SENATE FISCAL AGENCY

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MEMORANDUM

DATE: January 27, 2011

TO: Members of the Michigan State Senate

FROM: Frances Carley, Fiscal Analyst

RE: The Impact of Eliminating Michigan's EITC on the TANF MOE

TANF MOE Summary

The State receives $775.0 million annually from the Federal Temporary Assistance for Needy Families (TANF) block grant. As part of the grant requirement, the State must demonstrate Maintenance of Effort (MOE) spending from State General Fund/General Purpose (GF/GP) revenue, or GF/GP equivalent, for qualifying programs. Per Federal TANF guidelines, the minimum MOE standard is equal to 75% of the State's 1993-94 allocations for needy families ($624.75 million). This percentage increases from 75% to 80% for states that have not met the TANF work requirement. For Michigan, 75% of spending equals $468.5 million and 80% equals $499.8 million.

Michigan was not in compliance with its FY 2008-09 work requirement of 50%, and was therefore required to demonstrate MOE spending at the 80% level ($499.8 million) in that year. The State's FY 2009-10 work participation rate has not yet been approved by the Federal government. Due to a lengthy approval process, the State might not know whether spending was required at the 75% or 80% level until more than a year has passed since the end of a given fiscal year. Because it is possible that the State will not meet the work requirement in either the current or upcoming fiscal years, this analysis assumes the need to maintain MOE spending at the 80% level, or $499.8 million.

A limited number of programs/expenses meet the criteria and can be included in the MOE match. Currently, every known, eligible item is being counted in the MOE; there may, however, be additional sources of MOE that have not yet been identified. The FY 2010-11 MOE includes 18 programs/expenses from four departments: Department of Human Services, Department of Energy, Labor, and Economic Growth, Department of Treasury, and Michigan Department of Education.

Michigan EITC Summary

Created by Public Act 372 of 2006, Michigan's Earned Income Tax Credit (MEITC) for low-income earners was available beginning in tax year 2008. To be eligible for the MEITC, taxpayers must pay Michigan taxes and also qualify for the Federal EITC. The MEITC credit is currently 20% of the amount a person is allowed to claim for Federal EITC. For example, in FY 2010-11, a married couple with two qualifying children and an annual income of less than $46,044 can receive a Federal credit of $5,112 and an MEITC credit of $1,022; and individuals making less than $13,660 a year with no children can receive a Federal credit of $464 and an MEITC credit of $92.

According to a 2010 report from the Michigan Department of Treasury, more than 711,000 taxpayers received the MEITC in tax year 2008. The average credit equaled $204, with more than $145.2 million in total credits claimed. The average taxpayer claiming an EITC had a Federal adjusted gross income (AGI) equal to $15,805.

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Based on the current revenue estimate numbers, the MEITC is projected to be $340.0 million in FY 2010-11 and $360.0 million in FY 2011-12. The State is able to claim 60.7% of MEITC claims toward the MOE for a projected total of $206.4 million in FY 2010-11.

Excess TANF MOE

Using the current consensus revenue estimate for the MEITC, there are excess MOE claimable expenditures of approximately $184.8 million, bringing the state's total projected MOE claim in 2010-11 to $684.6 million.

The State Budget Office recommends maintaining a minimum cushion above and beyond the $499.8 million minimum MOE requirement to ensure that the state remains in compliance with the grant (see section on MOE Non-Compliance: Penalties and Fees, for more information).

If actual year-end spending in any of the 18 MOE eligible program areas is less than what had been projected, this excess would be reduced. If the State, however, applies for and receives TANF contingency funding, excess MOE is critical, as this funding would require a match above and beyond the current MOE spending.

TANF Contingency Funding

TANF contingency funding is available to states that demonstrate severe economic distress, as measured by changes in food assistance caseload or the unemployment rate. States can receive an increase in Federal TANF funding (up to 20% above the standard TANF grant) by meeting an enhanced Federal MOE standard (100% of the FY 1993-94 spending less day care expenditure) and providing GF/GP funding at the Federal Medicaid matching rate for each dollar of increased Federal support.

In FY 2007-08, the State received $155.0 million in TANF contingency funding - the maximum amount available - and $155.0 million again in FY 2008-09. In FY 2009-10, the State received emergency TANF funding instead of contingency funding. It is not yet known whether the State will qualify for additional funding in FY 2010-11. Depending on the program cuts in the FY 2011-12 budget, the State might not be able to provide a match for any contingency funding.

Elimination of MEITC

If the FY 2010-11 $206.4 million claim from the MEITC were eliminated from the MOE, there would be a deficit of approximately $21.6 million. Unless other sources of MOE are found, the State would then have to add a minimum of $21.6 million in State funding to one or more of the 18 approved MOE programs/expenses in order to meet the minimum spending requirement. Additionally, the State could not reduce or cut any of these 18 programs/expenses without making comparable increases in other approved line items. If applicable, the State also would not be able to provide a match for contingency funds.

Reduction of MEITC

If the MEITC were reduced to 10% of the Federal EITC level, the percent of claimable MEITC would drop from 60.7% to 49.4%. For example, in FY 2008-09, when the MEITC rate was 10%, the amount of claimable MEITC was $71.4 million (as opposed to the $206.4 million projected for FY 2010-11 at the 20% rate). If the MEITC rate were reduced to 10%, the State could retain an excess of approximately $49.8 million for the MOE.

TANF MOE Non-Compliance: Penalties

The State will face a double financial penalty if it is unable to demonstrate $499.8 million in eligible MOE spending; the State will not, however, lose the entire $775.0 million grant. First, the TANF grant will be reduced in the following year by the amount by which the MOE is short in the previous year. Second, the State will have to demonstrate additional MOE spending in the amount of the previous year's shortage. For example, if spending is $10.0 million below the MOE standard, the TANF grant will be $10.0 million less than in previous years (a grant of $765.0 million). The State would also be required to add another $10.0 million in MOE spending the following year, bringing the total MOE spending from $499.8 million to $509.8 million.

Conclusion

The State could eliminate the MEITC and then add additional funding to one or more approved MOE spending areas in order to meet the minimum MOE requirement. In this scenario, the State would not be eligible for contingency funding. While it is possible that there are other existing sources of MOE elsewhere in the budget, all of the known sources are currently included in the calculations. It also is possible to reduce the MEITC to 10% of the Federal EITC level and retain a balance of excess MOE; this excess would not necessarily be sufficient for the State to qualify for contingency funding. If the State were to remain out of compliance with the required MOE spending, a double penalty would be levied, but the State would not lose the entire TANF grant.

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c: Ellen Jeffries, Director
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