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## **Noncustodial Parents, and Child Support & EITC Policy: Are We Moving Families Toward Economic Security?**

### Introduction

Tax policies have profound effects—both positive and negative—on the ability of hard-working low-income Americans to support themselves, their children and their families. This is especially true for parents whose income is subject to court-ordered child support payments. And for families connected to cash welfare assistance, the default federal policy requires state governments to retain child support payments as reimbursement for cash welfare benefits. Though states have the option to “passthrough” some portion of that payment to families, a significant number of states do not. The combined effect of regressive state and federal tax laws and current child support policy overburdens poor and low-income parents, and contributes to their families’ financial instability.

Very low-income noncustodial parents—particularly African American and Latino fathers—struggle to make ends meet and pay child support while faced with income and sales tax policies that (in most states<sup>1</sup>) increase their tax burden rather than provide relief. Fathers of color, who are more likely to encounter employers offering them lower wages and less stable employment than other Americans, are among those least able to afford the extra tax burden. Progressive income tax policies—such as federal and state Earned Income Tax Credits (EITCs)—only provide nominal tax relief to typical low-income noncustodial parents who do not live with their children most of the time.<sup>2</sup>

This brief will: (1) examine recent state tax policy proposals that will inevitably result in increased tax burdens on low-income families; (2) consider the effect of federal and state Earned Income Tax Credits on parents who are court-ordered to pay child support; and (3) calculate the impact of that policy on parents in four focus states—Louisiana, Texas, Mississippi and Illinois—estimating that noncustodial parents in these states need to earn anywhere from \$32,000 to \$45,000 per year in order to pay child support while maintaining basic economic security for themselves and their children.<sup>3</sup>

### Disproportionate Tax Burdens

Legislators in many states have recently proposed or enacted “sweeping tax and budget proposals” that would “shift tax burdens substantially... to middle- and low-income households” but “cut taxes deeply for wealthy individuals,” according to the Center on Budget and Policy Priorities. Many of these proposals are modeled after policies promoted by the American Legislative Exchange Council (ALEC), including “the end of various state-based tax credits for low-income working families,” “sales taxes that are much higher,” and “deep cuts in income taxes, particularly for affluent households.”<sup>4</sup> Perhaps the most radical proposal is to eliminate state income taxes entirely, which would severely impact funding for critical public services that low-income families rely on, such as schools and health care. Since 2012, policymakers in seven states—most notably Louisiana—have pushed to repeal their state’s income tax.

In January of 2013, Louisiana Governor Bobby Jindal proposed to eliminate the state's income and corporate taxes and simultaneously increase sales taxes to the highest in the nation.<sup>5</sup> Advocates for low-income taxpayers and families strongly criticized this plan. Citizens for Tax Justice (CTJ) said that the plan would have a “devastating impact... on low-income families... unless, that is, Louisiana is prepared to enact a low-income tax credit, one so generous it would dwarf anything offered by other states.”<sup>6</sup> The Institute on Taxation and Economic Policy (ITEP) noted that “this proposal actually *raises* taxes on the poor” and that “any low income tax relief will likely be insufficient to offset the impact of the large sales tax hike” on low-income families.<sup>7</sup> Governor Jindal's original tax plan collapsed in early April 2013 after opposition also grew from business groups, but the governor and legislators remain committed to the “goal this year of getting rid of the state's income tax.”<sup>8</sup>

Regressive state tax policies that place burdens for public services on low-income individuals and families have worsened, particularly in Southern (and to a lesser degree, Western) states over the last 30 years. In a summary of findings from *Taxing the Poor: Doing Damage to the Truly Disadvantaged*, Rourke O'Brien shows that poor families in Southern states typically pay two to three times higher sales taxes than in Northeastern states, and that even in the three Southern states with a refundable tax credit—such as Louisiana—the credit is not large enough for families to actually receive a refund.<sup>9</sup> Newman also notes that “Southern states have steadily increased the tax burden on their poorest citizens by shifting the support of the public sector to sales taxes and fees for public services.”<sup>10</sup>

