

State Notes

TOPICS OF LEGISLATIVE INTEREST

Winter 2023



The Earned Income Tax Credit By Bobby Canell, Fiscal Analyst

Executive Summary

- The Michigan EITC is 6% of Federal EITC; there are ongoing discussions to increase the Michigan EITC.
- The average EITC cost for the State of Michigan from 2012-2019 was \$110.4 million each year.
- Raising the EITC mainly benefits low-income workers.

The Earned Income Tax Credit (EITC) (also known as the Earned Income Credit (EIC)) was established in Michigan under Public Act 372 of 2006. The tax credit was effective beginning in tax year 2008 and equaled 10% of the Federal EITC. The Michigan EITC has the same eligibility requirements as the Federal EITC; accordingly, if a taxpayer is eligible for the Federal credit, a taxpayer also is eligible for the Michigan credit. From 2009 to 2011, the Michigan EITC was set to 20% of the Federal level. Since 2012, the Michigan EITC has been set to 6% of the Federal credit.¹

In February 2022, Governor Gretchen Whitmer proposed raising the EITC to 20% of the Federal credit. Several bills were introduced in the Michigan House of Representatives and the Michigan Senate during the 2021-2022 session that would have raised the EITC. As introduced, Senate Bill (SB) 417 of 2021, which did not make it out of committee, would have gradually raised the EITC to 10% of the Federal credit (a Committee substitute would have gradually raised it to 30%), while House Bill (HB) 4568 of 2021, among other things, would have raised the EITC to 20% of the Federal credit. House Bill 4568 was vetoed by the Governor. The EITC portion of House Bill 4568 would have cost \$262.0 million per year. Senate Bill (SB) 3 of 2023 as passed by the Senate on January 26, 2023, would increase the EITC to 30% of the Federal level for tax year 2023 and beyond. This would be applied retroactively for tax year 2022. Senate Bill 3 has yet to be passed by the House as of the writing of this paper, but a conference report for HB 4001 includes an increase of the EITC to 30% of the Federal level, retroactive to tax year 2022.

The EITC was created to reduce the tax burden on low-income individuals, while encouraging those individuals to work. The credit is refundable, meaning if the credit exceeds the taxpayer's liability, the taxpayer will be paid the difference as a refund. Taxpayers must have earned income to receive the credit. According to the Internal Revenue Service, the following types of income count as "earned income":

- Wages, salary, or tips from which Federal income taxes were withheld on Form W-2, box 1.
- Money made from self-employment.
- Income from a job in which an employer did not withhold income tax.
- Benefits from a union strike.
- Certain disability benefits received before one's minimum retirement age.
- Nontaxable combat pay.

¹ "Michigan's Individual Income Tax 2019", Michigan Department of Treasury Office of Revenue and Tax Analysis Tax, December 2021. Available at: <https://www.michigan.gov/treasury>.



Earned income does not include income that is not earned, such as social security, unemployment benefits, alimony or child support, pensions and annuities, and interest or dividends. Given the increased interest in raising the EITC, this paper discusses the background and calculation of the Michigan EITC as well as outlines the revenue implications of changing the credit.

Federal EITC

Calculating the Federal EITC is one of the more complex provisions in the Federal tax code. On the Federal tax form, the EITC is one of a few instances in which the Internal Revenue Service offers to compute the credit for taxpayers. Eligibility criteria differ by filing status, whether the taxpayer has children, and, if so, the number of children. Understanding how the Federal EITC is calculated explains how much may be claimed as a Michigan EITC because the Michigan EITC is a percentage of the Federal credit. As stated above, taxpayers must have at least \$1 of earned income to be eligible for the credit. As earned income increases, the Federal credit rises, but after a certain level begins to phase out, as shown in Tables 1 and 2.

Table 1

Important Thresholds for Single EITC Filers in 2022				
2022 EIC Qualification Item (Federal)	No Children	With 1 Child	With 2 Children	With 3+ Children
1. Max. 2022 Earned Income Tax Credit Amount	\$560	\$3,733	\$6,164	\$6,935
2. Earned Income Base Amount required to get maximum credit	7,320	10,980	15,410	15,410
3. Phaseout Threshold Amount Begins (for Single, SS, or HoH)	9,160	20,130	20,130	20,130
4. Income (AGI) Maximum When Credit Eligibility Ends (for Single, SS, or HoH)	16,480	43,492	49,399	53,057
SS refers to married filing separately, HoH refers to Head of Household. Source: US Department of Treasury, Internal Revenue Service, 2022.				

