

***A State Earned Income Tax Credit for North Dakota's  
Working Families***



Compiled by the North Dakota Economic Policy Project (NDEPP)

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## Introduction

People in North Dakota work hard. Yet, every day thousands of working families face the challenges of making ends meet. Low-wage jobs in the state provide income insufficient to cover the high costs of healthcare, childcare, and job-related expenses. Despite having the lowest unemployment rate in the nation, North Dakota ties with Nebraska for the highest share of workers holding multiple jobs.<sup>1</sup>

At the same time, North Dakota's tax system is out of balance. People working in low-wage jobs like cashiers, home health workers, and sales associates pay a higher share of their income in state and local taxes than highly paid workers. In North Dakota, families with incomes that fall among the bottom 20 percent of the income spectrum pay 9.4% of their income in state and local taxes, on average, while families with incomes in the top 1% pay 4.3% of their income in taxes – less than half the share that low-income families pay.<sup>2</sup>

Now would be a prudent time to improve these inequities. A boom in North Dakota's oil industry has helped produce historic revenues for the state and a budget surplus projected to exceed \$1 billion by next June.

A state earned income tax credit (EITC) in North Dakota, modeled after the federal EITC, is an efficient way to help working families build a stronger financial future, to make North Dakota's

tax system more equitable, and to help local communities thrive.

## What is the Earned Income Tax Credit?

The federal earned income tax credit (EITC) is a refundable tax credit that can be claimed by low- and moderate-income working families to help offset payroll taxes and supplement low wages. A tax filer *must* earn wages in order to qualify for the credit, making it an effective incentive for families to join or stay in the workforce. The tax credit is targeted primarily to families with children.

The federal EITC has a 35-year track record of making work pay for low-income working families and is a policy that is supported by officials on both sides of the aisle.

Enacted in 1975 under President Ford, and expanded under Presidents Reagan, Bush and Clinton, research shows that the EITC increases employment among single parents, aids the transition from welfare to work, reduces family poverty and can help families to build assets for longer-term stability.

Called the government's 'most effective anti-poverty program', in 2009 the federal EITC lifted 6.5 million people out of poverty, including 3.3 million children.<sup>3</sup> According to the National Center for Children in Poverty, the federal EITC reduces child poverty for children by nearly 25 percent.

### **What is a State EITC and is it Right for North Dakota?**

The federal EITC has been so successful that during the last two decades, 23 states and the District of Columbia have established state-level earned income tax credits to supplement the federal credit and provide additional support to families earning low wages.

State EITCs are efficient. Typically, they are based on the existing federal EITC and take advantage of federal eligibility requirements and benefit structure. For this reason, there is little administrative cost to a state that chooses to implement its own credit.

State EITCs, like the federal, are most often “refundable,” meaning that if the credit exceeds the family’s income tax liability, the balance of the credit is paid to the family.

Three states, Delaware, Maine, and Virginia, have non-refundable EITCs. These credits reduce or eliminate state income tax liability for working families, but offer no benefits to working families beyond what they owe in income taxes. However, non-refundable credits are less effective as a work incentive.

A refundable state EITC would expand the power of the federal credit in offsetting taxes and promoting work.

***State EITCs are set as a percentage of the federal credit.***

***Twenty-three states and the District of Columbia have a state EITC. They currently range from 3.5-40 percent of the federal EITC.***

***The average state EITC is a little over 17%.***

**STATE EARNED INCOME TAX CREDITS BASED ON THE FEDERAL EITC**

<b>State</b>	<b>Percentage of Federal Credit (Tax Year 2010 Except as Noted)</b>	<b>Refundable?</b>
Delaware	20%	No
District of Columbia	40%	Yes
Illinois	5%	Yes
Indiana	9%	Yes
Iowa	7%	Yes
Kansas	18%	Yes
Louisiana	3.5%	Yes
Maine	5%	No
Maryland	25%	Yes
Massachusetts	15%	Yes
Michigan	20%	Yes
Minnesota	Average 33%	Yes
Nebraska	10%	Yes
New Jersey	20%	Yes
New Mexico	10%	Yes
New York	30%	Yes
North Carolina	5%	Yes
Oklahoma	5%	Yes
Oregon	6%	Yes
Rhode Island	25%	Partially
Vermont	32%	Yes
Virginia	20%	No
Washington	Not yet implemented; scheduled to go from 5% to 10% in 2011	Yes
Wisconsin	4% — one child 14% — two children 43% — three children No credit for childless workers	Yes

Source: Center on Budget and Policy Priorities.

