New Jersey today is in a position very similar to that of early 1999, in terms of advancing policies to help the working poor. Now, as then, a proposal has been put forward that would reward work and ease the tax burden on people and families whose best efforts can take them only to or slightly beyond the poverty line.

Last year the policy involved increasing the amount of money a family could earn before having to pay state income tax. This year it is the Earned Income Tax Credit. Either one of them would be a step in the right direction. Used in tandem they can be a powerful engine to help drive working poor families farther.

But the similarities between this year and last-between the income tax threshold and the EITC-are not just that they both are solid programs that help people make ends meet. In its original form, the income tax threshold proposal fell short. Indeed, it would still have required some families earning below the federal poverty level to pay state income tax. However the version eventually passed by the Legislature and signed into law—a $20,000 threshold after the phase-in period—put New Jersey into the forefront of states when it comes to reducing the tax burden on families who have a difficult time affording life’s bare necessities. In the end, the consensus was that going further was advisable—and possible.

And so it is with the Earned Income Tax Credit. Unquestionably, an EITC in the form proposed by Governor Whitman in her January budget address would help many hardworking New Jersey families. It would be better than what we have now, which is a federal Earned Income Tax Credit program but none at the state level. According to the Washington-based Center on Budget and Policy Priorities, "several recent studies indicate that the EITC has positive effects in inducing more single parents to go to work, reducing welfare receipt, and moderating the growing income gaps between rich and poor."

But an analysis of the proposed New Jersey EITC program, centering on the federal EITC and those enacted by other states, shows that under the current proposal New Jersey again would fall short of the standard being set elsewhere. The most serious shortcomings of the current EITC proposal lie in its eligibility criteria and the resulting level of benefits.

**HOW DOES AN EITC WORK?**

Since 1975 a federal Earned Income Tax Credit program has been in effect. The EITC is not
welfare of any form. Rather, it is a tax credit available to low- and moderate-income workers, with by far most of the help going to parents as opposed to workers without children. This is in recognition of the reality that raising children adds substantially to the cost of living. How much a family gets depends mostly on its earnings. In 1999 the maximum benefit for families with one child was $2,312. For families with two or more children it was $3,816. The EITC also is available to individuals and couples without children, but at a much lower level. The maximum for them in 1999 was $347.

The federal EITC is structured to help working families who are earning below the poverty line. Most of these families already earn too little to have to pay federal income tax. But they still get a boost from the EITC because it is refundable. This means that if the amount for which a family is eligible exceeds their income tax bill, they get a refund check for the difference.

Since its inception the federal EITC program has been expanded three times. Today, according to a recent Center on Budget and Policy Priorities report, it is "a central element of federal efforts to boost income from work and lessen poverty among families with children." Over the years, strong support for the federal EITC has crossed party and ideological lines.

In tax year 1997, some 19.8 million families and individuals received benefits under the federal EITC. New Jersey ranked 14th in the nation, with 455,475 recipients of the federal EITC.

The federal EITC is adjusted for inflation. And the benefit level is determined along a sliding scale. Benefits peak at the following income levels: $5,670 for people with no children; $6,800 for families with one child; $12,460 for families with two or more children. The more a family earns after that, the lower the benefits they receive. But while benefits peak at those levels, the amount of income that can be received in order for some EITC benefits to be claimed is as follows: $10,200 for people with no children; $26,928 for families with one child; and $30,580 for families with two or more children.

**HOW DO OTHER STATES DO IT?**

Just as the federal Earned Income Tax Credit serves to offset regressive payroll taxes for Social Security and Medicare, so can state EITCs ease the burden of state and local taxes that fall unequally hard on the working poor. State sales taxes and local property taxes are cases in point. Indeed, a state EITC would be especially valuable in New Jersey, since this state relies more heavily than any other state on local property taxes to fund education and other local government services.

In designing their Earned Income Tax Credit programs states have for the most part seen no reason to reinvent the wheel. And so 11 of the 12 states with a form of EITC have, in effect, piggybacked onto the federal program. The 12th state, Indiana, has what it calls an EITC but doesn't closely resemble the federal program or those in other states.