Table 2

Important Thresholds for Joint EITC Filers in 2022				
2022 EIC Qualification Item (Federal)	No Children	With 1 Child	With 2 Children	With 3+ Children
1. Max. 2022 Earned Income Tax Credit Amount	\$560	\$3,733	\$6,164	\$6,935
2. Earned Income Base Amount required to get maximum credit	7,320	10,980	15,410	15,410
3. Phaseout Threshold Amount Begins (for Married Filing Jointly)	15,290	26,260	26,260	26,260
4. Income (AGI) Maximum When Credit Eligibility Ends (for Married Filing Jointly)	22,610	49,622	55,529	59,187
Source: US Department of Treasury, Internal Revenue Service, 2022				

The American Rescue Plan Act (ARPA) made changes to the eligibility requirements for the EITC; some of these changes ended in 2021 and some are permanent. The major changes to the EITC



are the temporary change of expanded childless tax credits which ended in 2021. The ARPA changes will show as a small increase in cost to the Federal government, which translates to a small increase in cost to the State government during the 2021 tax year, but it will not have a lasting effect. For both single and joint filers with no children, the credit rate (the rate with which the credit increases) was 7.65% in 2022.² This rate means that, starting at \$1, each additional dollar of earned income will increase the credit by 7.65 cents.³ The credit amount continues to increase 7.65 cents per dollar earned until the filer reaches the earned income required to receive the maximum credit, shown in Tables 1 and 2. The phase-out rate, the rate at which the credit is reduced, also is 7.65%. The phase-out rate starts at different income levels depending on the taxpayer's filing status. For those who do not file as married filing jointly, the credit begins declining after \$9,160 of earned income and is reduced to \$0 at \$16,480 of earned income, as seen in Table 1. For married filing joint returns, the credit begins declining at \$15,290 of earned income and is reduced to \$0 at \$22,610 of earned income, as seen in Table 2.

Credit rates are higher for taxpayers with children. The credit rate for one child is 34%, with a phase-out rate of 15.98%. The credit rate for two children is 40%, with a phase-out rate of 21.06%. The credit rate for three or more children is 45%, with a phase-out rate of 21.06%. The income levels at which the credit begins to phase out are higher for those with children than those with no children, but do not depend on the number of children. For married taxpayers filing jointly, the credit begins to phase out at \$26,260, while for all other taxpayers the phase-out begins at \$20,130. However, because of the different credit rates and phase-out rates, the income level at which the credit is reduced to zero differs based on the number of children, as shown in Tables 1 and 2.

These income limits are adjusted for inflation. In tax year 2022, the maximum EITC a taxpayer may claim totals \$6,935, depending on filing status and the number of children.

Michigan EITC

The calculation for the Michigan EITC is relatively straightforward, as the Michigan EITC currently is 6% of the Federal EITC. The qualifications are identical to the Federal EITC, so those who qualify for the Federal EITC automatically qualify for the Michigan EITC. However, a taxpayer still must file a Michigan tax return to receive the Michigan credit.

Below are example calculations to illustrate how the Federal and Michigan EITCs vary with tax filing status (single, joint), number of children, and earned income.

Example 1: Single no children, with earned income of \$8,000.

This return would receive a \$492 EITC from the Federal government and, at the current 6% rate, a \$30 EITC from Michigan. The combined total of \$522 would represent 6.5% of earned income.

Example 2: Single parent of one child, with earned income of \$8,000

This return would receive a \$2,733 EITC from the Federal government and, at the current 6% rate, a \$164 EITC from Michigan. The combined total of \$2,897 would represent 36.2% of earned income.

² 26 USC 32.

³ Crandall-Hollick, Margot L., et al., "The Earned Income Tax Credit (EITC): How It Works and Who Receives It", CRS Report No. R43805, 1-12-2021.

Example 3: Married parents of two children, with earned income of \$25,000

This return would receive a \$6,164 EITC from the Federal government and, at the current 6% rate, a \$370 EITC from Michigan. The combined total of \$6,534 would represent 26.1% of earned income.

Example 4: Married parents of two children, with earned income of \$50,000

This return would receive a \$1,154 EITC from the Federal government and, at the current 6% rate, a \$69 EITC from Michigan. The combined total of \$1,223 would represent 2.4% of earned income.

