



Sound Research. Bold Solutions

December 19, 2017

To: Economic Security Project

From: Andy Nicholas, Associate Director of Fiscal Policy, Washington State Budget & Policy Center; Misha Werschkul, Executive Director, Washington State Budget & Policy Center; and Jennifer Tran, Senior Policy Analyst, Washington State Budget & Policy Center

Re: Proposal to implement, strengthen, and expand the Working Families Tax Rebate in Washington state

Overview

Implementing and expanding a state version of the federal Earned Income Tax Credit (EITC) is an essential and achievable first step toward building a tax code that helps all Washingtonians thrive. Nationwide the EITC prevents more families from falling into poverty than any other federal program. People who grew up in lower-income households that utilized EITC benefits later had greater success in school and work compared to those who grew up in similar households that did not benefit from the program. Yet lawmakers in Washington state have consistently failed to fund and implement Washington's state-level version of the EITC, the Working Families Tax Rebate (WFTR) since it was enacted in 2008.

The national conversation around the regressive changes to the federal tax code put forward by the Trump administration and Congressional Republicans has helped shine a light on the weaknesses associated with Washington state's highly upside-down state and local tax code. And lawmakers and advocates across the state are preparing major, sustained efforts to make meaningful steps toward building a more just and equitable tax code in the coming years.

The bold proposal outlined in this memo, which is being developed by the Economic Security Project (ESP) with assistance from the Washington State Budget & Policy Center (B&PC), would help fight rising inequality in the Washington state economy and tax code by greatly expanding and modernizing the WFTR. This expanded tax reduction for lower- and middle- income households would be funded by a new tax on millionaires' capital gains. The benefits of this approach include:

- **Significantly rebalancing Washington's upside-down tax code.** Workers and families with annual incomes of \$50,000 or less would see their taxes reduced by up to \$3,160 per year under the proposal. The poorest fifth of Washingtonians, who currently face the highest effective state and local tax rates in the nation, would receive the largest tax reduction in Washington state history. Tax bills among these households would fall all by nearly 11 percentage points to 5.9 percent from 16.8 percent. By contrast, the effective tax rate among households with annual incomes above \$507,000 (the richest 1 percent) would modestly increase to 4.1 percent from 2.4 percent. Total available tax resources that support schools, health care, and other important investments would not change under the proposal.
- **Fighting systemic racism and boosting rural prosperity.** The strengthened WFTR would disproportionately benefit communities and regions who have been systematically denied the benefits

or Washington's growing economy. More than two-thirds (67 percent) of Latinx households in Washington state would see their annual state and local tax bills fall under the proposal. And well over half of all Black (61 percent), American Indian/ Alaskan Native (60 percent), and mixed-race households would benefit from the expanded WFTR. A significantly larger share of residents living in rural areas – including large swaths of Eastern Washington, Southeast Washington, and Northwest Washington – would benefit from these reforms compared to those living in the prosperous urban and suburban areas in the Puget Sound region.ⁱ

- **Giving a hand up to children and families living in poverty.** Nearly 14 percent of children in Washington state currently live in poverty.ⁱⁱ If enacted, nearly 55,000 children would immediately be lifted out of poverty and the child poverty rate would fall to 10.5 percent. Overall, the expanded WFTR would boost incomes for 1.4 million households across Washington state. And more than 700,000 children live in households who would benefit.ⁱⁱⁱ
- **Providing a pro-worker and pro-family policy solution with low political risk.** The proposal offers lawmakers and advocates an opportunity to adopt a potent, pro-worker and pro-family narrative around taxes to counter the destructive tax proposals being promulgated by Congressional Republicans in Washington, DC. And, because it builds on existing laws and proposals, lawmakers would not be subject to the risks associated with introducing an all new tax that hasn't been thoroughly vetted by advocates, nonpartisan staff, and the media.
- **Laying the groundwork for more comprehensive progressive state and local tax reforms.** By providing tangible proof to a skeptical public that lawmakers in Washington state are working to serve the interests of workers and families and not merely the rich and powerful, the proposal will help build support for broader, more systemic tax reforms in the future.

While there are outstanding legal and administrative questions associated with the proposal, which ESP and the B&PC are actively working to resolve, this proposal has considerable merit. Policymakers and advocates for social and economic justice should seriously consider working to enact it in the coming years.

This memo provides an overview of the current proposal to greatly expand and strengthen the WFTR by enacting a tax on high-end capital gains. It also provides the political and historical context to build support for the proposal among Washington state lawmakers and local stakeholders.