Of the 11 states with programs modeled after the federal EITC, 10 have eligibility requirements identical to the federal program. What differs is the level of benefits, with each
state choosing credits at some percentage of the federal EITC. As the accompanying table shows, those percentages vary from less than 10 percent of the federal EITC to more than 40 percent.

Nine of the states allow workers without children to receive EITC benefits. Like the federal program, they do so at a much lower level than for families with children.

Eight states have an EITC that is refundable. In the past three years the number of states with refundable EITCs has increased, as has their value.

Like most other states, New Jersey's proposed EITC is refundable. And it too offers working families a percentage of what they would receive in federal EITC benefits. The New Jersey plan calls for an EITC at 10 percent of the federal benefit level in the first year of operation, with phase-ins to 15 percent in the second year, 17.5 percent in the third year and 20 percent in the fourth year.

This level of benefit starts New Jersey off about in the middle-higher than four states and lower than four. In its fourth year, New Jersey's EITC benefits would be higher than in most states, but still substantially below others. For example, New York's EITC will rise in 2001 to 25 percent of the federal EITC. Vermont's already is 25 percent. The average benefit in Minnesota for families with children is 29 percent of the federal EITC, but families at certain income levels can get up to 46 percent. In Wisconsin, families with three or more children can receive up to 43 percent of the federal EITC. The Rhode Island EITC is pegged at 26.5 percent of the federal EITC but is being phased down to 25 percent as part of a reduction in the state income tax.

**BEWARE OF THE CLIFF**

There is no place where New Jersey's proposal differs more from other state EITCs than in the area of income eligibility. New Jersey would be the only state that cuts off eligibility below the level of the federal EITC program.

The impact of this has been likened to falling off a cliff because while other states and the federal EITC phase out benefits somewhat gradually until families reach the maximum income level ($26,928 for families with one child and $30,580 for families with two or more children), New Jersey's proposed EITC abruptly cuts off at $20,000.

This cutoff would permit substantially fewer working families in New Jersey to receive the state EITC as compared to the federal EITC. As mentioned above, 455,475 families received federal EITCs in New Jersey in 1997. The state has estimated the number that would be served by the proposed state EITC to be 280,000. That means that more than 165,000 New Jersey families who get the federal EITC-approaching 40 percent of the total-would not get the state EITC.

Who are these families? They are the ones that don't qualify for Food Stamps or other public assistance, but who often are truly needy. Families like these are squeezed especially hard by New Jersey's high cost of living. Only Hawaii, for example, has higher average apartment rental rates. In only five other states is a higher percentage of the renting
population unable to afford fair market rent. Indeed a report prepared for Legal Services of New Jersey and the New Jersey Center for Economic Policy and Education found last year that a New Jersey family of four needs to make between $35,000 and $55,000 to pay for necessities, depending on the county in which they live. The report, The Real Cost of Living: The Self-Sufficiency Standard for New Jersey, defined necessities as housing, child care, food, transportation, health care and taxes.

One way to look at the "cliff" effect is to examine EITC benefits for families at 150 percent of the federal poverty levels ($20,820 for a family with one child and $25,050 for a family with two or more children). Such families qualify for the federal EITC but would not get the proposed New Jersey state EITC. The one-child family would have its state income tax reduced by $195 if they were eligible for the state EITC in its first year. The larger family would have its state income tax reduced by $233.

The difference between the federal EITC eligibility levels and those in the proposed New Jersey EITC raises a practical concern. People do not always know they are eligible for the federal Earned Income Tax Credit. At the national and state levels large-scale public awareness campaigns are undertaken to inform people about the EITC and remind them to apply. A two-tiered eligibility system would add unnecessary confusion to this effort, creating uncertainty among potential recipients as to whether they qualify and how much they can expect to get.

But the larger issue is one of fairness. The examples given above and those that follow show that by cutting off eligibility below the federal maximum allowable income the state program would cause there to be significantly different benefits for people making effectively the same amount of income. It penalizes families that have managed to just barely cross the $20,000 threshold: just when they earn enough to have to pay state income tax they lose their state EITC benefits. This is a "catch 22" that runs counter to other state and federal programs that offer incentives to promote work.

