy Basics: The Earned Income Tax Credit”, February 22, 2012

<sup>6</sup> Chapter 170 of the Laws of 1994. Chapter 170 also requires the New York State Department of Taxation and Finance to develop an annual report, “Analysis of EITC Credits Claimed”, detailing the number of EITC claimants and the total credits issued statewide and in each county. The last report available, November 2011, provides this information for 2009.

<sup>7</sup> United States Department of Health and Human Services Administration for Children and Families, Final TANF regulations, 64 federal Register 17719-17931 (April 12, 1999). New York’s EITC law contains language that the state EITC will revert to 20 percent of the federal EITC if TANF funds are reduced or no longer able to be claimed as maintenance of effort.

<sup>8</sup> New York State Department of Tax and Finance: Analysis of EITC Credits Claimed 2009, November 2011. Some federally EITC eligible households lose all or part of the state EITC because the value of their New York household credit is subtracted from the state EITC.

<sup>9</sup> Ibid

<sup>10</sup> Computed by dividing the annual minimum wage plus the federal and state EITC into an assumed work-week of 40 hours for 52 weeks annually. If one considers the 7.65 percent impact of payroll taxes (social security, medicare) that are not applied to the EITC, the wage equivalent would be \$10.70 hourly

<sup>11</sup> Nicole Gelinas, Manhattan Institute for Policy Research – Empire Center for New York State Policy, “Silver’s made in-New York wage price spiral”, NYTorch blog post, January 31, 2012

<sup>12</sup> David Neumark, Professor of Economics University of California, Irvine and William L. Wascher, Senior Associate Director, Division of Research and Statistics, Federal Reserve Board, “Minimum Wages”, MIT Press, 2008, page 182.

<sup>13</sup> Richard V. Burkhauser and Joseph J. Sabia. 2007 “The Effectiveness of Minimum Wage Increases in Reducing Poverty: Past, Present and Future.” Contemporary Economic Policy 25, no. 2, April 2007

<sup>14</sup> Joseph J. Sabia, American University and Richard V. Burkhauser, Cornell University, “The Effects of Minimum Wage Increases in New

York State: Evidence from a Natural Experiment”, October 2008

<sup>15</sup> Ibid, p.22.

<sup>16</sup> <http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/77xx/doc7721/01-09-minimumwageeitc.pdf>. Congressional Budget Office, Response to a Request by Senator Grassley, January 2007

<sup>17</sup> Center on Budget and Policy Priorities, “The Impact of State Income Taxes on Low Income Families in 2010”, November 15, 2011

<sup>18</sup> An option to receive a portion of federal EITC benefits with each paycheck attracted less than 10 percent of eligible EITC households before it was repealed in 2010.

<sup>19</sup> Center on Budget and Policy Priorities, “Policy Basics: The Earned Income Tax Credit”, February 2012

<sup>20</sup> New York State Department of Taxation and Finance, “Analysis of EITC Credits Claimed in 2009”, legislation enacted in 2006 created an enhanced, optional, enriched EITC for certain non-custodial parents in lieu of the existing State EITC.

<sup>21</sup> Elaine Sorenson, Urban Institute, “Initial Results from the New York Noncustodial Parent EITC”, Brief 16, August 2010

<sup>22</sup> The Internal Revenue Service publicizes locations of its VITA sites nationwide and many other non-profit organizations provide free tax preparation.

<sup>23</sup> Material presented by the IRS and New York State Department of Taxation and Finance on March 16, 2012 in NYC regarding tax preparation issues. Because of rigorous tax preparer screening efforts the vast majority of all EITC payments made, at levels of over 93 percent, are accurate

<sup>24</sup> “New York State Report of the Task Force on Regulation of Tax Return Preparers”, submitted to the NYS Department of Taxation and Finance, the Governor and the Legislature, September 28, 2011 as required under the laws of 2009, Chapter 59, Part VV, S.4

<sup>25</sup> National Consumer Law Center and Consumer Federation of America, “The Party’s Over for Quickie Tax Loans: But Traps Remain for Unwary Taxpayers, February 2012

<sup>26</sup> <http://tax-coalition.org/>

<sup>27</sup> Robert Cherry, Professor, Department of Economics, Brooklyn College, State University of New York in an unpublished paper, “Reducing Marriage and Middle Class Parent Penalties” argues that a current custodial parent receiving an EITC will be discouraged from marrying because the additional spousal income will make her ineligible – his suggested remedy is greatly expanded eligibility levels for married couples with young children

<sup>28</sup> Daniel P. Gutterman, Lucy S. Gorham and Jessica Dorrance, “Expanding the EITC for Single Workers and Couples without Children”, a policy brief prepared for the Center on Poverty, Work and Opportunity, University of North Carolina at Chapel Hill, January 2007

<sup>29</sup> U.S. Conference of Mayors, “Repairing the Economic Ladder, Findings and Recommendations of the Task Force on Poverty Work and Opportunity, January 24, 2007, page 17