*Offsetting Tax Liability*

Refundable state EITCs not only offset state income taxes, but also the impact of other state and local taxes disproportionately felt by low-income families, such as sales, excise, and property taxes.

In North Dakota, low-income families pay a higher share of their income in state and local taxes than other

residents. Families with incomes that fall among the bottom 20 percent of the income spectrum, or less than \$21,000 annually, pay on average 9.4% of their income in state and local taxes; families in the second quintile, or those earning between \$21,000 and \$35,000 annually pay 8.0 percent of their income in taxes. In contrast, families with incomes in the top 1%, \$406,000 or more annually, pay 4.3% of their income in taxes.<sup>4</sup>

### *Promoting Work*

The EITC is designed to encourage and reward work. For workers with very low earnings, the EITC grows with each additional dollar of wages until it reaches the maximum value. This creates an incentive for people to work and to work additional hours toward full-time employment. Research repeatedly confirms that both the federal and state EITCs increase workforce participation among eligible families.<sup>5</sup>

### *Building Long-term Financial Success*

A state EITC, coupled with the federal EITC, would provide a critical financial boost to those working families who need help most. In addition, aligning asset-building programs with a state EITC allows low-wage families to build their savings and work toward long-term financial success—an important step toward breaking the cycle of poverty from generation to generation.

The EITC may be a gateway to financial services and savings for the many low-income North Dakotans who lack bank accounts or access to financial institutions. Families that do not have the most basic access to mainstream financial services often rely on high-cost check cashing or other alternative financial services that consume large portions of their incomes and make it

even more difficult to put aside savings for the future.<sup>6</sup> EITC funds can be used to gain access to savings accounts and lower cost financial services.

In some states, a family's federal EITC refund can be deposited into an Individual Development Account (IDA), toward the purchase of savings bonds, or even to prepay college tuition.

North Dakota's IDA program, offered by Community Action of North Dakota, is a matched savings program that encourages individuals to save for education, the purchase of a home or to start a small business. This program already allows participants to make a one-time deposit of a federal EITC refund into their IDA. The program's guidelines could be expanded to include the deposit of state EITC refunds, as well.

### *Puts Dollars Back into Local Economies*

Low-income families spend virtually all of their income to make ends meet, and they tend to spend it where they live and work. Studies of the use of federal EITC dollars find that roughly two-thirds of refunds received are spent locally<sup>6</sup>. This benefits local businesses that are likely to see increased consumption of their products or services.

**PROPOSED STATE EITC BY NORTH DAKOTA LEGISLATIVE DISTRICT**

<b>Legislative District</b>	<b>Estimated # of federal tax returns</b>	<b>% eligible for state EITC</b>	<b>Estimated average state EITC</b>
ND Total	309,832	12.8	\$171
District 1	7,105	13.3	\$172
District 2	6,141	10.6	\$165
District 3	6,869	13.3	\$174
District 4	5,846	22	\$189
District 5	7,817	14.1	\$166
District 6	5,824	11.7	\$173
District 7	6,077	14.7	\$168
District 8	7,324	8.8	\$164
District 9	5,248	40.6	\$207
District 10	6,038	9.9	\$171
District 11	6,806	13.2	\$160
District 12	6,259	13.5	\$149
District 13	10,237	10.6	\$170
District 14	5,854	13.4	\$166
District 15	6,278	14.7	\$179
District 16	5,996	13.3	\$172
District 17	6,123	11	\$159
District 18	6,998	14.7	\$170
District 19	4,572	9.7	\$161
District 20	6,058	9.5	\$165
District 21	7,789	12	\$149
District 22	6,875	7.7	\$162
District 23	5,838	23.4	\$203
District 24	6,542	11.8	\$151
District 25	6,130	11.5	\$167
District 26	6,411	9.2	\$163
District 27	8,234	11.9	\$161
District 28	5,640	14.3	\$170
District 29	5,897	12.6	\$162
District 30	7,063	11.8	\$157
District 31	5,698	21.9	\$195
District 32	8,000	12.9	\$175
District 33	6,586	8.9	\$172
District 34	7,801	12.7	\$180
District 35	7,427	10	\$166
District 36	6,410	12.7	\$164
District 37	7,260	11.6	\$163
District 38	5,154	10.8	\$180
District 39	6,059	11.1	\$159
District 40	5,564	16.6	\$182
District 41	7,789	9.8	\$164
District 42	4,592	15.6	\$163
District 43	7,699	11.1	\$159
District 44	5,942	11	\$140
District 45	4,504	10.5	\$141
District 46	8,576	9.4	\$165
District 47	8,882	7.9	\$168

Source: The Brookings Institution, Earned Income Tax Credit Series, TY2006, <http://www.brookings.edu/metro/EITC>, compiled by North Dakota State Data Center at North Dakota State University- May 2010

### **Who would receive a State EITC?**

One in 9 taxpayers – roughly 40,000 people -- in North Dakota would benefit from a state EITC<sup>7</sup>.