Example 1 and Example 2 differ only in that the first example return has no children, and the second example return has one child. However, while both taxpayers exhibit the same earned income, the taxpayer in Example 2 would receive \$134 more from the State. Example 3 and Example 4 differ in the amount of earned income, although the number of children is the same. The taxpayer in Example 3 receives \$301 more than the taxpayer in Example 4 because the Example 4 taxpayer has reached the phase-out level and for each additional dollar earned, the credit is reduced.

Figure 1

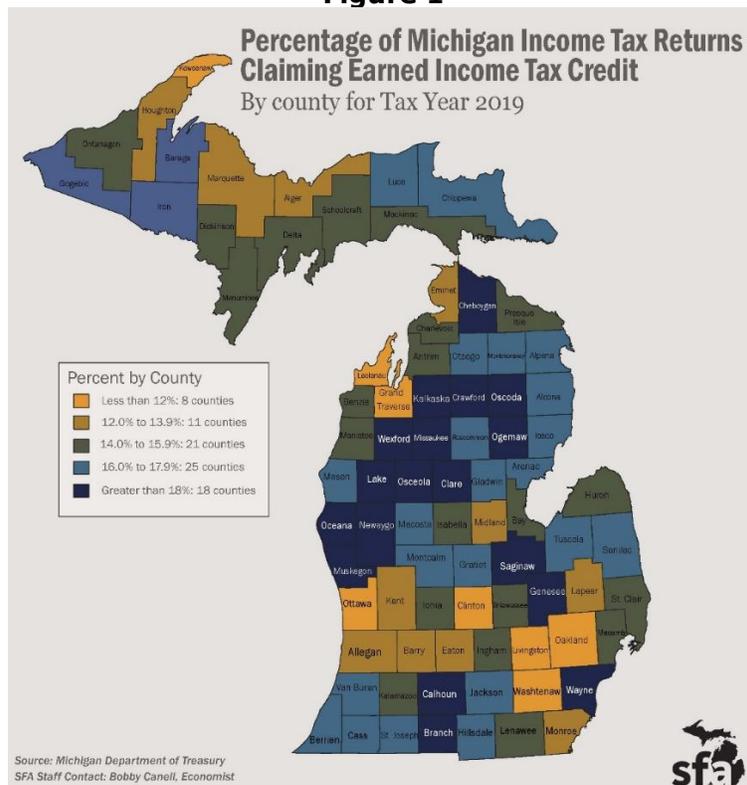


Figure 1 illustrates the percentage of all returns in a county that claim the EITC. The counties with the highest percentage of EITC returns in descending order are Lake, Wayne, and Oscoda. The counties with the lowest percentage of EITC returns in ascending order are Livingston, Leelanau, and Oakland. There is correlation between poverty levels and the EITC, with the counties with higher poverty levels typically having a higher percentage of EITC returns.

The distribution of EITC dollars across income groups is provided in Table 3. This table shows the income levels along with the number of Michigan claimants, as well as the total amount of credit



for that income group and the percentage of the credit that went to that income level. It includes both tax year 2019 and 2020. Tax year 2020 shows a decline in the number of EITC claims and the amount of all credits. These declines are in part due to fewer people being eligible for the EITC by not having any earned income during the pandemic. There also is a shifting upwards in income from 2019 to 2020 that increased some taxpayers' incomes above the threshold to collect the EITC. As 2020 was a unique year because of the pandemic, tax year 2020 data should be considered an outlier.

As of tax year 2019, there were 738,377 returns claiming the Michigan EITC. This accounts for just over 15% of the total returns in the State, with an average credit of \$150 per Michigan EITC return. For those returns between \$10,001 and \$15,000 of earned income the average credit is \$150; for those returns between \$20,001 and \$25,000, the average credit is \$250; and for those returns between \$40,001 and \$45,000, the average credit is \$85. Because of the income phase-out, the EITC generally represents a larger share of income for low-income claimants. For filers with incomes below \$25,000, the Michigan EITC averages approximately 1.1-1.2% of income, while at higher income levels, the share declines. For those with incomes between \$40,000 and \$45,000, the Michigan EITC represents 0.2% of income.