### Tax Credits for Low-Income Parents Who Are Court-Ordered to Pay Child Support

New tax policies that will have the ultimate effect of overburdening low-income and poor families are being proposed in a policy environment where advocates for families have also proposed stronger, more supportive federal and state Earned Income Tax Credits (EITCs) for these same families. Before examining state-specific policies it is useful to consider the impact of the EITC on the income of parents who are court-ordered to pay child support. For the purposes of this analysis, we will consider a typical noncustodial parent who files taxes as an individual without dependent children, but is ordered to pay child support for two children. For such a parent, the federal EITC was worth a maximum amount of \$475 in the 2012 tax year, and only for those who earned between \$6,210 and \$7,770 per year, phasing out to no credit as earnings reached \$13,980.<sup>11</sup> Also, it is important to reiterate here that federal law requires garnishment of a parent's federal tax refund to pay child support debt owed to the government for welfare reimbursement, insuring that some children do not benefit from their noncustodial parent's EITC refund.

For low-income parents who are court-ordered to pay child support, the federal EITC provides little or no “incentive to work.” The tax credit does not meaningfully help parents support themselves, much less their children. The financial security and stability of Black and Latino parents—both mothers and fathers—is particularly threatened by this policy as their children are much more likely to have received cash welfare benefits. According to the federal Office of Child Support Enforcement (OCSE), parents owed more than \$32 billion in child support to federal and state governments in 2010.<sup>12</sup> This requirement that parents reimburse the government for the cost of cash assistance to their children's households is another example of shifting the burden for public services to those who can least afford it.

For specific reference, CFFPP has examined the effect of the EITC on low-income parents who are court-ordered to pay child support in four states: Louisiana, Mississippi, Texas, and Illinois. For each state we make a calculation—based on a typical child support order for two children, and the BEST Income tables

developed by Wider Opportunities for Women (WOW)—to estimate the income level that a noncustodial parent needs to experience basic economic security.

### **Louisiana**

The Louisiana Building Economic Security Together (LABEST) coalition identified state tax policy reform as one of its top agenda items for the 2013 legislative session.<sup>13</sup> LABEST is working to “build a diverse statewide coalition to advocate for social protection programs that help low-income families achieve economic stability.”<sup>14</sup> Although Governor Jindal’s plan to drastically raise the state sales tax has been shelved, state policymakers remain committed to eliminating the state income tax (see above in this report), which will likely require the increase of already-high tax burdens on poor and low-income Louisianans.

Poor, low- and middle-income Louisianans pay a much larger share of their income in state and local taxes—particularly sales and excise taxes—compared to upper-income families. According to the Institute on Taxation & Economic Policy’s “Who Pays?” report, families with incomes below \$30,000 a year can expect to pay about 10.55% of their income in state and local taxes—the equivalent of more than five weeks of full-time work. For comparison, higher-earning families in the top 20%—above \$85,000 per year—can pay as little as 4.6% of their income in state and local taxes.<sup>15</sup>

Louisiana does offer a refundable state Earned Income Tax Credit (EITC), but according to the Louisiana Budget Project, it is set at 3.5% of the federal EITC, making it “the smallest state-level credit.”<sup>16</sup> For a parent who is court-ordered to pay child support, the Louisiana credit of 3.5% of the maximum federal EITC of \$475 amounts to only \$16.63 for the year. Even if the state’s EITC were doubled, as the Louisiana Budget Project recommends,<sup>17</sup> the credit would be worth only \$33.25, hardly enough to compensate for the state’s inequitable tax policies or make a difference in the financial situation of parents working hard to support themselves and their children.

