

The Michigan EITC: A Small Investment that Makes a Big Difference

As part of a tax package to reduce business taxes in 2011, the Michigan Earned Income Tax Credit was cut 70%, resulting in a tax increase for many low- and middle-income working families. The EITC keeps children and families out of poverty and helps to fuel economic activity. Restoration of the EITC must be part of the state's plan to promote economic growth. A strong state credit would go a long way toward helping veterans returning to the workforce, families making minimum wage, children living in poverty, and small businesses in urban and rural economies.

BACKGROUND

The state EITC is a refundable tax credit for working families, designed to promote economic opportunity, encourage and reward work and offset the taxes that these families pay – such as, income, sales, property, excise and other taxes. These taxes hit low- and middle-income families hardest, as they amount to a higher percentage of their total income than their high-earning counterparts. In Michigan, a parent working full time at the minimum wage of \$7.40 barely earns \$15,300 each year, but pays about 9 cents of every \$1 they earn in sales, excise and property taxes. Other Michigan families earning under \$52,000 pay around eight cents per dollar. In contrast, households earning \$331,000 or more pay only three cents of every dollar of their income in these taxes.¹ The EITC makes up for this disparity by reducing the taxes paid by low- and middle-income families, thereby allowing them to keep and spend more of what they earn.

The Michigan EITC piggybacks on the federal EITC as a percentage of the federal tax credit. When the state credit was created in 2006, it was originally set at 10% of the federal EITC in tax year 2008 and 20% in 2009 and subsequent years.² However, in 2011, the Legislature reduced the state EITC to just 6% for tax year 2012 and subsequent years. *This 70% reduction in the Michigan EITC is effectively a tax hike on low- and middle-income working families, who now receive a substantially smaller state tax refund. The average credit is now \$132, compared with \$439 in 2011.*

BENEFITS OF THE EITC

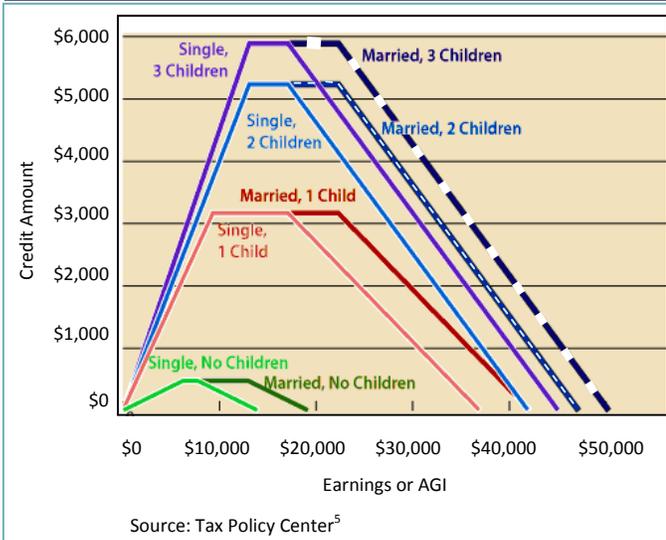
The EITC is an effective anti-poverty tool that helps hard-working families whose income puts them and their children below, or moderately above, the federal poverty line. Despite signs of recovery, many Michigan families continue to struggle with poverty, unemployment and underemployment – the state's unemployment rate is currently 8.9%, the sixth-highest in the nation.³ The state's child poverty rate remains high (25%), and its per-capita income (\$27,762) is well below the national average.⁴ In conjunction with its federal counterpart, the state EITC could provide much needed relief to these families if the credit was restored to 20%.

The EITC benefits local economies and small businesses that service low- and middle-income families, particularly in rural and urban areas where big box retailers are absent.

EITC FACTS

- To qualify, a family **must have earned income from wages**. Tax filers without work income do not qualify for the EITC.
- The EITC serves as a **temporary income supplement** for most families. Three out of five families who receive the credit use it for just 1 or 2 years until they get back on their feet.
- The EITC **offsets other taxes** paid by low- and middle-income families. Most EITC recipients pay a substantial share of their income in payroll, sales, state and local taxes.
- The credit has been shown to **increase employment** and reduce the need for public assistance.
- The credit **boosts the local economy** by allowing working families to keep more of the money they earn and spend it locally.
- The EITC **benefits businesses** by helping low-wage workers cover work-related costs – such as transportation and child care – which increase workers' reliability.

Figure 1
Earned Income Tax Credit by Number of Children and Filing Status, 2012



When families receive tax credits, they often spend them quickly in their communities to pay for basic needs, or use them to cover work-related costs such as transportation and child care, all of which help spur local economic activity and benefit many small businesses.

The EITC supports work and reduces poverty. Only individuals and families who work can qualify for the EITC. Over the past 15 years, numerous studies have found that the EITC significantly boosts the work efforts of families.⁶ Single mothers with young children and single mothers with low levels of education are most likely to experience an increase in employment and hours worked that is attributable to the EITC.⁷ By encouraging work and by supplementing the earnings of families whose incomes remain low despite their employment (such as full-time workers earning minimum wage), the EITC helps keep many households out of poverty.