The Earned Income Tax Credit

First enacted in 1975, the EITC is a tax reduction that mostly benefits lower-income families with children, although a very small EITC is available to a small share of single workers. The program is designed to encourage and reward work while offsetting the regressive bite associated with federal payroll and excise taxes.

Due to its success, the EITC has been expanded significantly under both Democratic and Republican administrations since it was first enacted. It is now the single most effective federal program for eliminating poverty among working age households.^{iv}

Structured to encourage work

The economists who designed the federal EITC sought to craft a program that would offset the disproportionate impact of regressive federal payroll and excise taxes on lower income households while providing recipients with a strong and constant incentive to work and increase their earnings.

This was accomplished by structuring the program so that benefits sharply increase as income (work) rises near the bottom of the income scale. Benefits then plateau and slowly phase out as income rises further. In 2017, a two-parent family with three children with annual income between \$14,040 and \$23,930 was eligible for maximum credit of \$6,318. Households with incomes up to \$53,930 were eligible for smaller credits.

Under this structure, participating households have a strong incentive to continue working and increasing their incomes. And myriad research shows that the EITC is highly successful at encouraging work among lower-income families with children. For example, among single mothers with children, a \$1,000 increase in EITC benefits leads to a 7.3 percentage-point increase in employment and a 9.4 percentage-point decrease in the share of families living with incomes below the federal poverty line, according to a 2015 study from the National Bureau of Economic Research.^v

Historically, due to its emphasis on work, the EITC has enjoyed bipartisan support at the national level and in many states. While no Republicans supported the WFTR when it was enacted in 2008, advocates may be able to build support among Republican lawmakers in Washington state by emphasizing the EITC's success at encouraging work among lower-income workers and families.

Long-term benefits to health and prosperity

While programs that fulfill a specific need, such as housing assistance, food assistance (SNAP), and medical care (Medicaid), represent an important backstop for thousands of Washingtonians living in poverty, tax credits, or direct cash assistance, delivered via the EITC has been shown to greatly boost prosperity in the long run.

The EITC improves outcomes for families at virtually every stage of life, according to a summary of recent research from the Center on Budget and Policy Priorities (CBPP).^{vi} For example, families and children from families receiving the EITC tend to experience:

- Improved infant and maternal health;
- Better school performance;
- Greater college enrollment;
- Increased work and earnings in the next generation; and
- Higher social security benefits due to increased earnings and participation in the labor force.

Lawmakers in Washington state could amplify these benefits in communities across the state by funding and implementing the WFTR.

Washington state's upside-down tax code

Washington state has repeatedly been shown to have the most upside-down, or regressive state and local tax code of any U.S. state. On average, the poorest fifth of households, those with annual incomes below \$26,000, pay nearly 17 percent of their annual incomes in Washington state and local taxes. By contrast, the richest 1 percent of households – those with at least \$507,000 in annual income -- pay less than three percent.^{vii} The difference or gap between the effective tax rate paid by the poorest fifth and top 1 percent of households is wider in Washington state than in any other state and contributes to inequality in our state.

The upside-down nature of Washington's tax code is predominantly due to the state's excessive reliance on retail sales taxes and other excise taxes. That's because purchases of soap, toothpaste, toilet paper, and other common goods subject to the sales tax account for a disproportionately large share of annual family budgets among these households.

The Working Families Tax Rebate

The Working Families Tax Rebate, which, for legal and constitutional reasons unique to Washington state, is referred to as the Working Families Tax Exemption in the state tax code, is a state-level EITC that was enacted in 2008. The WFTR was intended to partially offset the negative impact of Washington's upside-down tax code on lower -and moderate - income families while enhancing the numerous benefits of the federal EITC. But lawmakers have repeatedly failed to allocate the funding necessary to implement the program. (See box "A brief history of the WFTR" for more details.)

How the WFTR works

The WFTR is designed to closely match the structure of the EITC. It shares virtually all the features, parameters, and eligibility requirements associated with the federal program, as well as the same proven benefits.

