Merging Family Tax Credits to Include the Most Vulnerable Families

Introduction

This document outlines a comprehensive plan for enhancing family tax credits in Maryland. It will examine the shortcomings of the current system, propose a new policy, analyze potential outcomes, and discuss the methodology, political considerations, and supporting research.

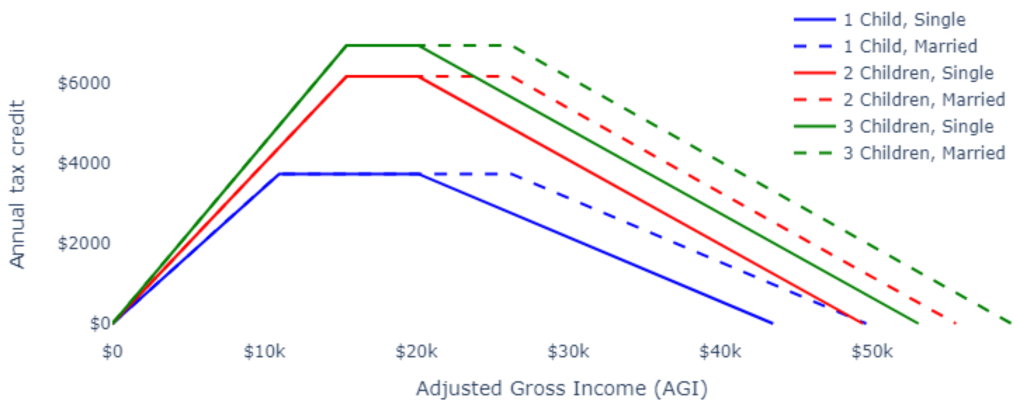
Existing Tax Credits

Maryland currently has a variety of tax credits aimed at boosting the incomes of low and middle income families, including the Earned Income Tax Credit (EITC), Child and Dependent Care Tax Credit (CDCC), and Poverty Line Credit (PLC). Maryland also has a medley of deductions and exemptions that reduce tax liability. While these programs reduce the tax liability of many middle income families, they tend to miss the most vulnerable families at the bottom of the income distribution.

The EITC excludes Maryland's poorest children

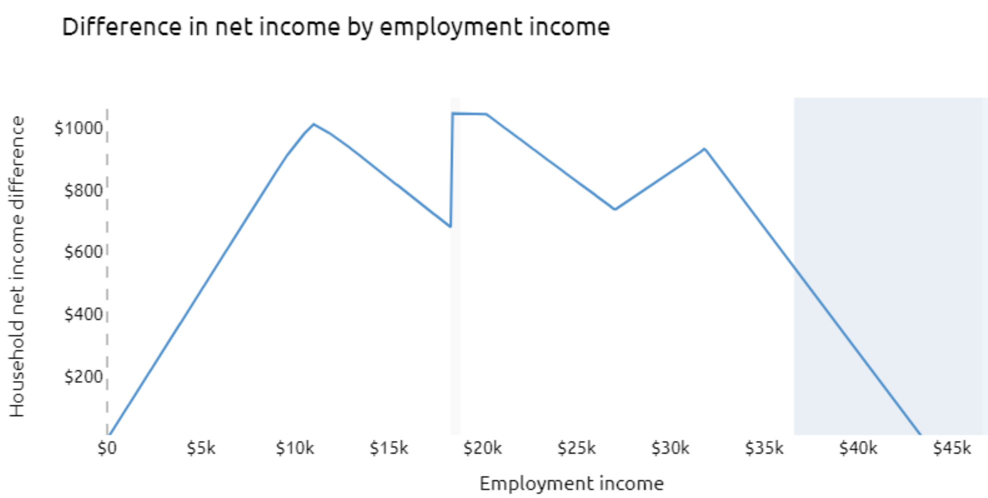
Maryland's largest family tax credit is the Earned Income Tax Credit (EITC), which incurs an annual cost of approximately $300 million under current legislation. The state currently offers a 50 percent non-refundable match of the federal EITC and a 28 percent refundable match.

State policymakers must recognize that the federal Earned Income Tax Credit (EITC) is structured in a way that excludes the poorest families, through the use of a phase-in and work requirement. The chart below details the federal EITC and demonstrates how the poorest families are excluded via the trapezoid pattern.