The EITC has long-term benefits, particularly for children. Although most families receive the EITC for just 1 or 2 years,

and only 5% of all households experience poverty for multiple years at a time,⁸ the credit continues to benefit families long after they have moved up the economic ladder. Research shows that an increase in hours worked and earnings may have long-term benefits, such as higher wage growth in later years, and lower levels of poverty in retirement (due to an increase in Social Security credits earned).⁹

More significantly, the EITC and other programs that boost household income may also enhance children’s academic achievement, according to various studies. In one study, each \$1,000 in additional income to a struggling family raised the test scores and improved the overall academic performance of children in that family.¹⁰ An income-boosting credit of \$3,000 was found to increase a child’s academic performance by the equivalent of two months of additional education, according to another study.¹¹

The children of families whose incomes are supplemented by programs such as the EITC may also benefit in the longer term, as they enter the workforce. A 2011 study found a strong correlation between children’s improved test scores due to tax credits, and their adult work and earnings.¹² In another study, children in low-income families who received an income boost of \$3,000 per year in the children’s first five years of life, earned 17% more as adults, and worked 135 hours more per year, than their low-income peers whose families did not receive the additional income.¹³

Only 19% of Michigan tax filers receive EITC refunds

The EITC stimulates urban and rural economies. The EITC funnels millions of dollars into the local economies of urban and rural counties.¹⁴ According to the Michigan-based Anderson Economic Group, the federal EITC has a multiplier effect of between 1.2 and 1.7 times the original

amount, depending on population density. For the state as a whole, the Anderson Economic Group estimates a multiplier effect of nearly 2.1, with \$1.67 generated for every \$1 of EITC received in 2009.¹⁵ (“Multiplier effect” refers to new income generated by the injection of extra money into the economy: the original injected investment is spent and becomes someone else’s income. This new income, in turn, is again spent and becomes a third person’s or business’ income, and so on).

The state’s largest city, Detroit, received an estimated \$61.2 million in state EITC in 2011, and Congressional District 1, which has the highest concentration of rural counties in the state, received \$21.2 million the same year. With the reduction of the Michigan EITC to 6%, funds to Detroit will drop significantly to an estimated \$18.4 million in tax year 2012 – a loss of nearly \$43 million. Congressional district 1 will see a loss of nearly \$15 million, to an estimated \$6.4 million the same tax year.¹⁶ As a result, the economic impact

Table 1:
Changes in State EITC Assistance, 2011 and 2012

Tax Year	Michigan EITC Rate	Estimated Total EITC Received	Average EITC per Eligible Household
2011*	20%	\$349,210,085	\$439
2012**	6%	\$104,732,590	\$132

* Based on returns from January 2009 – July 2009
 ** Projections based on latest available data (sources: The Brookings Institution and the IRS)

Table 2:
Impact of EITC Reduction on Family of 3,
Earning Minimum Wage (\$7.40)

	Tax Year 2011 (State EITC 20%)	Tax Year 2012 (State EITC 6%)	Change in income (2011—2012)
Gross Work Earnings	\$15,392	\$15,392	\$0
Federal EITC	\$5,112	\$5,236	+\$124
Michigan EITC	\$1,022	\$314	-\$708
TOTAL INCOME	\$21,526	\$20,942	-\$584

of the EITC will be greatly diminished in many urban and rural areas of the state, and the small businesses serving these communities will be negatively affected.

A strong EITC helps struggling households. When combined with the federal EITC, a strong Michigan EITC can help families earning low wages avoid poverty and keep their children from enduring the lifetime hardships associated with poverty – including low academic performance in school, and low incomes and higher unemployment rates as those children reach adulthood.

Many Michigan families were able to avoid the pitfalls of poverty in 2009-2011, when the state EITC stood at 20% of the federal credit. As Table 1 shows, in 2011 an estimated \$349.2 million in Michigan EITC was disbursed to households in the state. In contrast, with the changes beginning in tax year 2012, the estimated disbursement falls to \$104.7 million.¹⁷ This is a loss of over \$244 million to low- and middle-income families.

In a household of three, a single mother working full-time and earning the state’s minimum wage of \$7.40 has an estimated gross income of only \$15,392 with which to support her two children. That is well below the federal poverty levels of \$18,530 and \$19,090 for 2011 and 2012,¹⁸ respectively. With a strong state credit, that family’s total EITC refunds would be \$6,134, including \$1,022 in Michigan

EITC at 20% of the federal credit. The state EITC helps raise that family’s income to 116% of the federal poverty line, or \$21,526 in 2011. In contrast, in 2012, with a reduced state EITC of only 6%, the family’s total EITC drops to \$5,550, including a *much smaller \$314 in Michigan EITC*. This family’s 2012 income *declines* to a total of \$20,942, barely keeping this household above the federal poverty level.

For the mother in the example above, the loss of income could mean not being able to afford to put food on the table, buy prescription medicine, or keep the heat on in cold Michigan winters. In the long term, struggling to just afford basic needs might keep this mother’s children from succeeding in school, or graduating altogether.

CONCLUSION

The Michigan EITC is a powerful anti-poverty tool that has helped many families over its four years of existence. In tax year 2011, an estimated 796,000 Michigan households received the credit and, at 20% of the federal credit, 16,400 children were kept from falling into poverty. In tax year 2012, with a substantially lower state credit (6%), the Michigan EITC will only keep an estimated 4,700 children out of poverty, while leaving another 11,700 children behind.

**Children kept out of poverty
by Michigan EITC:**

20% = 16,400

6% = 4,700

The families most affected by the 70% reduction in the state EITC will be forced to make tough choices,

and will be unable to participate in the local economy as fully as they could if the Michigan EITC were to be restored. As a result, not only will individual low- and middle-income households be affected, but so will the small businesses that serve them.

Knowing what is at stake for families, businesses and local economies, as the state economy shows signs of improvement, the Michigan Legislature should make restoration of the EITC a priority.

ENDNOTES

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