Had the WFTR been funded and implemented after it was enacted, certain lower-income Washingtonians would be

A brief history of the Working Families Tax Rebate

- 2007: The Washington State Budget & Policy Center (B&PC), the Statewide Poverty Action Network, and other advocates come together to develop a proposal for a state EITC.
- January 2008: Legislation to create a "Working Families Tax Exemption," based on the EITC, is introduced.
- April 2008: WFTR program passed out of the legislature and signed into law.
- July - August 2008: Washington State Department of Revenue (DOR) begins work on implementing the WFTR.
- September 2008: Governor Gregoire orders DOR to halt implementation due to budget shortfalls.
- July 2010: Legislature appropriates \$1.1 million to DOR to restart implementation work.
- September 2010: DOR again suspends implementation work due to budget shortfalls. Legislature subsequently redirects unused implementation funds to other priorities.
- December 2012: DOR sends report on implementation progress to the legislature. Concludes WFTR can be implemented if legislature reauthorizes and funds the program.
- 2014: Legislation that would repeal the WFTR introduced but does not pass.

eligible to receive a matching credit from Washington state equal to 10 percent of the benefit they receive from the federal EITC. The only significant deviation from the federal program is that the WFTR includes a minimum credit of \$50 per year – a feature that was added to reduce administrative costs for the Department of Revenue and to increase participation in the program.

In 2017, EITC recipients in Washington state would have been eligible to receive annual credits from the state ranging from \$50 to \$632, depending on the number of dependent children living in the household.^{viii}

Because it adheres closely to the federal EITC, the WFTR furthers the same primary goals associated with the federal program – namely to reward and encourage work among lower-income households with children.

The WFTR is the most effective tool for reducing taxes among working families

Because it benefits those most in need of a tax reduction, funding the WFTR is the most effective and efficient way to reduce the tax code's disproportionate toll on working families.

Some have suggested reducing the state sales tax rate across the board to deal with this problem. But the benefits of a broad-based rate reduction would be spread across all households – including the richest households who don't need a tax reduction. As a result, reducing the sales tax rate is a very inefficient and expensive way of making the tax code more equitable. Reducing the state sales tax rate by a single 1 percentage-point, to 5.5 percent from 6.5 percent, would cost the state more than \$1.5 billion per year in forgone tax resources.^{ix}

By contrast, funding the WFTR would be a much more cost-effective way reducing taxes among lower- and moderate- income Washingtonians. For example, every \$100 million spent on reducing the sales tax rate would reduce taxes among the poorest households by about \$12 per year on average. The same amount spent on the WFTR would reduce taxes by an average of \$88 per year among these households, more than 7 times the impact of a general sales tax reduction.^x

Expanding and strengthening the WFTR

As it is currently structured, the WFTR would be a potent tool for boosting prosperity among Washingtonians who work hard for low pay. The program could be significantly expanded and improved, however. To make much more significant steps toward reducing inequality and flipping Washington's upside-down tax code right-side up, the ESP and B&PC propose the following slate of enhancements to the WFTR:

- **Increasing the WFTR to improve its effectiveness:** Under current law, the WFTR is set at 10 percent of the EITC, providing maximum rebates of just over \$600 per year. ESP and B&PC propose to increase the matching rate to 50 percent of the EITC. Doing so would significantly heighten the impact of the program by increasing the maximum rebate to more than \$3,100 in the coming years.
- **Expanding the program for childless workers:** While a very small federal EITC is available for workers without children, the program predominantly benefits working families with children. The current proposal would expand the benefits for childless workers, making them comparable to the benefit

received by households with one child. This expansion would mean a childless worker would be eligible to receive annual rebates of up to \$1,200.

- **Rewarding all forms of work:** Under the current law, the WFTR only goes to families that work at a traditional job and receive regular paychecks. Yet many other types of activities contribute to our health and wellbeing of families, communities, and the state economy. ESP and B&PC propose to recognize this reality by allowing people living in lower income households who stay at home to care for young children, a dependent with a disability, or an elderly parent to benefit from the program. These workers, along with college students from families with low incomes, would be able to receive annual rebates of up to \$1,200.
- **Recognizing all low-wage workers who contribute to economic growth:** Under current law, only U.S. citizens would be eligible receive WFTR benefits. Yet immigrants who work hard for low pay contribute to Washington's growing economy and a high quality of life every bit as much as citizens do. Accordingly, the current proposal would allow documented and undocumented immigrants to benefit from the WFTR.
- **Providing rebates monthly rather than annually:** A key limitation of the EITC is that benefits are paid out in a single lump sum each year. Many families would be better able to make ends meet if credits were supplied more stably and dependably throughout the year. Over 90 percent of the participants in pilot programs that provided monthly payments said afterward that they preferred monthly payments to lump sums.^{xi} ESP and B&PC are examining ways to provide WFTR payments monthly.