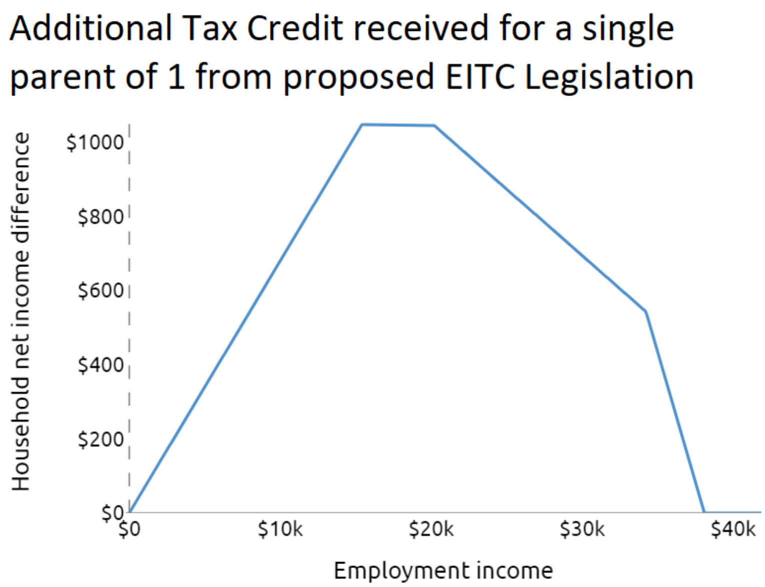


As a result of this design: the poorest 16 percent of households do not receive the full credit because they do not have enough income, only 3 percent of children living in poverty receive the full credit, and 0 percent of children living in deep poverty live in households that receive the full credit.

By simply matching the federal EITC, Maryland also fails to assist these same marginalized families. The next chart illustrates the relationship between earned income and the state EITC credit amount for a single parent with one child.



It is evident that this policy does not align with our values. Rather than addressing the underlying issues, some Democrats have suggested increasing the matching percentage back to 45 percent, the rate from 2020-2022. The following chart illustrates the impact of this legislation on a single parent with one child.



As demonstrated in the chart, the proposed enhancement of the EITC would continue to exclude the poorest families from receiving the full credit. Additionally, this legislation would perpetuate an already unjust system. A two-parent household with three children can potentially miss out on up to $13,000 in tax credits from both the federal and Maryland government because they are too poor.

As a result of these exclusive policy designs:

- Across the state of Maryland 15 percent of children live in poverty.
- Marylanders of color are nearly twice as likely as White residents to live in poverty
- Poverty is concentrated in our urban centers. In Baltimore, 1 in 3 kids live in poverty.

We cannot afford to further exclude the poorest families from assistance.

