The Tax Code as Social Policy in Rural America

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Abstract
This concept paper, commissioned by the Rural Policy Research Institute, describes the increasingly fundamental role that the federal tax code plays in providing support to rural communities, especially their lower-income residents. It charts the overall growth of social policy expenditures through the tax code, and explains why these expenditures may be particularly meaningful for both families and places in rural America, focusing on the value of selected federal tax credits in two states relative to agricultural subsidies. It concludes by analyzing the various opportunities and challenges that would accompany a more concerted effort to highlight the tax code’s importance as a tool for enhancing economic and social well-being in rural places.

Introduction
The federal income tax system has almost always done much more than merely collect revenues to support the nation’s spending. From its inception in the early 20th century, the income tax code has provided special preferences for certain groups of taxpayers, or types of activities, that reduce the amount of tax a family or business may owe. While these incentives, or tax expenditures, have long been associated with perks for the wealthy, policy and socioeconomic trends over the past few decades have expanded the importance of the tax system for more disadvantaged groups. Indeed, one estimate finds that the code provided over $86 billion in tax credits to low-to-middle-income families in 2003 (Gitterman, Cotton, and Howard 2003).

Discussions around what government does for disadvantaged people and places still tend to focus on more “traditional” programs on the expenditure side of the federal ledger, such as welfare cash assistance, economic development funds, health insurance subsidies, and public housing. Undoubtedly, these programs provide crucial benefits to the families and communities on the receiving end of the expenditures. However, focusing on these programs to the exclusion of tax-related expenditures overlooks a large and important growth center in American social policy.

Current policy developments, moreover, suggest three reasons why those interested in the well-being of lower-income families and communities—particularly in rural areas—may wish to draw more attention to the tax code’s importance in this respect.

First, the Bush administration, together with many senior officials on Capitol Hill, have in the past year initiated serious discussions around the prospect of fundamental tax reform and tax simplification. The President’s Advisory Panel on Tax Reform (2005) has held numerous hearings and considered several options that would radically transform the way in which the federal government raises revenues from individual taxpayers. These include shifting away from taxes based on income to those based on consumption, such as a value-added tax (VAT), a flat tax, and a national retail sales tax. Although these proposals are often motivated by concerns around simplicity and efficiency, nearly all would raise the tax burden on low-to-middle-income families in the context of revenue-
neutral reform. This is because they would very likely reduce the tax expenditures
directed to these groups relative to the amounts they receive under current tax law
(Burman 2005). While the future of these reform proposals remains very much in doubt,
their design emphasizes that the continued progressivity of the federal tax system should
not be taken for granted.

Second, the budget picture as a whole indicates that the federal government is highly
unlikely in the near term to adopt significant new spending measures targeted to lower-
income Americans. The latest CBO estimate places the FY 2005 budget deficit at $331
billion. Over the next decade, under reasonable assumptions regarding tax policy and
expenditures for military operations in Iraq and Afghanistan, the cumulative deficit will
equal $4.1 billion (Horney and Kogan 2005). The Administration and Congressional
leaders have used this bleak budget picture as a pretext for proposals to cut expenditures
for many programs that assist lower-income families and communities, including
Medicaid, Food Stamps, the Community Development Block Grant, the Housing
Voucher Program, and programs for education and training. At the same time, the budget
resolution adopted by Congress in May 2005 anticipates further tax cuts primarily
targeted to higher-income individuals (Horney 2005). Thus, while the budget picture has
severely constrained opportunities to expand expenditures for disadvantaged people and
places, it has not tempered Washington’s enthusiasm for tax expenditures.

Third, an effort to look beyond traditional expenditure programs shares its aims with a
growing movement to re-think the way in which the federal government invests in rural
communities. That movement seeks to advance American rural policy beyond providing
subsidies to farmers, or to rural residents and localities generally, towards making
strategic investments in infrastructure, skills, and quality of life that create new rural
growth centers (Atkinson 2004). Other researchers are developing a cross-cutting picture
of how the federal government invests in rural places, to help those communities gain a
better understanding of how to challenge and reformulate rural public policies (SRDI
2005). Any such reformulation must take account of the federal tax code’s current role in
promoting the economic well-being of rural places and their residents.