As the following sections will show, expanding and strengthening the WFTR in this way would greatly boost prosperity among lower- and moderate -income households across Washington state. To provide the resources necessary to fund the new and improved WFTR in a way that does not worsen the regressivity of Washington's tax code, ESP and B&PC propose a new tax on high-end capital gains. The details of the tax are still being finalized and the rate and exemption thresholds may change in future iterations. The estimates that follow are based on an 11.75 percent tax on capital gains above \$25,000 per year (\$50,000 for a joint filers). A separate memo on the capital gains tax is forthcoming.

The proposal would dramatically rebalance Washington's upside-down tax code

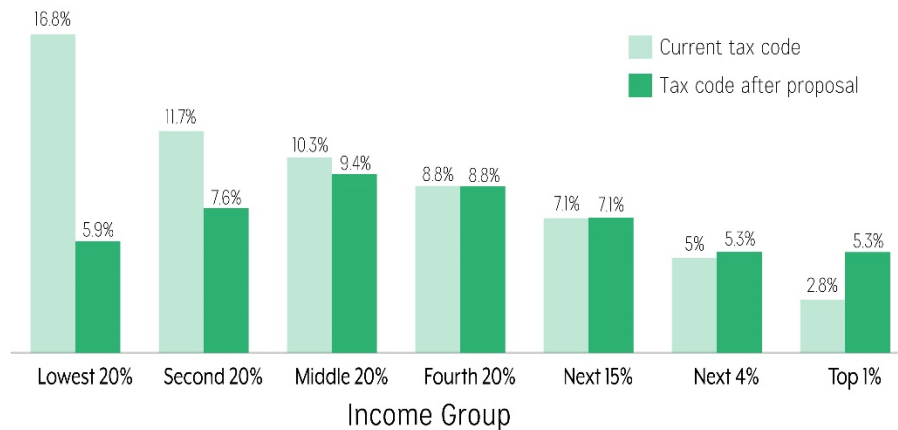
The combination of the significantly expanded WFTR and a new capital gains tax would serve to greatly reduce the inequities in Washington state tax code. As Figure 1 shows, under current law, the poorest fifth of Washingtonians pay 16.8 percent of the incomes on state and local taxes while the richest 1 percent pay only 2.4 percent. Under the proposal the effective rate among the poorest fifth of Washingtonians would fall to 5.9 percent, a decline of nearly 11 percentage points. If enacted, the expanded WFTR would represent the largest tax reduction for lower income households in Washington state history.

The costs of funding the program would be very small for those at the top of the income scale who already enjoy some of the lowest effective state and local tax rates in the United States. The proposed capital gains tax would

increase taxes among the richest 1 percent of households by a mere 2.6 percentage points, bringing the average effective tax rate among the group up to 5.3 percent.

Figure 1. Proposal would make Washington state's tax code significantly more equitable

Washington state and local taxes as a share of family income by income group

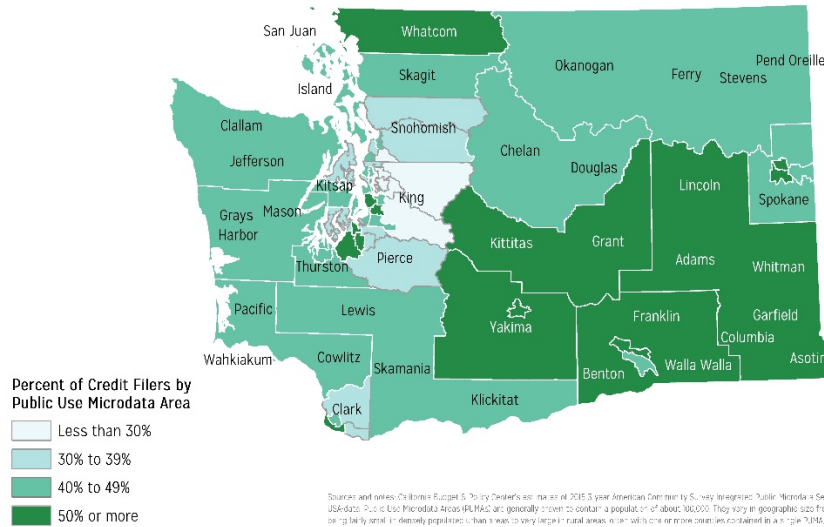


SOURCE: Institute on Taxation and Economic Policy

The proposal would boost prosperity among rural Washingtonians

If enacted, the expanded WFTR would be especially beneficial to rural areas of Washington state. As the map below shows, more than 50 percent of households in large swaths of Eastern Washington, Southeastern Washington, and Northwestern Washington would benefit from the enhanced rebate. While hundreds of thousands of lower-income households in the Puget Sound region would also benefit, the share of the population benefitting is lower due to that region's disproportionately high share of economic opportunity.

