NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: HB 952 (First Edition)

SHORT TITLE: Earned Income Tax Credit

SPONSOR(S): Representatives Insko et al.

FISCAL IMPACT

Yes (X) **No ( )** **No Estimate Available ( )**

($million)

	FY 1999-00	FY 2000-01	FY 2001-02	FY 2002-03	FY 2003-04
REVENUES					
General Fund	($91.2)	($104.4)	($112.9)	($116.0)	
EXPENDITURES					
General Fund	$.94	$.85	$.87	$.89	-

POSITIONS: 0 - Department of Revenue will use temporaries and overtime

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Revenue

EFFECTIVE DATE: The act is effective for taxable years beginning on or after January 1, 1999, and expires for taxable years on or after January 1, 2002.

BILL SUMMARY: The bill creates a refundable earned income tax credit (EITC) for the state individual income tax equal to 10% of the federal EITC. For 1998, a taxpayer must have a gross income of under $26,473 with one qualifying child or a gross income under $30,095 with two or more qualifying children. A qualifying child can be a son, daughter, adopted child, grandchild, stepchild or foster child under age 19 (under age 24 if full-time student) or any age if disabled. The child must live in the taxpayer's household more than six months. To receive the earned income credit without children, a taxpayer's income must be under $10,030 and must be age 25 to 64. The taxpayer's investment income must be $2,300 or less.

BACKGROUND:
How much can a taxpayer receive from the federal earned income tax credit? The Internal Revenue Service (IRS) prints an Earned Income Tax Credit (EITC) Table in the 1040 Instructions booklet for taxpayers to look up their credits. For the 1998 tax year, the following credits apply:

A. **Childless Taxpayer** = The maximum credit earned is $341 with an income between $4,450 and $5,600. For every $50 increase in income after $5,600, the credit is reduced $4. The credit is phased out entirely at $10,000 in income.

B. **Taxpayer with One Child** = The maximum credit is $2,271 with an income between $6,650 and $12,300. For every $50 increase in income after $12,300, the credit is reduced $8. The credit is phased out entirely at $26,450 in income.

C. **Taxpayer with Two or More Children** = The maximum credit is $3,756 with an income between $9,350 and $12,300. For every $50 increase in income after $12,300, the credit is reduced $11. The credit is phased out entirely at $30,095 in income.

A state earned income tax credit is offered in ten states. Nine of the ten states piggyback on the federal earned income tax credit, expressing the state rate as a percentage of the federal credit. The following states offer state earned income tax credits:

Refundable	% of Federal Credit
Kansas	10%
Maryland	12.5% (15% in 2001)
Massachusetts	10%
Minnesota	15% without children; 25% with children
New York	20%
Vermont	25%
Wisconsin	4% - one child
	14% - two children
	43% - three children

Non- refundable	% of Federal Credit
Iowa	6.5%
Oregon	5%
Rhode Island	27%

ASSUMPTIONS AND METHODOLOGY:

Revenue

In 1996, the Internal Revenue Service reported that 662,627 North Carolinians with adjusted gross income of less than $30,000 filed returns with earned income tax credits (EITC) worth $995.1 million. Of the North Carolina taxpayers that requested the EITC, 524,594 received refunds totaling $802.1 million. North Carolinians received refunds for 79.2% of their earned income credit in 1996.

Based on information from the IRS and the Congressional Budget Office (CBO), the Center on Budget and Policy Priorities in Washington, D. C. estimates the EITC benefits received by North Carolina residents to be as follows in the next four years.

FY 1999-00 $1,073 million

FY 2000-01	$1,099 million
FY 2001-02	$1,129 million
FY 2002-03	$1,160 million

Assuming 100% participation in the state EITC program, a 10% state credit would yield the following tax benefit:

FY 1999-00	$107.3 million
FY 2000-01	$109.9 million
FY 2001-02	$112.9 million
FY 2002-03	$116.0 million

It is unlikely that 100% participation will be achieved in the first year or two of an EITC program due to the lack of taxpayer awareness about the credit and the need to file a state tax return for those persons not filing state returns now. States with refundable credits have experienced 80% to 85% participation in the first year after enactment. In a telephone interview with the Wisconsin Department of Revenue, tax officials estimated that only 85% of the taxpayers eligible for the new Wisconsin EITC applied for the credit in the program's first year. In Minnesota, the state Revenue Commissioner reported in 1997 that 10,000 Minnesota residents who qualified for the federal EITC failed to file state returns to collect the Minnesota EITC. These 10,000 citizens represented 15% of the eligible population. The New York Department of Taxation and Revenue found that only 83 % of the taxpayers eligible for the state EITC applied in the program's first year. The number of applicants rose to 90% of eligible taxpayers in the second year of the EITC.

This fiscal note assumes that North Carolina taxpayers will follow the pattern of other state taxpayers in applying for a state EITC. In Tax Year 1999, it is assumed that 85% of the eligible taxpayers will apply for the credit. In Tax Year 2000, taxpayer awareness of the credit should increase and so will the percentage applying for the credit increase to 95%. In the final two years of the credit, 2001 and 2002, applications are assumed to reach 100%. Applying these percentages to the numbers shown above, the revenue impact will be as follows:

FY 1999-00	$91.2 million
FY 2000-01	$104.4 million
FY 2001-02	$112.9 million
FY 2002-03	$116.0 million

<u>Expenditure</u>

According to a study by KPMG Peat Marwick in 1992, the Tax Fairness Act of 1989 removed 411,510 taxpayers from the tax rolls by substantially raising the standard deduction and personal exemption amounts on the individual income tax return. In 1999, the Department of Revenue believes that 450,000 taxpayers that are not currently filing tax returns will once again file tax returns in order to receive the new credit authorized in House Bill 952. These returning taxpayers will increase the workload and costs of the following divisions in the Department:

	First Year	Recurring Costs
Computer Programming (1)	$36,075	
Accounting Division (2)		
Labor	$15,438	$15,438
Additional checks and envelopes	19,705	19,705
Postage	148,500	148,500
Returns Processing Division (3)		
Labor	$483,342	$483,342
Storage Rental	10,000	10,000
Shelving	15,000	
Personal Taxes Division (4)		
Tax Forms & Instructions	$20,636	$82,625
Labels & Envelopes	12,413	
Postage	180,000	76,500
Total	$941,109	$836,110

(1) The computer programming costs are based on 555 hours of work at $65/hour.

(2) The Accounting Division will need to print checks, buy envelopes and pay first class postage for 450,000 refund checks. The Division will use temporary workers for the estimated 1,728 additional hours it anticipates it will need.

(3) The Returns Processing Division will incur costs in Validation ($171,395), Data Entry ($287,430), Error Resolution ($22,656), and Central Files ($26,861). This Division will utilize existing workers in an overtime mode to complete the 29,502 hours of work. The primary use of existing workers versus hiring temporary workers is due to space constraints and the ability to forgo buying additional equipment.

(4) The primary cost in the Personal Taxes Division is postage. The first year cost assumes first class mail because the taxpayer is not in the Revenue computer database and does not have a pre-addressed mailing label. In the second year, the taxpayer will be in the system, mailing labels will be printed, and a bulk postage rate can be used.
Salaries for overtime pay were adjusted for inflation with rates provided by the Office of State Budget and Management and identical to the rates used in the General Fund Model. All other costs were not inflated.

FISCAL RESEARCH DIVISION 733-4910
PREPARED BY: Richard Bostic

APPROVED BY: Tom Covington

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