This paper offers a brief look at the importance of the federal income tax code for rural
residents and the places they live. It first explains the nature and history of tax
expenditures, and then underscores the role of what it terms “working family credits”—a
series of tax provisions whose benefits are targeted primarily to low- and middle-income
families, and that have grown in value during recent years. Next, it highlights the reasons
why these credits may have particular meaning for rural families and communities,
drawing on analysis of data from Census 2000 and the IRS. It further compares the value
of selected tax credits to more traditional rural subsidies within two states, showing the
variation across different types of rural communities. The paper concludes by discussing
the various opportunities and challenges—which political and economic—that await
efforts to bring greater attention to the power and potential of the federal tax code as a
social policy tool in rural America.

The federal tax code as a social policy tool
Different aspects of the federal individual income tax code might be classified as furthering social policy goals. For instance, the system’s progressive nature—which taxes higher incomes at progressively higher rates—limits the burden on taxpayers with relatively limited ability to pay. The unit of taxation in the American system—the family—acknowledges the primacy of families as units for expenditures and care giving, and stands in contrast to the many other Western nations that raise taxes at the individual worker level. But to most observers, special provisions in the code that reduce the tax otherwise owed, generically termed “tax expenditures,” represent the primary vehicles for advancing social policy goals through the revenue side of the ledger. As the Joint Committee on Taxation (2005) notes, these provisions are referred to as expenditures because they can be considered analogous to direct spending programs that provide a statutory entitlement to government funds.1

Tax expenditures have grown enormously in magnitude over the last 25 years. In 2005, the Joint Committee estimated that the combined value of tax expenditures for individuals in the tax code totaled $803 billion. This was up from $330 billion in 1980 (adjusted for inflation), an increase of more than 140 percent (JCT 1980, 2005).2 By comparison, total federal government outlays increased by an inflation-adjusted 77 percent over the same period (Budget of the U.S. Government 2005). This implies that an increasing share of government expenditure over this period has taken place in the tax code, rather than through direct outlays. Sammartino, Toder, and Maag (2002) argue that federal budget rules from the 1980s and 1990s that curtailed the growth of spending programs encouraged Congress to use tax expenditures to achieve similar policy goals. Others instead argue that tax credits increasingly acted as a compromise position between Democrats who sought to boost social expenditures and Republicans who sought to reduce tax burdens (Gitterman, Cotton, and Howard 2003).

The meaning of these tax expenditures for low- and moderate-income people and places differs greatly, however, based on the specific design of the expenditure. One of the most important distinctions concerns that between deductions and credits. The former type of provision lowers the amount of income subject to tax, while the latter provides a dollar-for-dollar reduction in income tax liability. The benefits of deductions largely bypass low- and moderate-income households. First, most such households take the standard deduction, so that providing itemized deductions for particular types of preferred activities provides them with no financial incentive at all. Second, even when those households do itemize deductions, they typically fall into low marginal tax rate tax brackets—0, 10 or 15 percent—so that the deduction is worth very little (no more than 15 cents per dollar of expenses).

1 JCT notes that it treats as tax expenditures those provisions that represent exceptions to normal income tax law. The personal exemption, standard deduction, and the existing tax rate schedule are treated as part of normal tax law, and thus not as tax expenditures.
2 These figures are instructive as to the proliferation of tax expenditures over the last 25 years; however, as Burman (2003) notes, summing different categories of tax expenditures is problematic for several reasons. While neither figure provides a truly accurate sense of the total cost of tax expenditures to the Treasury, the difference in magnitude between the sums clearly demonstrates the growing importance of tax expenditures over the last 25 years.
Unlike deductions, credits do not increase the rate of subsidy as income rises from moderate levels. The effect of a credit on lower-income households depends, however, on whether the credit is refundable. A **refundable** credit is paid in full even if it exceeds the filer’s income tax liability. A **nonrefundable** credit can only be used to reduce income tax liability, not to receive a net payment from the government. With a few important exceptions, most credits are nonrefundable. This means that they cannot provide any benefit at all to the 40 percent of tax filing units who have no income tax liability. Still, they may provide significant tax reductions to moderate- and middle-income families with modest tax liability.