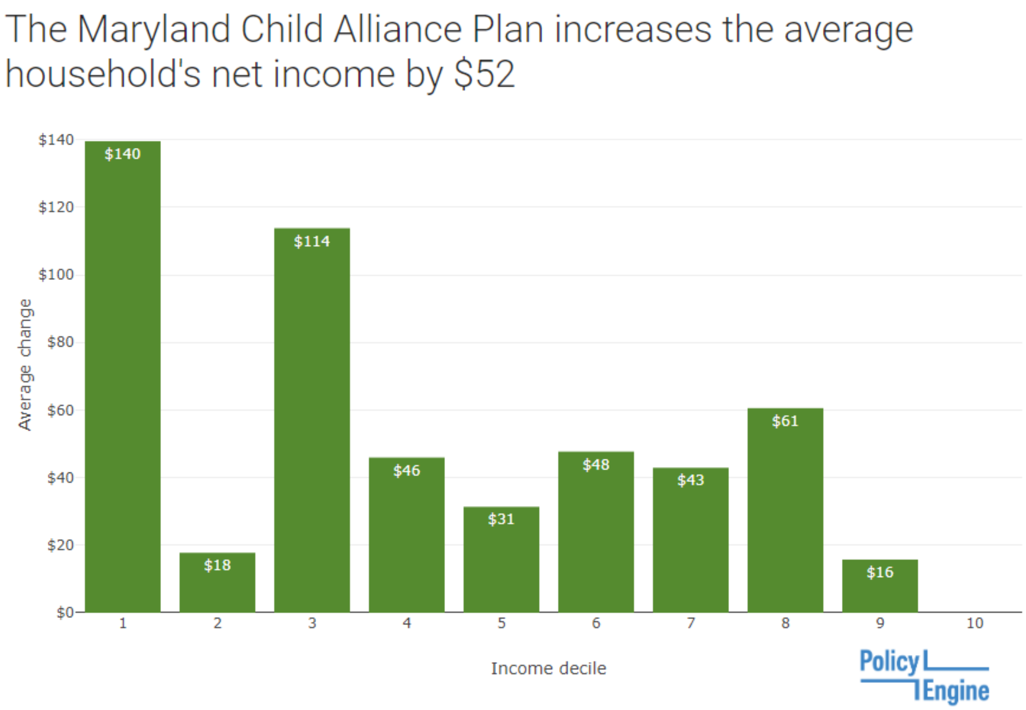
A More Inclusive Alternative

The Maryland Child Alliance suggests that Maryland improves its existing Earned Income Tax Credit (EITC) for families by merging it into a fully refundable Child Tax Credit (CTC). A CTC is a tax credit available to taxpayers with dependents under the age of 18. This new approach would maintain the benefits for most middle-class families, while also ensuring that the poorest families have full access to the credits.

The proposed plan would replace the current EITC for households with children and introduce a $1,000 per child CTC. The CTC would gradually decrease at a rate of 10 percent starting at $40,000 in income for joint filers, and $20,000 in income for other filing statuses.

Outcomes

We employed PolicyEngine, a free web application that calculates the effects of public policy, to evaluate the impact of the reform across various metrics. Our estimates indicate that the plan would cost roughly $250 million annually while cutting child poverty by 6.3 percent and overall poverty by 2.7 percent, **lifting 20,000 Marylanders out of poverty, including more than 10,000 children.** The reform would also decrease overall inequality across the state by 0.2 percent. As shown in the chart below, the bottom 9 deciles would be net winners from the reform in aggregate.



Overall, 12.6 percent of people would be net winners from the reform, while 3.6 percent of people would come out behind. The remainder of this section will discuss in detail the winners and losers of this reform.

Before delving into the net winners and losers of the reform, it is crucial to acknowledge that these distinctions are somewhat arbitrary. Household incomes can fluctuate significantly from year to year, particularly for those near the bottom of the income distribution. A [2017 Pew Report] found that 34 percent of households had incomes that changed by more than 25 percent year to year, with marginalized groups disproportionately represented in this group. Therefore, while these statistics may be informative, the most crucial metric is that the new Child Tax Credit would provide the most funds to families when they need it the most.

The following table details the net winners and losers of the reform by marriage status and number of children. For example, a single parent of two children will be a net winner if she has less than $25,000 in income, be a net loser if she has between $25,000 and $54,000 in income, and see no change if she has greater than $54,000 in income.

Marital Status	**Number of Children**	**Winners Range (AGI)**	**Losers Range (AGI)**
Single	1	<$11,500 13,000 - $20,000	$11,500 - $13,000 $20,000 - $46,000
Single	2	<$25,000	$25,000 - $54,000
Single	3	<$40,000	$40,000 - $57,000
Single	4	<$60,000	No net losers
Single	5	<$70,000	No net losers
Married	1	<$10,500 $16,000 - $25,000 $30,000 - $36,500	$10,500 - $16,000 $25,000 - $30,000 $36,500 - $53,000
Married	2	<$47,000	$47,000 - $49,500
Married	3	<$70,000	No net losers
Married	4	<$80,000	No net losers
Married	5	<$90,000	No net losers

The following chart illustrates the impact of the reform on a few different family types and income levels.

Marital Status	**Number of children**	**Adjusted Gross Income**	**Child Tax Credit Amount**	**Previous EITC Amount**	**Net Difference**
Married	1	$0	$1,000	$0	+$1,000
Single	2	$10,000	$2,000	$1,120	+$880
Married	3	$20,000	$3,000	$2,062	+$938
Single	4	$30,000	$4,000	$2,184	+$1,816
Married	5	$40,000	$5,000	$820	+$4,180
Single	1	$25,000	$500	$965	($465)

Overall, the biggest winners are extremely low-income folks and large families, some of the most vulnerable populations across the state. While there are some net losers, no family would lose more than 5 percent of their income. Meanwhile, 20 percent of people in the bottom decile would see more than a 5 percent boost to their family resources.

