

HOW A STATE EARNED INCOME TAX CREDIT WOULD BENEFIT HAWAII'S LOW-INCOME FAMILIES AND CHILDREN



The Federal EITC

The credit varies by a taxpayer's filing status and number of children and is fully refundable, meaning that any excess beyond the taxpayer's liability becomes a payment. The amount of the credit increases with earned income until it reaches a maximum level, then it plateaus as earnings continue to grow eventually phasing out at higher income levels. In 2015, working families with children that have annual incomes below roughly \$39,000 to \$53,300 (depending on marital status and the number of dependent children) may be eligible for the credit.⁶

In the 2013 tax year, the most recent year for which data are available, over 27 million working families and individuals received the federal EITC.⁷ In Hawaii, 109,016 tax filers claimed the federal credit.⁸ Across the nation, the average EITC was \$3,074 in 2013 for a family with children (increasing wages by about \$256 a month).⁹ In Hawaii, the average EITC was \$2,122 for a family with one child, \$3,374 for a family with two children and \$3,710 for a family with three children.¹⁰

For too many of our families, having a job does not necessarily translate into financial stability. Many of Hawaii's parents work but earn too little to provide adequately for their families given the high cost of living in the state, and too many working families live on the edge of poverty.

The federal Earned Income Tax Credit (EITC) has long been recognized as one of the nation's most effective anti-poverty measures, lifting millions of Americans out of poverty each year by allowing them keep more of what they earn.¹ The tax credit targets low-income and moderate-income families and is credited with encouraging work and supporting children's development through various stages of life.² Despite the effectiveness of the federal EITC in reducing poverty among working families, earnings plus the federal tax credit do not guarantee an escape from poverty for all families struggling to make ends meet. In many cases, state level EITCs have helped to fill that gap across the country. Unfortunately, Hawaii remains one of 24 states without a state EITC.³ In a state where low-income residents pay more state and local taxes as a share of their income than higher-income residents,⁴ a refundable credit against state income taxes would contribute toward keeping the tax system fair. A state EITC equal to at least 10% of a filer's federal EITC would also be a highly cost-effective way to help many of Hawaii's low-income families meet their basic needs with their own income.

Figure 1. Hawaii Families with Related Children That Are Below Poverty By Family Type, 2014⁵

Hawaii	Number	Percent
All families	17,000	12%
Married couple families	7,000	7%
Single parent families	10,000	23%

The EITC and Family and Child Well-being

Growing up in poverty and economic hardship can have long-lasting consequences for children. Decades of research have documented the association between poverty and negative health, developmental, and education outcomes for children.¹¹ For example, children raised in families at or near the poverty level are more likely to be born with low birth weight, experience poor health, have limited access to high-quality child care and education, have lower academic achievement scores, and experience behavioral problems, grade failure, and drop-out.¹² The effects of poverty build over time, with consequences at one stage impeding progress at a later

stage. Thus, children who grow up in poverty and economic hardship tend to hold low-wage jobs or be under-employed as they transition into adulthood, many times perpetuating the cycle of poverty.

Enacted in 1975 primarily as a means of tax relief, the federal EITC has been expanded significantly in the decades following and is now considered an effective measure to reduce poverty among working families with children.¹³ The EITC reduces poverty by supplementing the income of low-wage workers, pushing many families above the poverty line (see Figure 2). The credit also reduces poverty and lessens the severity of economic hardship by providing an incentive to work. Studies show that the credit expansions over the decades have significantly increased the work effort of single-parents, particularly single-mothers, reducing their dependence on government benefits over the long term.¹⁴

Figure 2. The Brookings Institution’s Estimates of People and Children Kept Out of Poverty by the EITC, 2011 - 2013¹⁵

	All Persons	Children Only
U.S.	6,195,000	3,147,000
Hawai’i	36,000	18,000

In addition to the EITC’s effectiveness in reducing poverty and boosting work effort, a growing body of research documents important links between the credit (both at the federal *and* state-levels) and family and child well-being.