A further distinction among tax expenditures separates those that are intended to benefit particular places and their residents, versus those that are spatially neutral in their design. The first category is a much smaller one, focused in most cases on distressed inner cities and rural areas (e.g., Empowerment Zones and Renewal Communities), environmentally contaminated properties, and certain state and local infrastructure projects. While these place-based tax expenditures have often attracted a great deal of attention when eligibility decisions are made, their overall magnitude pales in comparison to that of other tax expenditures, even in places that benefit from both types of incentives (Spencer 2004).

This paper focuses the bulk of its attention on a set of federal tax expenditures that are designed to benefit primarily low-to-middle-income families, regardless of where they live. These **working family credits** have grown rapidly in the last decade, and many did not even exist at the beginning of the 1990s. They promote basic social policy goals—encouraging work, helping parents care for children, and promoting higher education and saving for retirement—but offer very different levels of subsidy, and benefit slightly different classes of taxpayers. The five credits are outlined below in Table 1.

1. **Earned Income Credit**—The EITC, as it is commonly known, supplements earnings for workers and families with modest incomes. The amount of credit for which a taxpayer is eligible depends on his/her earnings and number of children in the family. Families with two or more children and earnings in the $10,000 to $15,000 range qualify for the largest credit amounts—up to $4,400 in tax year 2005. Families with one child can earn up to $2,660, and very low-income workers without children (earning less than $12,000) are eligible for a credit of up to $400. Because the credit increases in size through about $10,000 in earnings, and then “plateaus” over a roughly $5,000 range, it encourages work, and can result in an effective $2 to $3 per hour earnings boost for full-time, year-round workers. It is the most important credit for lower-income families because of its size, and also because it is refundable—taxpayers receive the full value of the credit for which they qualify regardless of their income tax liability.

2. **Child Tax Credit**—The CTC was enacted in 1997 to provide additional income support to families with children. In tax year 2005, it will provide a $1000 per-child credit to couples with incomes up to roughly $110,000, and heads of household with incomes up to $75,000. Unlike the EITC, the CTC is not a fully refundable credit. It
is, however, partially refundable. Lower-income working families may qualify for the **Additional CTC** (ACTC), which provides a refundable credit equal to 15 percent of their earnings in excess of $11,000, up to $1,000 per child. Very low-income families with children, with earnings under $11,000, do not qualify for the CTC or ACTC but do qualify for the EITC.

3. **Child and Dependent Care Credit**—The CDCTC offsets a portion of taxpayers’ costs for paid child care, for children or other dependents under the age of 13. A version of this credit has existed since 1976, and was expanded most significantly starting in 2003. The amount of credit for which a family qualifies depends on its income and its total child care expenses. In general, the value of the credit ranges from 20 percent to 35 percent of expenses of up to $3,000 per child (for up to two children). Because the credit is nonrefundable, moderate- and middle-income parents tend to benefit more from the CDCTC than low-income parents (JCT 2005).

4. **Education Credits**—The federal tax code provides two related credits, both introduced in 1997, to help taxpayers pay for postsecondary education for themselves and/or their children. The **Hope Credit** provides up to a $1,500 credit for tuition and fees paid for students in their first two years of postsecondary education, who are pursuing a degree at least half-time. The **Lifetime Learning Credit** is more flexible. It is available to students in any year of postsecondary education, who need not be pursuing a degree or enrolled at least half-time. It generally covers 20 percent of tuition and fees of up to $10,000. As with the CDCTC, though, both of these credits are nonrefundable. The HOPE Credit provides most of its benefits to middle- and higher-income taxpayers, while the Lifetime Learning Credit’s benefits are somewhat more concentrated among moderate and middle earners (Choitz, Dowd, and Long 2004).

5. **Credit for Qualified Retirement Savings Contributions**—The Saver’s Credit, as it is commonly known, effectively provides a government match for low-to-moderate-income families’ deposits’ into retirement savings accounts—generally IRAs and employer-sponsored 401(k) plans. A 50 percent credit—equal to a dollar-for-dollar match—is available for married couples with incomes up to $30,000, and heads of household with incomes up to $22,500. The credit rates phase down with increasing income. Like most other credits, the Saver’s Credit is nonrefundable, so it does not benefit the lowest-income filers. Because the income ceiling is rather low, however ($50,000 for couples), moderate-income families reap most of the credit’s benefits, often in the course of making their first contribution to a retirement savings plan (Gale, Iwry, and Orszag 2005).