CFFPP estimates that a parent in Louisiana needs to earn between about \$18 to \$21 per hour working full time—or about \$38,000 to \$43,000 per year—in order to both pay child support for two children and experience basic economic security. Incomes at this level are about five times too large to qualify for the maximum federal EITC benefit. The lower estimate is a statewide average for parents living in smaller cities and rural areas, while the higher estimate is for the New Orleans area. CFFPP’s estimates are based on the BEST Income tables developed by Wider Opportunities for Women (WOW), and then increased by 27% to account for the size of a typical Louisiana child support order for two children.<sup>18</sup>

### **Mississippi**

The Coalition for a Prosperous Mississippi (CPM) identified the need for a statewide EITC as recently as 2011.<sup>19</sup> However, Tax Credits for Working Families has commented that “the political climate makes future passage unlikely.”<sup>20</sup> As in Louisiana, poor, low- and middle-income Mississippians pay a much larger share of their income in state and local taxes—particularly sales and excise taxes—compared to upper-income families. According to the Institute on Taxation & Economic Policy’s “Who Pays?” report, families with incomes below \$39,000 a year can expect to pay about 10.45% of their income in state and local taxes—the equivalent of more than five weeks of full-time work. For comparison, those earning in the top 20%—above \$70,000 per year—can pay as little as 5.4% of their income in state and local taxes.<sup>21</sup>

Mississippi's state and local tax policies are also notable because food is not exempt from sales tax, and, as described above, there is not yet a state EITC to offer tax relief to low-income individuals and families. As the Mississippi Economic Policy Center (MEPC) has noted: "Mississippi's current tax structure challenges working families... Mississippi taxes food at the full 7%. Mississippi is one of only two states to fully tax food without any offsets."<sup>22</sup> To improve tax fairness, MEPC suggested the creation of a state EITC with a rate of up to 20% of the federal EITC.<sup>23</sup> While more generous than Louisiana's current EITC, this would still only amount to \$95 per year for a noncustodial parent with an income low enough to receive the maximum credit.

In Mississippi, CFFPP estimates that a parent needs to earn about \$15.58 per hour working full time—or about \$33,000 per year—in order to both pay child support for two children and experience basic economic security.<sup>24</sup> In Hinds County, where Jackson—the state capitol and largest city—is located, the wages needed for a noncustodial parent paying child support to achieve economic security are higher: about \$16.59 per hour, or about \$35,000 per year. Incomes at this level are more than four times too large to qualify for the maximum federal EITC benefit. CFFPP's estimates are based on the BEST Income tables for Mississippi developed by Wider Opportunities for Women (WOW), and then increased by 20% to account for the size of a typical Mississippi child support order for two children.<sup>25</sup>

### Texas

RAISE Texas, a community-based asset building coalition, has committed to expanding access to community-based and free tax preparation services as part of its 2013 policy agenda.<sup>26</sup> Because Texas has no state income tax and therefore no state-based Earned Income Tax Credit,<sup>27</sup> the focus of RAISE Texas' effort is to increase uptake of the federal EITC refund, especially among parents—both custodial and noncustodial—who are parties to court-ordered child support cases.<sup>28</sup>

Promoting the federal EITC may be ineffective for parents who are court-ordered to pay child support because, as discussed above, the federal refund is minimal. Only parents earning sub-poverty wages are eligible, and if a parent owes child support debt to the government for welfare reimbursement then the EITC refund is retained by the state. In Texas, about 19% of all child support debt is owed to the government to reimburse welfare costs.<sup>29</sup> According to the Federal Office of Child Support Enforcement (OCSE), this amounted to about \$2.1 billion in child support arrears owed to the state of Texas in 2010.<sup>30</sup>

Texas is noted for having one of the most regressive state and local tax policy regimes in the country, earning the ranking of "#5 of the Terrible 10" from the Institute on Taxation & Economic Policy (ITEP). Poor and low-income Texans pay a much greater share of their income in state and local taxes—particularly sales and excise taxes—compared to upper-income families. According to ITEP's "Who Pays?" report, families with incomes below \$32,000 a year can expect to pay from about 10.4% to 12.6% of their income in state and local taxes—the equivalent of up to one-and-a-half months of full-time work. For comparison, those earning in the top 20%—above \$90,000 per year—can pay as little as 3.2% of their income in state and local taxes.<sup>31</sup> In ITEP's analysis:

