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Proposed Child Care Credit Would Erase City Tax Burden for Some Families

APPROXIMATELY 200,000 NEW YORK CITY TAX FILERS with incomes low enough to escape state and federal income taxes will still pay the city's personal income tax (PIT) in 2007, according to an estimate by IBO. The child care tax credit proposed by Mayor Michael Bloomberg, which is designed to ease the cost of child care for low-income families, would have the additional benefit of eliminating the need to pay city personal income tax for about 33,000 families.

The number of tax filers owing city but not state or federal income taxes has doubled over the past nine years (see IBO's 1999 report *New York City's Tax on the Working Poor*). This has occurred despite the city having since established a refundable earned income tax credit (EITC) in 2004 that eliminated personal income tax liability for many low-income workers. These 200,000 filers pay taxes for households with 632,500 adults and children. Even if the child care credit is established, which will provide \$42 million of tax relief to low-income families with child care expenses, there still would be 167,000 filers who will owe city but not state and federal income taxes.

The 200,000 filers who this year will owe income taxes only to the city, assuming no change in tax laws, will pay a total of \$55.6 million in personal income tax—\$278 per filer on average. Almost all (94.1 percent) of these filers will have annual incomes in 2007 between \$20,000 and \$50,000, with most—146,000 filers—in the \$20,000 to \$35,000 range.

The lack of indexing for inflation of the state and city tax brackets, in contrast to those of the federal tax, is one reason why the number of taxpayers who incur only city tax liability has grown over time. Another is that credits against the state income tax available to low-income filers—particularly the earned income and child care tax credits—have become increasingly generous relative to comparable city credits. Almost 71 percent of the 200,000 filers who will pay only the city PIT received the earned income tax credit. But the city's EITC is equal to only one-sixth the value of a taxpayer's state EITC.

What is perhaps most notable about the tax filers who are too poor to owe state and federal income tax but who owe city income tax is that almost all are families with children—193,000 filers, or 96.5 percent of the total. Moreover, over four out of five (81.5 percent) of these families with children are headed by single parents. And almost half (47.5 percent) of the families take the state's child care credit, a credit not available against the city PIT.

Proposed City Child Care Credit. Establishing a city personal income tax credit for child care expenses would decrease the number of families paying only the city PIT. If enacted, the Mayor's

City Income Tax Payers With No State or Federal Liability

Dollars in millions

	Number of filers	PIT Liability	Fiscal Cost
Current Law	200,000	\$55.6	\$-
With Mayor's Proposal	167,000	\$50.1	\$42.0
With 50% Child care Credit	121,000	\$21.5	\$162.2
With 50% EITC and Child Care Credit	85,000	\$14.9	\$292.6

SOURCES: IBO; Mayor's Office of Management and Budget.

proposed child care credit, which has already been endorsed by the City Council, would provide an average credit of \$364 to those filers who pay only the city PIT, eliminate PIT liability for approximately 33,000 of these and reduce the number who only owe city PIT to 167,000 filers. This group's remaining PIT liability after accounting for the credit would be \$50.1 million, or \$301 per filer on average. As before, virtually all of the group paying only the PIT would be families with children, with most being single-parent households with incomes between \$20,000 and \$35,000.

The proposed city credit would be less generous and more limited than either the state or federal child care credit. Under the proposal, the amount of the city credit would be determined as a percentage of the comparable state credit, which in turn is calculated as a percentage of the federal child care credit. The state credit equals 20 percent to 110 percent of the federal credit, depending on income, with the greatest percentage received by families whose incomes are \$25,000 or less. New York City filers in this group would receive a credit equal to 75 percent of the state credit. The percentage rapidly phases out over the \$25,000 to \$30,000 income range, and no family with an income above \$30,000 would receive a city credit. The proposed city tax credit would be refundable—families would receive a check for any portion of the value of the tax credit that is greater than what they owe in personal income tax.

In contrast, families at all income levels are eligible for the state and federal credits, albeit at lesser rates than those for low-income families. The proposed city credit would be more limited than the state and federal credits in another way: only child care expenses for children up to 3-years old would be allowed for determining the city credit, compared to expenses for children up to 12 years of age for the non-city credits.

Easing the City Tax Burden for More Families.

If the proposed child care credit were more generous, fewer city families too poor to pay state or federal taxes would be burdened by city taxes. For all levels of income, city residents face a marginal city PIT rate that is at least half—and in some cases far more than half—their marginal state rate. Thus, for city credits to have a

similar impact on city tax liabilities as their state counterparts do on state liability, they would need to be set at percentages of the state credit more in line with the relative marginal tax rate.

If a city child care credit were defined as simply one-half of the state credit, which covers children up to age 12, 121,000 families would continue to owe city personal income tax, paying a total of \$21.5 million, or \$177 per filer.

Combining a more generous child care credit with a more generous EITC would remove even more low-income filers from the city's tax roles, but at a significantly greater cost. If the city EITC were also equal to 50 percent of the comparable state credit—up from its current value of 16.7 percent—only 85,000 families would remain in the group owing only city PIT, paying a total of \$14.9 million, or \$175 per filer. Families with incomes between \$20,000 and \$35,000 account for most of the families whose city tax liabilities would be eliminated with this combination of enhanced child care and earned income tax credits.

The Mayor's Office of Management and Budget projects it would cost the city \$42.0 million for the first year of the proposed credit. Establishing a child care credit more generous than the one currently proposed would be far more costly to the city, whether or not the city EITC were enhanced as well. IBO estimates that the cost of establishing a child care credit equal to one-half of the state credit without increasing the EITC would be \$162.2 million. If both the EITC and new child care credit were set at half the state levels, the cost would be \$292.6 million.

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