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3 Taxpayers may also deduct up to $4,000 in tuition and fees, under rules similar to those for the Lifetime Learning Credit, though they may not take both the deduction and the credit for the same student.
Table 1. Summary of Working Family Tax Credits

<table>
<thead>
<tr>
<th>Credit</th>
<th>Eligible taxpayers</th>
<th>Size of credit</th>
<th>Refundable?</th>
<th>Cost, 2005 (SB)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Earned Income Credit (EITC)</td>
<td>Families with children and income up to $37,000; childless workers up to $12,000</td>
<td>Up to $4,400; average $1,800</td>
<td>Yes</td>
<td>39.0 (approx 34.0 refundable)</td>
</tr>
<tr>
<td>Child Tax Credit (CTC)</td>
<td>Families with children and income over $11,000, under $110,000</td>
<td>Up to $1,000 per child</td>
<td>Partially</td>
<td>46.6 (approx 17.0 refundable)</td>
</tr>
<tr>
<td>Child and Dependent Care Credit (CDCTC)</td>
<td>Families with paid care expenses for children under age 13</td>
<td>20 to 35% of expenses up to $3,000 per child (2 max)</td>
<td>No</td>
<td>3.0</td>
</tr>
<tr>
<td>Hope and Lifetime Learning Credits</td>
<td>Parents or students with postsecondary educational expenses</td>
<td>Hope: up to $1,500; Lifetime: 20% of expenses up to $10,000</td>
<td>No</td>
<td>5.2</td>
</tr>
<tr>
<td>Saver’s Credit</td>
<td>Taxpayers with incomes under $50,000 who make contribution to IRA, 401(k), etc.</td>
<td>10% to 50% of contribution up to $2,000</td>
<td>No</td>
<td>1.7</td>
</tr>
</tbody>
</table>

Source: Author’s analysis of IRS and JCT publications

Many states, it should be noted, provide versions of some of these credits through their own income tax codes. For instance, 14 states and the District of Columbia offer earned income credits that provide families with a portion of their federal EITC. A handful of other states have “low-income credits” that reduce taxes on poor families but are not refundable like the EITC. As many as 27 offer some version of a child and dependent care credit, with 13 making the credit refundable for some families.⁴

Of course, working family credits are hardly the largest federal tax expenditures. The revenue foregone from the deductions allowed for home mortgage interest and property taxes paid amounted to $92.2 billion in 2005, nearly as much as all five working family credits combined. Similarly, the preferential tax rates for capital gains income and exclusion of capital gains at death together matched the revenue loss for these five credits (JCT 2005). People in rural areas benefit from these provisions as well, though arguably to a lesser extent than individuals elsewhere, since most tax expenditures are “upside-down” incentives that benefit higher-income taxpayers disproportionately (Howard 1997).

The importance of working family credits for rural America

The profile of families in rural America indicates that they may derive particular benefit from the range of working family credits available in the federal tax code. Moreover, the places in which these families live benefit indirectly from these credits, as they provide local residents with more income and stimulate greater local economic activity and enhance social well-being.

What are the characteristics of rural families that make these credits potentially important tools? First, incomes tend to be lower in rural areas than in other parts of the U.S. In 1999, household income in rural areas averaged between $40,000 and $43,000, far behind the $60,000 average in metropolitan areas (Table 2). Of course, costs of living are generally lower in less populated, more remote areas of the U.S. But the federal tax code applies one set of income standards to the entire U.S., with the result that low- and moderate-income families may benefit from working family credits even if the costs they bear lower-than-average costs for basic necessities like housing and food. In this way, lower incomes in rural America indicate that greater proportions of its residents are eligible for many of these tax benefits.

Secondly, the income differences between rural areas and small towns, and cities and suburbs, are even greater for families with children, the target of the most valuable working family credits. The difference between the average incomes for families with children in metropolitan versus rural areas approached $22,000 in 2000 (Table 2).

Third, tax credits, rather than tax deductions, hold greater value for rural families than for families elsewhere. One of the biggest factors influencing whether tax deductions are meaningful for a family concerns whether that family pays significant mortgage interest and real estate taxes, enough to outweigh the value of the standard deduction (equivalent to $10,000 for a married-couple family in 2005, and $7,300 for heads of households). While rural households own their homes at higher rates (72 to 76 percent) than metropolitan households (65 percent), the value of those homes is considerably lower (by about $76,000 on average), thus limiting the value of deductions generally for these families (Table 2). Consequently, only 22 to 27 percent of rural tax filers filed a Schedule A form in 2003 to itemize their deductions, compared to 38 percent of metropolitan filers.