Expanded Working Families Tax Rebate Would Boost Prosperity Among Rural Washingtonians

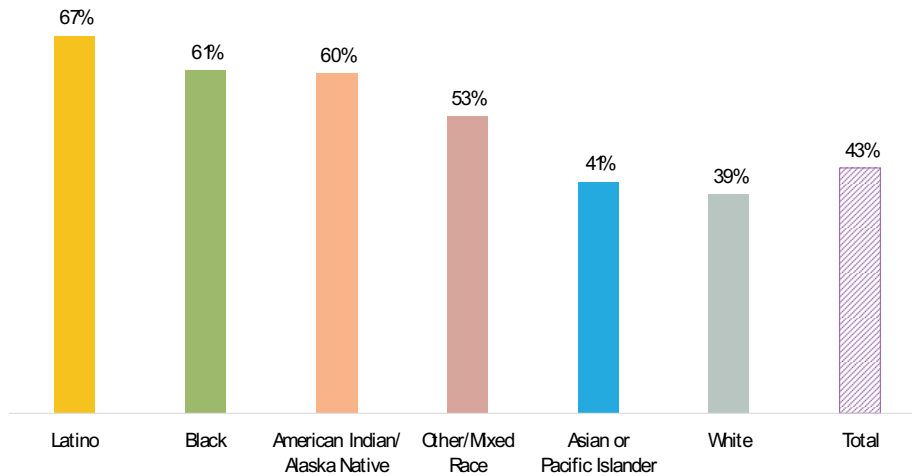


Proposal would begin to address systemic racism in the Washington state economy

Washingtonians of color continue to struggle against centuries of systemic barriers intentionally designed to deprive them of equal access to opportunity and economic success. The expanded WFTR would represent significant, though incomplete, progress toward eliminating those barriers. More than two-thirds (67 percent) of Latinx households in Washington state would see their incomes boosted under the proposal (See graph below). Similarly, 61 percent of black households and 53 percent of mixed-race families would benefit from the program.

Over half of Latino, Black, American Indian, and Other/Mixed Race tax filers in Washington state would benefit from expanded WFTR

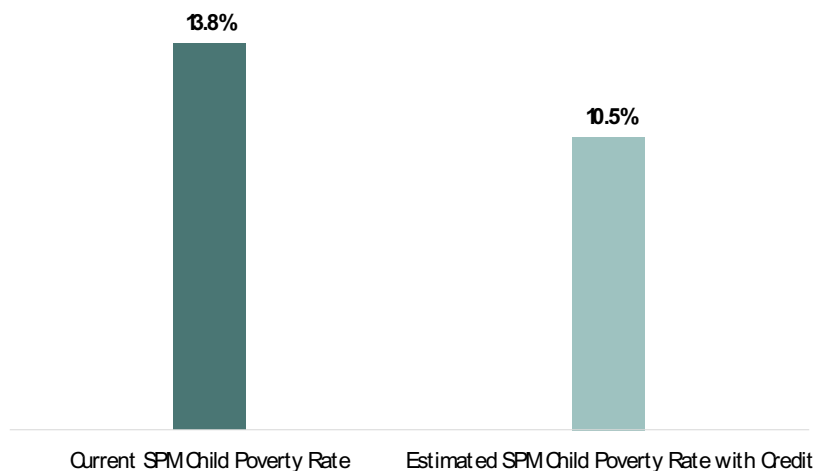
Percent of tax filers eligible for expanded WFTR by race and ethnicity, Washington state, 2013 to 2015



Proposal would build a brighter future for children living in poverty

Far too many children (14 percent) in Washington state live in impoverished households. The expanded WFTR would immediately lift nearly 55,000 of these children out of poverty and reduce the child poverty rate to 10.5 percent (see graph below). Overall, 1.4 million households – including more than 700,000 children -- would benefit under the proposal.

