

Earned Income Credit Utilization by Welfare Recipients

What is the earned income credit?

The earned income credit is an income tax credit for low-income working individuals and families. The credit is available at both federal and state levels and has been around since 1975, when Congress first approved it to offset the burden of Social Security taxes and to provide an incentive to work. Congress enacted expansions in 1990 and in 1992, which were phased in over a period of years. Since the late 1990s, many states also implemented or expanded their own credits, which are typically calculated as a percentage of the federal credit.

How does Minnesota's earned income credit work?

The Minnesota Legislature reformed its earned income credit, the Working Family Credit (WFC), in 1998, creating a two-tiered credit that replaced the earlier single-tier system. Traditionally, the earned income credit phases in with earnings until it reaches a maximum, staying at that maximum until earnings reach what is known as a phase-out floor. After that point, the credit begins to phase out.

Under the Minnesota WFC, instead of reaching a maximum and phasing out, the credit phases into a second and higher maximum, stays at that maximum until earnings reach the phase-out floor, and then phases out from there. Before this change, there was the potential that household earnings would increase, but net income would decline.

In addition to altering the structure of the credit, the legislature also raised the maximum amount of the credit.

Who takes advantage of the credit?

For the entire population of eligible EIC recipients, about 80 percent to 85 percent receive the federal earned income credit. Among people enrolled in Minnesota's welfare program, the Minnesota Family Investment Program (MFIP), 54.3 percent of all households and 65.2 percent of households eligible to receive the credit did so in 1999. (These percentages were calculated by merging data on MFIP recipients with Minnesota state income tax returns and other earnings data.)

What affects whether a person or family receives the earned income credit?

Using 1992 through 1999 data, researchers found a number of factors that contribute to lower rates of receiving the WFC. Among these factors are the following:

- Barriers to work or to filing a tax return
- Reduced incentives to quickly exit Temporary Assistance for Needy Families (TANF), which is the federal welfare program
- Exemption from TANF work requirements
- Decreased availability of free tax preparation sites
- Decreased access to organizations that inform recipients of the EIC

- Decreased access to family, friends, and neighbors who can inform non-English-speaking recipients of the EIC

In addition, people falling into these groups were less likely to be eligible for more than \$50 of the Minnesota WFC. Researchers also found that certain racial and ethnic demographic groups, such as American Indians or Hispanics, were less likely than the average population to take advantage of the Minnesota credit.

What are the policy implications of these findings?

By gaining a clearer picture of who is taking advantage of these credits, policymakers can better understand how to bring together the proper mix of services in order to assist people in moving out of poverty. Increasing the maximum earned income credit and providing free tax preparation were both tied to increases in receipt of the EIC, which is a proven tool to obtain and maintain employment and help people increase their income.

For more information: Contact legislative analyst Donald Hirasuna at 651-296-8038. This short subject was written by research assistant Abigail Johnson and based on the article “Earned Income Credit Utilization by Welfare Recipients: A Case Study of Minnesota’s Earned Income Credit Program,” by Donald Hirasuna and Thomas Stinson, *Journal of Policy Analysis and Management*, volume 26, number 1 (2007), pages 125–148.

The Research Department of the Minnesota House of Representatives is a nonpartisan office providing legislative, legal, and information services to the entire House.