These factors noted, there remain significant gaps between rural and metropolitan families on other measures, suggesting that some working family tax credits may benefit rural families less often. In particular, the credits related to some form of “asset development”—retirement savings and postsecondary education—may be used less often in rural America. Evidence for this includes the lower proportion of rural households in Census 2000 that reported interest or dividend income, suggesting lower savings activity overall in these places. Similarly, elderly poverty in rural areas is higher, which may also reflect inadequate retirement savings (Table 2). With respect to education credits, the proportion of adults enrolled in some form of postsecondary schooling is lower in rural

5 Figures reported in this paper acknowledge that under the new OMB classification system, both micropolitan and non-core-based statistical areas may be recognized as “rural.” Thus, data are generally reported for both types of areas.
than in metropolitan areas. In this way, the future of these asset-related credits presents opportunities to expand their usage in rural America, thereby benefiting the families who live there.

Table 2. Selected characteristics of households in rural, micropolitan, and metropolitan areas, Census 2000

<table>
<thead>
<tr>
<th>Area Type</th>
<th>Avg. HH Income</th>
<th>Avg. income, families with children</th>
<th>% home-owners</th>
<th>Avg. home value (owners)</th>
<th>% HH w/ investment income</th>
<th>% elderly in poverty</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rural*</td>
<td>$40,384</td>
<td>$43,653</td>
<td>76.6</td>
<td>$89,488</td>
<td>32.1</td>
<td>13.8</td>
</tr>
<tr>
<td>Micro</td>
<td>$44,465</td>
<td>$48,232</td>
<td>72.2</td>
<td>$102,223</td>
<td>33.4</td>
<td>11.4</td>
</tr>
<tr>
<td>Metro</td>
<td>$59,628</td>
<td>$65,454</td>
<td>64.5</td>
<td>$165,535</td>
<td>36.5</td>
<td>9.2</td>
</tr>
</tbody>
</table>

* counties in non-core-based statistical areas
Source: Author’s analysis of Census 2000 data

The demographic and economic profile of rural families accords with evidence on the places that receive disproportionate benefits from working family credits. Previous research established that families in rural areas claimed the EITC at higher rates than those in suburbs or small metropolitan areas (Berube and Tiffany 2004). Updated data reveal that in tax year 2002, between 20 and 22 percent of rural tax filers claimed that credit, compared to 16 percent of tax filers in metropolitan areas. Moreover, the average value of EITC claimed in rural areas exceeds that elsewhere. In 2003, EITC filers in non-metropolitan counties claimed a credit averaging over $1,790, compared to $1,766 in metropolitan areas.

While similar data are not yet available for the other working family credits, this evidence suggests that those credits directing the bulk of their benefits to low- and moderate-income families provide particular help to small towns and rural areas. Those providing most of their subsidy to middle-income families, such as the Child Tax Credit and the Education Credits (Burman 2003b), do not appear to provide disproportionate subsidy to rural Americans in their current form. Preliminary evidence shows that in 2002, the percentage of filers claiming the Child Tax Credit did not differ among non-core-based, micropolitan, and metropolitan areas.6

The concentration of lower-income families in rural places—and thus the concentration of working family credits in those areas—differ from region to region, and state to state. In the Northeast and the Midwest, filers in rural areas show lower receipt of the EITC than those in cities, and than the national average. In the South and West, however, rural filers are more likely to claim the EITC than those in other types of communities. In a number of these states, such as Tennessee and Oregon, the majority of EITC recipients reside in rural and micropolitan areas (Berube and Tiffany 2004). Nationwide, nearly 4.2 million families living in these areas received the EITC in 2003.

6 However, Additional Child Tax Credit claims (the refundable portion of the Child Tax Credit) are likely overrepresented in rural areas, as they typically accrue to families with incomes between $10,000 and $20,000.
The over-representation of taxpayers who benefit from the EITC in several parts of rural America is most evident from a national map of credit claim rates (Figure 1). From southern Virginia, through the Carolinas and Georgia, and into the Deep South extending north to Arkansas lies a nearly contiguous stretch of mostly rural counties where at least 30 percent of all taxpayers receive the EITC—roughly double the national rate. Communities along the Southwest Border, and those in heavily rural farming and American Indian areas of the West, also exhibit far above-average use of the EITC.