Texas tax laws actually redistribute income away from ordinary families and towards the richest Texans. ... With poverty rates on the rise, the Texas tax system is actually pushing families further into poverty.<sup>32</sup>

CFFPP estimates that a parent who is court-ordered to pay child support in Texas needs to earn between about \$15 to \$20 per hour working full time—or about \$32,000 to \$42,000 per year—in order to pay child support for two children and experience basic economic security. Incomes at this level are about four to five times too large to qualify for the maximum federal EITC benefit. The lower estimate is for Texas parents living in smaller cities and rural areas, while the higher estimate is for larger cities, such as Dallas or Houston. CFFPP’s estimates are based on the BEST Income tables developed by Wider Opportunities for Women (WOW), and then increased by 25% to account for the size of a typical Texas child support order for two children.<sup>33</sup>

### Illinois

The Illinois Asset Building Group (IABG) successfully advocated for the doubling of Illinois’ state Earned Income Tax Credit, which Governor Quinn signed into law in January 2012. IABG stated: “It is estimated that more than 1 million Illinoisans will be directly impacted by this increase.”<sup>34</sup> The Illinois state EITC rose to 7.5% of the federal EITC for the 2013 tax year, and will rise again to 10% for 2014.<sup>35</sup>

As in other states, such as Louisiana, that have a modest refundable state EITC, the Illinois credit is of much greater value to custodial parents who can claim their children as dependents when filing taxes than to noncustodial parents who cannot. For a typical low-income noncustodial parent, the maximum Illinois EITC will amount to only \$47.50 for the year. Even if the state’s EITC increased to 15% of the federal credit, as the Make Work Pay Coalition recommended in 2011,<sup>36</sup> it would be worth only \$71.25, not nearly enough to compensate for Illinois’ inequitable tax policies or to make a meaningful difference in the financial situation of parents working hard to support themselves and their children.

Illinois’ state and local tax rates have the distinction of being among both the highest and most inequitable in the country. Illinois earned the rank of “#4 of the Terrible 10” from the Institute on Taxation & Economic Policy (ITEP), worse than Texas, and only superseded by Washington State, Florida, and South Dakota. Poor and low-income Illinoisans pay a much larger share of their income in state and local taxes—particularly sales and excise taxes—compared to upper-income families. According to ITEP’s “Who Pays?” report, families with incomes below \$36,000 a year can expect to pay from about 12% to 13.8% of their income in state and local taxes—the equivalent of more than seven weeks of full-time work. For comparison, those earning in the top 20%—above \$93,000 per year—can pay as little as 4.9% of their income in state and local taxes.<sup>37</sup>

In Illinois, CFFPP estimates that a parent needs to earn about \$19.72 per hour working full time—or about \$42,000 per year—in order to both pay child support for two children and experience economic security. In Chicago, the wages needed for a noncustodial parent paying child support to achieve economic security are larger: about \$21.36 per hour, or about \$45,000 per year. Incomes at this level are more than five times too large to qualify for the maximum federal EITC benefit. CFFPP’s estimates are based on the BEST Income tables for Illinois developed by Wider Opportunities for Women (WOW), and then increased by 28% to account for the size of a typical Illinois child support order for two children.<sup>38</sup>

### **Conclusion and Policy Recommendations**

Low-income parents who are court-ordered to pay child support are caught in a complex web of federal, state, and local tax policies. This is particularly the case for Black and Latino fathers who are more likely to earn lower wages and experience longer unemployment due to the failure of the labor market and employers to value their labor at family-sustaining wages.<sup>39</sup> As described above, the federal Earned Income Tax Credit offers minimal tax relief to typical noncustodial parents, and only to those earning sub-poverty wages. And, when parents who qualify for the EITC owe child support debt to the government, the refund will be retained by the state rather than forwarded to their children's household. Additionally low-income noncustodial parents, like other people with low incomes, pay an inequitable portion of their incomes to state and local taxes, further reducing the income available to support themselves and their children. State EITCs—if they exist at all in a given state—provide only a fraction of the federal EITC's already-limited tax relief.