The benefits, moreover, would reach every part of the state. The map below

indicates the share of taxpayers who could benefit from a state EITC in every legislative district, based on 2006 data (the most recent year for which these data are available). In District 9 (Rolette County), the district with the highest share of eligible households, over 40 percent of taxpayers could benefit.<sup>8</sup>

### **Funding a State EITC**

A state EITC set at 10% of the federal credit would cost less than one half of one percent of North Dakota's revenues for the current 2009-2011 biennium, (approximately \$14.4 million.)<sup>9</sup> Most states with a state earned income tax credit rely on general funds to cover the costs.

Some states use surplus Temporary Assistance for Needy Families (TANF) funds to help pay for a portion of their state EITC. However, whether a state EITC is funded through general funds or another revenue option, a state refundable EITC can be counted toward North Dakota's TANF "maintenance of effort" requirements.

### **Conclusion**

Implementing a refundable EITC in North Dakota will make work pay for thousands of low- and moderate income working families who would have additional funds to address their immediate needs, or to start saving for achieving long-term financial success. One in 9 taxpayers in North Dakota – people all across the state – would benefit.

A state EITC also will move North Dakota toward a more equitable tax structure by providing a tax cut to low- and moderate-income families who pay a higher portion of their income in taxes than upper income families.

Finally, a North Dakota State Earned Income Tax Credit would stimulate local economies, help families save for the future and boost a working parent's ability to provide a better future for their family.

The North Dakota Economic Policy Project focuses on research and policy analysis aimed at shaping budget and policy outcomes by providing accurate, timely, evidence-based information that informs, broadens and enriches the discussion on budget and taxes to policymakers, the media, advocates, and the public. NDEPP is non-partisan and independent. NDEPP is funded by the Northwest Area Foundation.

The North Dakota Economic Policy Project has partnered with the Center on Budget and Policy Priorities State Fiscal Analysis Initiative (SFAI) and has been accepted as a 'planning grant status' organization.

SFAI groups work at the state level to improve economic security and opportunity. They do so by analyzing the barriers that can prevent low-income families from improving their lives and by identifying sound policy solutions, like fairer tax systems, better health care, affordable child care, work supports, and income assistance.

NDEPP is also affiliated with the Economic Policy Institute's EARN network. The Economic Analysis and Research Network (EARN) is a network of state and regional multi-issue research, policy, and advocacy organizations.

EARN's mission is to improve the lives of Americans through state and local policy, and change the nature of the national policy debate—state by state. EARN seeks to advance progressive policy at the state and regional level, to deliver important national messages, and to use the collective capacity of its organizations to develop new ideas and strategies.



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## Notes:

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2. Institute of tax and Economic Policy, "Who Pays, A Distributional Analysis of the Tax System in all 50 States" [http://www.itepnet.org/state\\_reports/whopaysfactsheets](http://www.itepnet.org/state_reports/whopaysfactsheets)
3. Arloc Sherman, "Stimulus Keeping 6 Million Americans Out of Poverty in 2009, Estimates Show," Center on Budget and Policy Priorities, September 9, 2009.
4. Institute of Tax and Economic Policy, "Who Pays, A Distributional Analysis of the Tax System in all 50 States" [http://www.itepnet.org/state\\_reports/whopaysfactsheets](http://www.itepnet.org/state_reports/whopaysfactsheets)
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6. The city of San Antonio, for instance, estimated that each \$1 in EITC would generate a further \$1.58 in local economic activity, and each additional \$37,000 would result in one additional permanent job. Alan Berube, "Using the Earned Income Tax Credit to Stimulate Local Economies," The Brookings Institute <http://www.brookings.edu/metro/pubs/berube20061101eitc.pdf>
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10. "2009-2011 Budget Highlights," Office of Management and Budget

## Additional Resources:

Center on Budget & Policy Priorities (CBPP), "A Majority Of States With Income Taxes Have Enacted State Earned Income Tax Credits," October 5, 2007, [http://www.cbpp.org/eic2007/EIC\\_Participation.pdf](http://www.cbpp.org/eic2007/EIC_Participation.pdf)

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