Table 3

Michigan EITC Claims in 2019 and 2020								
Adjusted Gross Income	2019				2020			
	Number Claiming MI EITC	Amount (Million)	% of Total Dollars	Average	Number Claiming MI EITC	Amount (Million)	% of Total Dollars	Average
\$1 - \$5,000	68,456	\$2.0	1.8%	\$28.54	60,335	\$3.1	3.5%	\$52.05
\$5,001 - \$10,000	102,703	8.1	7.4	79.31	78,178	\$6.1	6.7	77.49
\$10,001 - \$15,000	158,015	23.9	21.6	151.17	104,397	\$0.7	11.8	102.18
\$15,001 - \$20,000	97,642	25.6	23.2	262.67	73,567	15.2	16.9	207.27
\$20,001 - \$25,000	72,482	18.1	16.4	249.69	75,747	17.1	18.9	225.36
\$25,001 - \$30,000	67,928	14.0	12.6	205.69	78,528	16.0	17.7	203.40
\$30,001 - \$35,000	61,871	9.5	8.6	154.05	69,771	11.0	12.2	157.56
\$35,001 - \$40,000	51,403	5.4	4.9	104.63	58,194	6.3	7.0	108.84
\$40,001 - \$45,000	31,357	2.6	2.4	83.91	35,923	3.1	3.4	85.07
\$45,001 - \$50,000	17,649	1.1	1.0	60.11	20,049	1.3	1.4	64.12
More than \$50,000	8,871	0.3	0.2	31.11	11,404	0.4	0.5	36.05
Total	738,377	\$110.6	100.0%	\$149.76	666,093	\$90.2	100.0%	\$135.47

Note: Totals may not add up due to rounding
 Prepared By: Office of Revenue and Tax Analysis, Michigan Department of Treasury

Table 4 shows the 2019 data previously seen in Table 3 and includes claims by adjusted gross income (AGI) as a percentage of total EITC claims. The final column in Table 4 shows the claims in each income row as a percentage of the total number of returns claiming the EITC. Returns with an AGI between \$5,001 and \$10,000 account for 13.9% of the total EITC claims but only 7.4% of the total dollars. Returns with an AGI between \$15,001 and \$20,000 account for 13.2% of the total EITC claims and 23.2% of the total dollars. Returns with an AGI between \$35,001 and \$40,000 account for 7.0% of the total EITC claims and 4.9% of the total dollars. This shows the skew toward the middle of the income distribution as explained by the credit and phase-out rates in Tables 1 and 2.



Table 4

Comparing the Distribution of Michigan EITC Claims and Payments, 2019				
2019				
Adjusted Gross Income	Number Claiming MI EITC	Amount (Million)	% of Total Dollars	Claims by AGI Category as a Percentage of Total EITC Claims
\$1 - \$5,000	68,456	\$2.0	1.8%	9.3%
\$5,001 - \$10,000	102,703	8.1	7.4	13.9
\$10,001 - \$15,000	158,015	23.9	21.6	21.4
\$15,001 - \$20,000	97,642	25.6	23.2	13.2
\$20,001 - \$25,000	72,482	18.1	16.4	9.8
\$25,001 - \$30,000	67,928	14.0	12.6	9.2
\$30,001 - \$35,000	61,871	9.5	8.6	8.4
\$35,001 - \$40,000	51,403	5.4	4.9	7.0
\$40,001 - \$45,000	31,357	2.6	2.4	4.2
\$45,001 - \$50,000	17,649	1.1	1.0	2.4
More than \$50,000	8,871	0.3	0.2	1.2
Total	738,377	\$110.6	100.0%	100.0%

Note: Totals may not add up due to rounding

Changing the Michigan EITC

Increasing the Michigan EITC would reduce revenue for the State. Data from the 2019 tax year show that the cost to the State of Michigan due to the EITC at its current rate of 6% is \$110.6 million, which is almost identical to the average rate between tax years 2012 and 2019 of \$110.4 million per year. If the rate were 30% instead of 6%, it would cost the State \$552.0 million, an increase of \$441.6 million based on the average rate between tax years 2012 to 2019. As the data vary from year-to-year, costs in the 2023 tax year will be slightly different; however, there is very little variation in the number of people collecting the Michigan EITC as shown in [Figure 2](#). Raising the EITC rate to 30% would not increase the participation rate significantly. The number of claims each year remains relatively constant. As a result, each 1% change in the credit costs roughly \$19 million. [Table 5](#), below, illustrates the expected costs of changing the rate.