Strong policy changes are required if hard-working parents struggling to pay child support—particularly fathers of color—are to achieve economic security for themselves, their children, and their families. Earned Income Tax Credits are often described as an “incentive to work,” but existing EITCs do little to help noncustodial parents close the gap between sub-poverty wages and the annual earnings they actually need to experience basic economic security—\$32,000 to \$45,000 per year in the states and cities reviewed above. CFFPP proposes that, for low-income parents who are court-ordered to pay child support, the following bold policies would be much stronger and compelling “incentives to work”:

- Expand and dramatically increase federal refundable EITC benefits to all low-income households, regardless of whether a parent has custody of a child. Federal EITC benefits should be doubled, and refunded to households earning three times the current maximum, according to a proposal from the Political Economy Research Institute (PERI).<sup>40</sup>
- Eliminate the garnishment of federal EITC refunds to pay child support debt owed to the government. Ensure that noncustodial parents are able to use EITC refunds to first meet their own basic needs, and that any garnishment is used to support their children, rather than reimbursing the government.
- Tax credits for employers to subsidize the hiring of long-term unemployed and underemployed workers.
- Dramatically raise the federal minimum wage by 70% to 100%—potentially up to \$14.50 per hour—to lift full-time minimum-wage earnings much closer to the level needed for parents paying child support to experience basic economic security.<sup>41</sup>
- Increased and stronger enforcement of anti-discrimination labor laws, so that Black and Latino workers will encounter fewer employers who illegally consider race and ethnicity when hiring.

## Endnotes:

- <sup>1</sup> The Institute on Taxation & Economic Policy (ITEP) recently reported that “virtually every state’s tax system is fundamentally unfair, taking a much greater share of income from middle- and low-income families than from wealthy families” (Davis et al, 2013, p. 1).
- <sup>2</sup> The poorest noncustodial parents who are court-ordered to pay child support are typically unable to claim their children as dependents for tax purposes, and are therefore not eligible for more generous EITC benefits. This is because such parents’ children typically do not live in their household for the majority of nights in the year, which is the standard the Internal Revenue Service uses to determine which parent can claim custody for tax purposes. See Internal Revenue Service (2013), p. 13.
- <sup>3</sup> To achieve basic economic security, CFFPP has previously estimated an income of about \$40,000 (in 2010 dollars) as a national recommended average for noncustodial parents paying child support for two children. Parents with less income than this will likely not experience basic economic security because they will be forced to make tradeoffs between housing, food, medical care, transportation, emergency savings, other basic needs—and paying child support. An income of \$40,000 is about 369% of the 2010 federal poverty guideline for individuals. For a detailed discussion of basic economic security as it applies to low-income parents who are court-ordered to pay child support, please see “BEST Incomes for Noncustodial Parents Paying Child Support” in CFFPP (July 2011).
- <sup>4</sup> Williams and Johnson (2013), p. 1.
- <sup>5</sup> “Louisiana already has one of the highest combined average state and local sales tax rate in the country and the increase would put the state at the top of that list, according to information from The Tax Foundation” (Adelson, March 14, 2013).
- <sup>6</sup> Citizens for Tax Justice (CTJ) (2013).
- <sup>7</sup> Institute on Taxation and Economic Policy (ITEP) (2013).
- <sup>8</sup> McGaughy (2013).
- <sup>9</sup> O’Brien (2011).
- <sup>10</sup> Newman (2013).
- <sup>11</sup> Tax Policy Center (2013). For estimates of the EITC at various income levels, please see the Center on Budget and Policy Priorities (CBPP), “2012 Earned Income Tax Credit Estimator,” <http://www.cbpp.org/eic2012/calculator/>
- <sup>12</sup> Office of Child Support Enforcement (OCSE) (2010).
- <sup>13</sup> Conversation with Joyce James, Director, Louisiana Building Economic Security Together (LABEST), February 22, 2013. LABEST is a project of Urban Restoration Enhancement Corporation, in Baton Rouge, Louisiana.
- <sup>14</sup> “What is LABEST?” accessed December 3, 2013. <http://www.la-best.org/about.html>
- <sup>15</sup> Davis et al. (2013), pp. 61-62.
- <sup>16</sup> Spires (2012), p. 2.
- <sup>17</sup> Ibid., p. 1.
- <sup>18</sup> Wider Opportunities for Women (WOW) (2013).
- <sup>19</sup> Coalition for a Prosperous Mississippi (CPM) (2011).
- <sup>20</sup> Tax Credits for Working Families (2013a).
- <sup>21</sup> Davis et al. (2013), pp. 73-74.
- <sup>22</sup> Miller and Sivak (2008), pp. 14-15. The other state that taxes groceries is Alabama. The Alabama Asset Building Coalition (AABC), a coalition in the Ford Foundation’s BESOL initiative, has identified eliminating the grocery tax as “the No. 1 asset-building priority in the minds of Alabama citizens” (Stetson, 2012). See also Sanders (2011).
- <sup>23</sup> Ibid., pp 6 and 16.
- <sup>24</sup> Also see endnote 3 above. For a detailed discussion of basic economic security as it applies to low-income parents who are court-ordered to pay child support, please see “BEST Incomes for Noncustodial Parents Paying Child Support” in CFFPP (July 2011).
- <sup>25</sup> Wider Opportunities for Women (WOW) (2013).
- <sup>26</sup> RAISE Texas (2013a).
- <sup>27</sup> Tax Credits for Working Families (2013b).

