INFORMATION BRIEF
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Utilization of Minnesota's Working Family Credit as Parents Transition from Welfare to Work

Earned income tax credits (EITC) have contributed to lower welfare caseloads and higher labor force participation by single mothers. This information brief summarizes research by Donald Hirasuna and Thomas Stinson on Minnesota's EITC, the Working Family Credit, and provides insights into how current and former welfare households may react to changes in the WFC and other policy parameters. Analysis was conducted using data on Minnesota welfare recipients from 1992 through 1999.

Minnesota Working Family Credit

The Minnesota Working Family Credit (WFC) is a tax credit for low-income individuals that encourages work with an earnings supplement. To receive the credit, individuals must file a state income tax return, and the amount received depends on the individual's earnings.

Two-Tiered Credit Structure

The Minnesota WFC has a two-tier structure. In the first tier, the credit phases in with earnings until it reaches a maximum to the first tier, where it remains constant with earnings until earnings reach the phase-in to the second tier. With further increases in earnings, the credit phases in again until it reaches the maximum to the second tier. The credit remains constant until it reaches a phase-out floor in which any further increases in earnings or income reduce the credit

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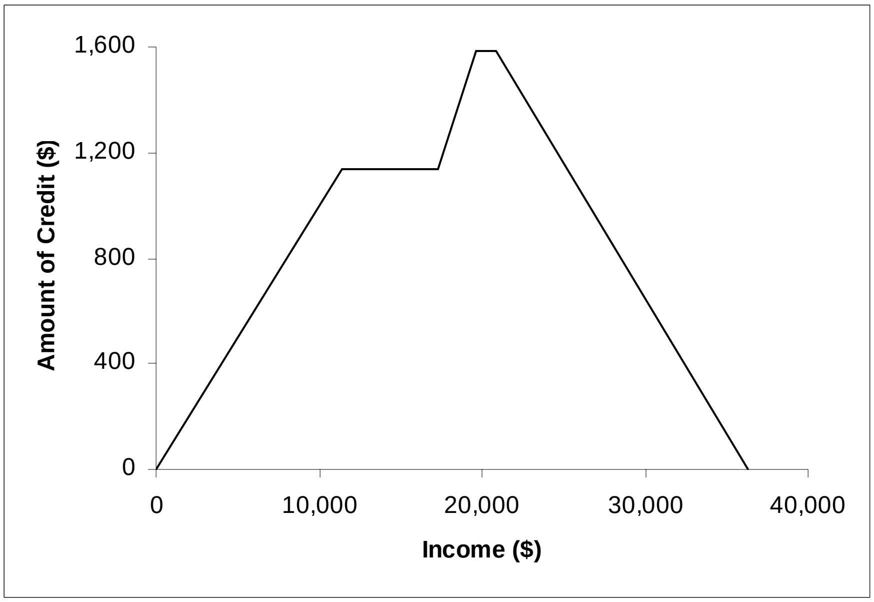
amount. The state authorized the second tier to compensate for situations where individuals increase their earnings and potentially end up with less net income, which is due to transitions off cash grant welfare and food stamps and increases in income taxes. By compensating for the potential decrease in income and extending the credit beyond the welfare eligibility limits, the WFC can help parents transition from welfare to work. Figure 1 graphs the two-tier earned income credit for a single parent with two children.

Figure 1
Minnesota Working Family Credit, 2006



Differences Between the WFC and the Federal EITC in WFC's Ability to Help Families Transition from Welfare to Work

The WFC differs from the federal EITC in several ways that could affect its role in helping parents transition from welfare to work.

- To receive the WFC, an individual must file a state tax return in addition to a federal return.
- American Indians who solely live and work on their reservation are ineligible for the WFC.
- Migrant farm laborers must file a nonresident tax return to receive the WFC.
- Some former welfare recipients may move out of the state and are no longer eligible for the state earned income credit.

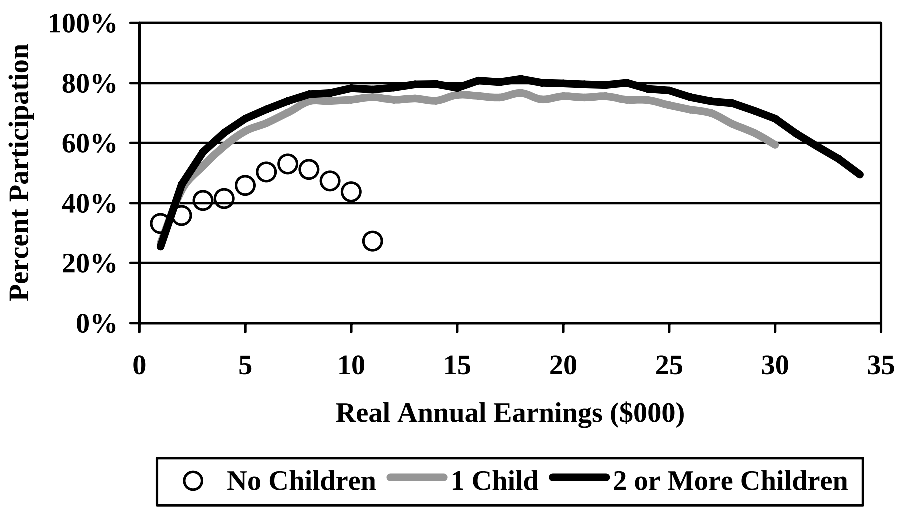
The WFC and Welfare Households

Expansions to the federal EITC and state earned income credits, such as the WFC, helped some parents transition from welfare to work by supplementing earnings beyond the income eligibility limits of welfare. Researchers tend to find that receipt rates of the WFC and the federal EITC are generally lower among welfare recipients. However, at least part of this may correlate with a higher concentration of persons with lower earnings among welfare recipients.

- On average, 38 percent of all current and former welfare recipients receive the WFC.
- Among those eligible for the WFC, 64 percent received the credit, which is lower than national averages for all individuals eligible for the federal EITC—75 percent to 85 percent.
- Receipt of the WFC is similar to national averages for individuals with earnings between $10,000 and $25,000.

Figure 2 charts receipt rates among current and former welfare recipients potentially eligible for the WFC based upon their earnings and number of children. The chart shows that parents receive the WFC at higher earnings levels when they may be transitioning off of welfare.

Figure 2
Receipt Rates for WFC by Earnings Level and Number of Children



- For individuals with higher earnings, the lower receipt rates may reflect data limitations: The researchers may not have data on other income sources or self-employment earnings that render some individuals ineligible for the WFC.
- Parents who no longer have children under 18 may receive the credit at lower rates because the credit amount is small relative to the time costs of filing a tax return.

Ways Current and Former Welfare Households May React to Changes in the WFC

Research suggests that an increase in the generosity of the credit increases the chances that eligible households will claim the WFC:

- Among all current and former welfare recipients, a 10-percent increase in the maximum credit increases the probability of receiving the credit by 1.8 percent to 2.5 percent
- Expansions to individual segments of the WFC, such as a higher phase-in rate for the first tier, result in higher receipt rates of the WFC.

In general, a more generous credit provides a greater incentive for those who would not otherwise file a tax return to file to claim the WFC. More generous credits may also increase labor force participation among current and former welfare recipients.

For more information about welfare recipients' utilization of tax credits, visit the health and human services area of our web site, www.house.mn/hrd/issinfo/hlt_hum.htm. This information brief is based on Donald Hirasuna and Thomas Stinson's working paper "Minnesota's Earned Income Tax Credit Program: Utilization by Current and Former Welfare Households and the Impact of Policy Parameters."