There would be 54,500 fewer children living in poverty with the credit expansion
 Current child poverty rate and estimated child poverty rate under expanded WFTR proposal in
 Washington state, 2013 to 2015



Building momentum and public will for systemic reform

Decades of misleading messaging from anti-tax lawmakers and conservative organizations has convinced many lower- and moderate-income Washingtonians that progressive reforms to the state tax code would ultimately harm them. Even though these households would benefit most from a progressive state tax overhaul, past revenue reform efforts in Washington state have failed in large part because working families were convinced that any major state tax change – even reforms that would only raise taxes on those at top of the income scale – would ultimately wind up increasing their taxes.

Funding and implementing the WFTR is the logical first step toward rebuilding trust with Washingtonians skeptical of tax reform. The WFTR would represent tangible proof, in the form of annual or monthly tax rebate payments, that systemic tax reform can be broadly beneficial for their families and their communities. It would also provide concrete evidence to hundreds of thousands of working Washingtonians that lawmakers are working to protect their interests, not just the interests of the rich and powerful.

Nationwide messaging resources available

A strong nationwide infrastructure exists to assist advocates and lawmakers in their efforts to enact, retain, and expand state EITCs like the WFTR. In addition to ESP, the Center on Budget and Policy Priorities (CBPP) and the Hatcher Group have invested considerable resources toward developing effective strategies and messages to advocates promote state EITCs.^{xii}

Additional resources

[A Primer on the Working Families Tax Rebate.](#)

[Fact sheet: The Working Families Tax Rebate Would Advance Racial Equity for Washington Families.](#)

[Fact sheet: Expand Tax Credits to Promote Work and Fight Poverty.](#)

[Working Family Tax Credits Help Military Families.](#)

[Working Families Tax Rebate Administration Would Be Straightforward and Efficient.](#)

[A Working Families Credit for Washington State.](#)

End notes

ⁱ California Budget & Policy Center's estimates of 2015 3-year American Community Survey Integrated Public Microdata Series USA-data

ⁱⁱ According to the poverty threshold under the US Census Bureau's Supplemental Poverty Measure represents the cost of meeting the basic needs of housing, utilities, food, and clothing.

ⁱⁱⁱ California Budget & Policy Center's estimates of 2015 3-year Current Population Survey Integrated Public Microdata Series USA-data.

^{iv} Center on Budget and Policy Priorities, "Policy Basics: The Earned Income Tax Credit," Updated October 21, 2016, <https://www.cbpp.org/research/federal-tax/policy-basics-the-earned-income-tax-credit>.

^v Hilary Hoynes and Ankur J. Patel, "Effective Policy for Reducing Inequality? The Earned Income Tax Credit and the Distribution of Income." NBER Working Paper 21340. 2015, National Bureau of Economic Research, <http://www.nber.org/papers/w21340.pdf>.

^{vi} Chuck Marr, Chye-Ching Huang, Arloc Sherman, and Brandon Debot, "EITC and Child Tax Credit Promote Work, Reduce Poverty, and Support Children's Development, Research Finds," Center on Budget and Policy Priorities, Updated October 1, 2015, <https://www.cbpp.org/research/federal-tax/eitc-and-child-tax-credit-promote-work-reduce-poverty-and-support-childrens>.

^{vii} Institute on Taxation and Economic Policy, "Who Pays? A Distributional Analysis of the Tax Systems in All 50 States," 5th edition, January 2015, <https://itep.org/whopays/>.

^{viii} Washington State Budget & Policy Center calculations. Data from the Tax Policy Center, "EITC Parameters 1975-2017," February 2017, <http://www.taxpolicycenter.org/statistics/eitc-parameters>.

^{ix} Washington State Department of Revenue, “Revenue Raising Alternatives,” November 2016 Forecast, <https://dor.wa.gov/sites/default/files/legacy/Docs/Reports/2016/RevAlts2016.pdf>.

^x Washington State Budget & Policy Center calculations of data from the Department of Revenue’s Tax Alternative Model. Estimates of the impact of a sales tax reduction and the WFTR on the second poorest 10th of households.

^{xi} Dylan Bellisle and David Marzahl, “Restructuring the EITC: The Credit for the Modern Worker,” Center for Economic Progress, http://www.economicprogress.org/sites/economicprogress.org/files/restructuring_the_eitc_a_credit_for_the_modern_worker_0.pdf

^{xii} Resources from CBPP are available [here](#); those from the Hatcher Group are [here](#).