PolicyEngine Methodology

PolicyEngine is a nonprofit that builds free, open source software to compute the impact of public policy. They have built a microsimulation model of the US tax and benefit system—the same approach the Congressional Budget Office uses when scoring major federal legislation. Microsimulation models involve two steps:

1. Translating all tax and benefit rules into code, in a way that allows for recomputing taxes and benefits under policy reforms
2. Applying those rules to each household in a representative survey dataset

For step 1, PolicyEngine is the only open model of the federal and state tax-benefit system (they have thus far modeled state income taxes in six states, including Maryland). It validates its model of hundreds of variables and policy parameters with thousands of tests that run each time they update the model. These tests both capture specific policy features **(like the Maryland EITC)** and larger-scale consistency with other models like the National Bureau of Economic Research's TAXSIM model.

For step 2, PolicyEngine applies the Current Population Survey (CPS), which is run by the Bureau of Labor Statistics. The CPS powers reports like the official and supplemental poverty measures, as well as poverty simulations from institutions like Columbia University. It generally understates income, tax credits, and benefit outlays, and PolicyEngine plans to enhance it with tax records and machine learning this year. For the time being, PolicyEngine's estimates understate the budgetary impacts of reforms like the Maryland Child Alliance Plan. To adjust for these underestimates, the budgetary estimate above has been multiplied by a factor of two in order to make a more accurate estimate. This factor of two aligns well with other cost estimates and allows for a fairly confident prediction.

Finally, PolicyEngine makes its microsimulation model accessible via a free web app at policyengine.org. Users can design custom policy reforms by adjusting any of the parameters they model, and PolicyEngine will run its microsimulation model and display impacts across various interactive graphics. Users can also define a household, and PolicyEngine will estimate their taxes and benefits under current law and the reform.

View the Maryland Child Alliance Plan in PolicyEngine here.

The Politics of State Child Tax Credits

Research shows that providing benefits for families is a political winner. An analysis from Data For Progress showed that the expanded Child Tax Credit (CTC) was associated with better perceptions of the economy and greater trust in Democrats. Their report also found that 53 percent of Americans supported extending the federal CTC expansion, compared to just 39 percent who were in opposition. Among Democrats, 97 percent of respondents supported extending the program.

Other leaders of blue states have found that cash to families is a winning message. California, Massachusetts, New Jersey, New Mexico, New York, and Vermont already have fully refundable Child Tax Credits. Alaska has a fully universal child benefit and Colorado, Idaho, Maine, and Oklahoma have non-refundable credits. In Massachusetts, the state with arguably the most comparable politics to Maryland, the Child Tax Credit is so popular that Democrats and Republicans have been fighting to raise it and take credit. After the state legislature passed a Child Tax Credit bill, Charlie Baker doubled it. Now, Maura Healey, is already demanding that the state legislature take action to increase their CTC even further.

Further, New York Democrats recently announced a plan to merge their EITC into their CTC due to the commonsense consensus building around the failures of the EITC and the unnecessary complexity of multiple tax credits aimed at families.

Maryland has an opportunity not only to join these states in creating a state Child Tax Credit but to be a leader for other states to replicate

Benefits of Reducing Child Poverty

The impact of child poverty and family cash assistance programs has been rigorously studied by academics. While approaches and geography vary, the findings have been remarkably consistent: **boosting children out of poverty with cash support enhances child well-being across a variety of different indicators**. One recent study found that every $1,000 we spend on CTCs produces $5,600 in societal benefits—from increased tax revenue, decreased crime rates, lower healthcare spending, and other future decreases in social welfare costs. In fact, even households that never have children are net winners primarily due to increased economic growth and decreased crime rates.

As legislators search for answers on how to reduce crime, they should turn to proven research that clearly demonstrates that reducing child poverty is an efficient way to to reduce crime. A 2022 paper attempted to quantify the social benefits from decreased crime and estimates that for every $1,000 of cash support to children, society saves $1,117 from decreased crime activity alone.

To gain a deeper understanding of the research on child poverty, visit the Empirical Studies section of the Maryland Child Alliance website.

Conclusion

This document has outlined the shortcomings of the current family tax credit system in Maryland and proposed an alternative plan that addresses these issues. The Maryland Child Alliance plan suggests merging the Earned Income Tax Credit (EITC) for families into a fully refundable Child Tax Credit (CTC) to ensure that the poorest families have full access to the credits. The plan is designed to maintain the benefits for most middle-class families, while also dramatically cutting child poverty across the state by including households who have been historically left behind. In addition, the proposed plan aims to simplify the family tax credit system, making it easier to understand who is being helped and by how much, facilitating future reforms to cut child poverty.