- **Maternal and Infant Health.** Parents experiencing ongoing economic hardship exhibit higher levels of stress, which can, in turn, manifest itself in physical health problems. Prenatal poverty also influences cognitive development in-utero (through maternal health) and is associated with low birth weight, a predictor of various negative outcomes across the lifespan. Research shows that low-income mothers who experience higher EITC payments report reduced mental stress and “excellent or very good” physical health.¹⁶ In addition, increased income from the federal and state credits is associated with a greater likelihood of prenatal care, reduced maternal smoking, and decreased rates of low birth weights as well as increases in average birth weights.¹⁷
- **Educational Achievement and Attainment.** While the pathways by which family income and poverty affect educational outcomes continue to be debated by the experts, there nevertheless exists undeniable evidence of achievement gaps by income as well as differential rates in high school completion and college attendance.¹⁸ Research documents associations between increases to family income and improved educational outcomes, with a number of studies specifically linking generous state and federal EITCs throughout various ages of childhood to higher educational achievement and long-term attainment.¹⁹ Children in low-income families that receive larger state or federal EITCs tend to score better on reading and math achievement tests. Receipt of larger EITCs during childhood also increases the likelihood of high school completion and college attendance. In addition, larger credits make college more affordable for low-income families with high school seniors and are associated with higher college enrollment, especially in states that offer a tax credit tied into the federal refundable credit.
- **Employment and Earnings in Adulthood.** The improved educational outcomes associated with increased income from the EITC also have implications for employment and earnings when children

reach adulthood. While not solely focused on income from the EITC, there is some evidence which suggests links between boosts to family income (especially when they occur early in a child's life) and increased work hours and earnings for those children later in life.²⁰

Expanding the Benefits of the Federal Credit with a State EITC

A state EITC can leverage the associated benefits of the federal credit and further combat poverty and economic hardship among working poor and low-income families. A combination of the federal and state credit can be particularly helpful to those moving off public assistance and into the workforce by closing the poverty gap, or at least substantially reducing the gap, for these families. State credits may help to meet ongoing expenses associated with working (such as transportation), thereby supporting work efforts. For those with incomes somewhat above poverty who continue to experience economic hardship, the boost from a state credit may allow these families to cope with unforeseen costs that otherwise threaten their financial stability.²¹ Similar to how the federal EITC helps to offset federal taxes paid by low-income working families, a state EITC can also alleviate the substantial burden of state and local taxes imposed on low-income working families in Hawai'i.

State EITCs typically “piggyback” on the federal EITC meaning that, for the most part, they have the same eligibility requirements and are set at a fixed percentage of the federal credit. As a result, states can take advantage of the existing federal structure so that filers simply multiply their federal EITC by a specified rate to determine their state credit.²² All but three of the current state EITCs are refundable.²³ Nonrefundable credits can only be used to offset income taxes owed, and families with very low earnings typically owe little or nothing in state income taxes. A nonrefundable state credit would not supplement a family's income above its earnings and would, therefore, do little to help lift Hawai'i's families.²⁴

Hawai'i could implement a state EITC that is refundable and set at 10% of the federal. In 2013, there were 606,001 tax returns submitted by Hawai'i filers to the Internal Revenue Service, and 109,016 of these (or 18%) received the federal EITC, for a total of \$237,727,136 coming to the state.²⁵ Using calculations from the Brookings Institution, and based on 2013 tax data, the estimated number of children in Hawai'i that would benefit from a state EITC in the first few years could range from 41,622 to 97,118, depending on the participation rate of those who are eligible. The amount of state EITC dollars that would go to households with children is estimated to range from \$6,861,093 to \$16,009,218, again, depending on the level of participation and based on a state EITC equal to 10% of the federal tax credit (See Figure 3).



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Figure 3. Estimated State EITC Participation Rates, Number of Children Benefitting, and Dollar Amounts that Would Help Eligible Hawai'i Families with Children (based on state EITC set at 10% of federal credit)²⁶

Estimated participation rates after implementation of a Hawai'i state EITC:	The estimated number of children in households that would benefit from the state EITC in the first few years of implementation:	The estimated amount of state EITC dollars that would go to households with children:
Low (30% participation)	41,622	\$6,861,093
Medium (50% participation)	69,370	\$11,435,156
High (70% participation)	97,118	\$16,009,218

Conclusion

The annual receipt of large tax refunds provides low-income families with unusual budget opportunities to pay past-due bills, reduce debt, and build assets and savings.²⁷ A state EITC could give thousands of Hawai'i's families a much-needed boost by allowing them to keep more of what they earn. Working parents should be able to afford basic needs and support their families. A relatively small investment in the tax credit can make a big difference for Hawai'i's low-income children and families.

Endnotes & Citations

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Suggested Citation

Suggested citation: Pobutsky, A. & Stern, I.R. (2016). How a State Earned Income Tax Credit Would Benefit Hawai'i's Low-Income Families and Children. Honolulu, HI: University of Hawai'i, Center on the Family.



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