- <sup>28</sup> RAISE Texas (2013b).
- <sup>29</sup> Office of Child Support Enforcement (OCSE) (2010).
- <sup>30</sup> Ibid.
- <sup>31</sup> Davis et al. (2013), pp. 111-112.
- <sup>32</sup> Institute on Taxation and Economic Policy (ITEP) (2011).
- <sup>33</sup> Wider Opportunities for Women (WOW) (2013). As of December 2013, WOW's BEST Income tables covered 27 states and the District of Columbia, as well as a nationwide average, however Texas was not yet included. CFFPP's estimates of BEST Incomes for Texas parents paying child support are based on the statewide averages of two neighboring states—New Mexico and Louisiana—and major urban areas within those states—Bernalillo County (Albuquerque), New Mexico, and Orleans Parish (New Orleans), Louisiana.
- <sup>34</sup> Mullany (2012).
- <sup>35</sup> Finzel and Torres Flores (2013).
- <sup>36</sup> Make Work Pay in Illinois (2011).
- <sup>37</sup> Davis et al. (2013), pp. 51-52.
- <sup>38</sup> Wider Opportunities for Women (WOW) (2013).
- <sup>39</sup> For a summary of recent research on racial discrimination in the labor market see “Study Concludes: ‘America Is Still Racially Segregated in the Workplace’ Leading to Lower Wages for Black Men” in CFFPP, April 2011.
- <sup>40</sup> For a detailed analysis of how PERI's EITC proposals apply to low-income parents who are court-ordered to pay child support, see Center for Family Policy and Practice (CFFPP), June 2012.
- <sup>41</sup> Ibid.

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**Mission Statement:** The mission of the **CENTER FOR FAMILY POLICY AND PRACTICE (CFPP)** is to strengthen society through the expansion of opportunities for low-income parents – mothers and fathers – to protect and support their children. CFPP operates as a policy think tank to remove the unique barriers and negative public perceptions that affect low-income men of color. Through technical assistance, policy research and analysis, and public education and outreach, CFPP works to support low-income families and develop public awareness of their needs.

**Contact Us:** If you would like to share comments, questions, ideas for future briefing topics, or to sign up for our email list, please contact Nino Rodriguez, Program and Policy Specialist, at [nrodriguez@cffpp.org](mailto:nrodriguez@cffpp.org), or visit the CFPP website at: <http://www.cffpp.org/emailupdates.php>

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