Two examples will illustrate this:

**Married Family With 2 Children**

At $19,000 of gross earnings the family would be eligible for both the federal and state EITCs. This family would pay no state or federal income tax. Because the EITCs at both level are refundable, the family would receive $2,623 from the federal government and another $525 from the state-for a combined EITC benefit of $3,148.

Compare them to a married, two-child family with gross earnings of $21,000. This family would get a $2,191 benefit from the federal EITC, but nothing from the state. Indeed, the family would have to pay $224 in state income tax, having crossed the $20,000 threshold. Adjusting incomes to reflect benefits and taxes we find that the second family, though it had $2,000 more in gross income, netted only $819 more than the first family because of the proposed EITC eligibility rules.

**Single-Parent Family With One Child**
Again, one family grosses $19,000 and the other $21,000. The first family pays $452 in federal income taxes but gets back $1,378 from the federal EITC. It pays no state income tax and gets back $276 from the state EITC. So the net combined state and federal EITC is $1,202.

The second family pays $752 in federal income tax but gets back $1,051 from the federal EITC. This family gets no state EITC and pays state income taxes of $259. When all of this is tallied, a family that grossed $2,000 more, netted only $838 more than the other family.

In both cases the absence of a state Earned Income Tax Credit made a significant difference.

With any program like an Earned Income Tax Credit there must be some level at which a family no longer is eligible for benefits. The issue of whether there is a dis-incentive to work when an extra dollar translates into a loss of benefits will always be raised. But the federal EITC system has taken steps to minimize this problem by gradually phasing out benefits, up to a reasonable level of income. Instead of gradually phasing out as a family approaches self-sufficiency, New Jersey's proposed EITC abruptly cuts off the family that still is highly vulnerable just as it tries to gain financial footing.

**WHAT CAN NEW JERSEY DO?**

If New Jersey joined other states in adopting federal EITC income eligibility cutoff limits the amount of money involved would not be great. Indeed, 75 percent of the benefits paid through the federal EITC go to families with income levels that would make them eligible under New Jersey's proposal. The state has estimated that in its first year of operation, the EITC as proposed would cost $48 million. If every person and family in New Jersey who received federal EITC benefits in 1997 had been eligible for a state EITC at the percentage level being proposed (10 percent in year one) the total cost would have been $65.4 million. That is a difference of $17.5 million in a budget anticipating a considerable surplus—-a relatively small price tag for spreading important benefits to another 165,000 recipients.

New Jersey's Earned Income Tax Credit program should have the same eligibility standards as the federal EITC. We need it and we can afford it. Doing this would:

Expand state EITC coverage for more than 165,000 additional families over what has been proposed.

Avoid confusion as to who was eligible for which program.

Reward work at a level commensurate with the federal program and other state EITCs.

New Jersey is the nation's second most affluent state. But that status masks a wide difference between a relatively small number of people who are doing fabulously and everyone else - especially the working poor. The need to prevent that gap from widening even further argues for taking other steps as well:

**Raising the phased-in benefit to 25 percent of the federal EITC.**
Phasing in the benefits more rapidly, possibly over two years instead of four.

Including individuals without children - even if only at the low benefit levels they receive in other states and with the federal EITC.

This is the time and place for displaying a high level of generosity. It is the time because New Jersey's economy is booming and the state budget anticipates significant surplus revenue. It is the place because, while it isn't easy being poor no matter where you live, it is especially trying in a high cost-of-living state like New Jersey. Not to adopt a state-of-the-art Earned Income Tax Credit in New Jersey raises the question of why New Jersey would exert a lesser effort to help the working poor than other states, including some where the cost of living is much less steep.

New Jersey Policy Perspective appreciates the assistance of the Center on Budget and Policy Priorities and the Association for Children of New Jersey in putting together this analysis. An important source for Earned Income Tax Credit information was the CBPP publication A Hand Up: How State earned Income Tax Credits Help Working Families Escape Poverty, 1999 edition, by Nicholas Johnson. Calculations on the impact of the proposed state EITC eligibility limits on two families were made by ACNJ with technical assistance from CBPP.

**COMPARISON OF STATE EITC PROGRAMS**

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<tr>
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<th>Refundable</th>
<th>% of Federal Benefit</th>
<th>Same Income Cutoff as Federal EITC</th>
<th>Covers Workers with No Children</th>
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