According to the Congressional Research Service, in 2016, 80.4% of people eligible for EITC in Michigan claimed it. An increase in the EITC is unlikely to increase the participation rate by much; however, it is possible that the participation rate could increase as the credit increases. If the participation rate increases, then the total cost to the State of Michigan, in terms of reduced revenue, would be higher. On a similar note, if the number of people claiming the credit increases, individuals claiming the Michigan credit likely would be claiming the Federal EITC as well. If more taxpayers claimed the Federal EITC, Michigan residents would receive more money, which would have a positive effect on the economy and overall tax revenue. This could offset some of the increased costs of increasing the Michigan EITC rate. Based on Table 4, there were 738,377 claimants in 2019. Assuming the participation rate from 2016 still holds true, there are roughly 920,000 eligible claimants, or roughly 180,000 claimants in Michigan not claiming the EITC. To receive the EITC, a taxpayer must fill out a tax return; many of those who are eligible for, but do not receive, the EITC may not be filing returns. This may be because potential claimants do not realize that they would receive these refundable credits, or the credits they would receive could be too small to be worth the cost of filing their returns.



Figure 2

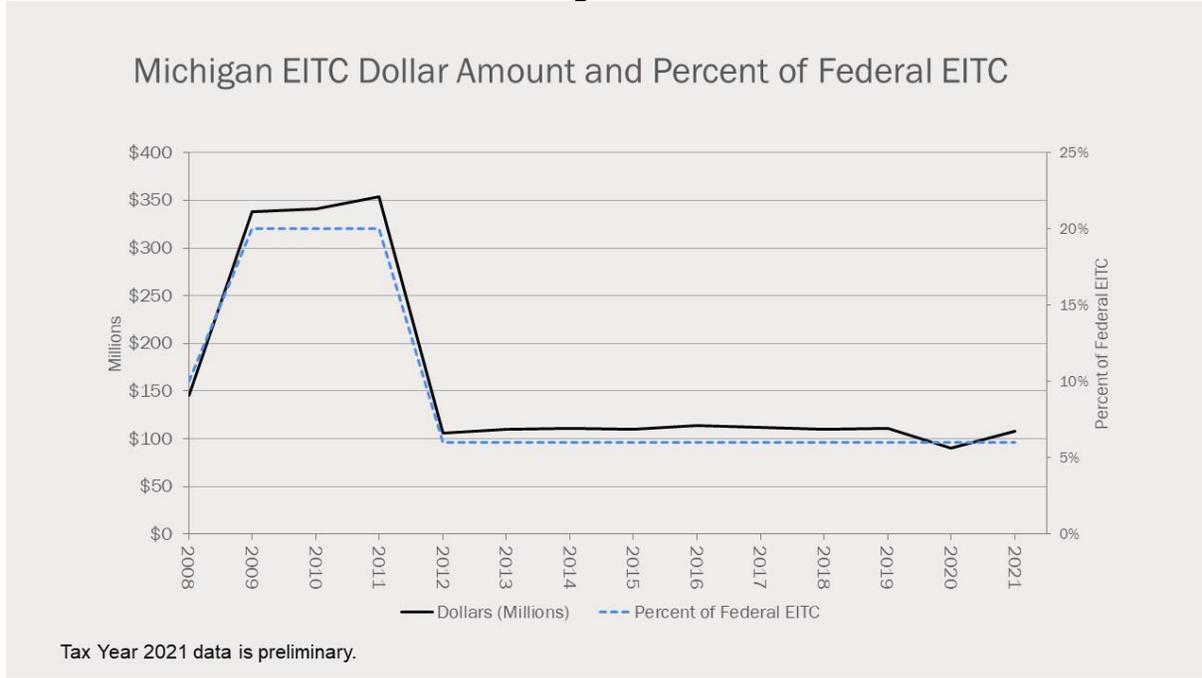


Table 5

Fiscal Impact of Changing the EITC Rate		
Percent of Federal Credit	Total Cost	Change from Current Law
*6%	\$110.4	\$0
10	184.0	73.6
15	276.0	165.6
20	368.0	257.6
25	460.0	349.6
30	552.0	441.6
35	644.0	533.6
40	736.0	625.6

*6% is the current rate, Total Cost is the 2012-2019 average

Summary

The EITC is designed to relieve the tax burden on low-income individuals and to encourage people to work. The Michigan EITC is calculated as a share of the Federal credit and that share has changed over time. Michigan has offered an EITC since 2008, and since 2012, the Michigan EITC has been 6% of the Federal credit. The current EITC reduces State revenue by approximately \$110.0 million per year. The Governor and the Legislature have offered multiple proposals to change the EITC. This paper provides a discussion of the EITC calculation and outlines the revenue implications of changing the credit.