Still, the fact that the federal government provides significant financial assistance to rural families and communities through the tax code has gone largely unnoticed to date. In part, this owes to the significant attention paid to more “traditional” expenditures the federal government makes in these areas via, among other programs, USDA farm subsidies. Analysis of the respective size of the EITC and these programs suggests, however, that for many counties and states working family credits make a potentially larger economic contribution to family and community well-being. Two example states illustrate how widely the relative importance of these investments varies (Table 3):

- **In Montana**, USDA farm subsidy programs contributed more than $353 million statewide in 2003, with the overwhelming majority of that total ($334 million) flowing to rural/micropolitan counties. That same year, residents of Montana earned $114 million in EITC, with $78 million flowing to filers in rural/micropolitan areas of the state. Statewide, then, USDA programs provided $3 for ever $1 in EITC claimed. Still, 17 of Montana’s 56 counties—14 of them outside metropolitan areas—received more via the EITC alone than from USDA subsidy programs. Lake County, located just north of the Missoula metropolitan area, benefited from $1.1 million in USDA subsidies in 2003, but saw an inflow that year of $4.2 million from EITC claims.

- **In South Carolina**, USDA programs made a somewhat smaller impact on the state economy than in Montana, contributing $126 million in 2003. This paled in comparison to the EITC, which delivered nearly $770 million to lower-income filers throughout the state that year. In fully 44 of the state’s 46 counties, EITC claims exceeded USDA subsidies. The disparity reflects that rural areas of South Carolina depend less heavily on the agriculture industry than similar areas in states like Montana. At the same time, it also highlights that in many states throughout the South, the low-wage work that predominates in rural areas renders working family credits like the EITC even more vital investments in the local economy.

### Table 3. Comparison of USDA Programs and EITC in MT and SC Counties, 2003

<table>
<thead>
<tr>
<th></th>
<th>Total USDA subsidies, 2003 (M)</th>
<th>Total EITC, 2003 (M)</th>
<th>Ratio EITC/USDA in rural/micro counties</th>
<th>% counties where EITC &gt; USDA</th>
<th>County with lowest ratio</th>
<th>County with highest ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>MT</td>
<td>$353.3</td>
<td>$114.1</td>
<td>0.23</td>
<td>30.4</td>
<td>Liberty</td>
<td>Silver Bow</td>
</tr>
<tr>
<td>SC</td>
<td>$126.0</td>
<td>$770.0</td>
<td>0.17</td>
<td>44.4</td>
<td>Beaufort</td>
<td>Pickens</td>
</tr>
</tbody>
</table>

7 Farm subsidy data include commodity, conservation, and disaster relief programs. Source: Environmental Working Group Farm Subsidy Database, online at [www.ewg.org/farm](http://www.ewg.org/farm)
<table>
<thead>
<tr>
<th>SC</th>
<th>$126.3</th>
<th>$769.5</th>
<th>3.15</th>
<th>95.7</th>
<th>(0.01)</th>
<th>(369.6)</th>
</tr>
</thead>
</table>

Notably, this analysis considers the size of USDA subsidies relative to the EITC alone. It does not account for the combined value of the five working family credits outlined earlier, because no data yet exists on the size of the other credits at the local level. Very rough assumptions (based on program size nationally) indicate, however, that the Additional Child Tax Credit (the refundable portion of the CTC) may boost refund amounts for EITC recipients by an effective 40 percent.\(^8\) Other working family credits further increase the financial value of the tax code for rural areas. At the same time, the analysis excludes other federal programs aimed at promoting economic development in rural America, though they generally rank far smaller in size. Nonetheless, the figures highlight once again that rural areas are hardly an agricultural monolith, and that in many places the federal government’s wage subsidies for low-wage workers outweigh its subsidies to farmers in sheer dollar terms.

Beyond magnitude, it is admittedly difficult to gauge the true economic effects of working family tax credits relative to federal expenditures to support agriculture and rural development. EITC dollars, for instance, are likely spread more widely among the population, and in smaller average dollar values, than USDA expenditures in rural areas. Several surveys find that families who receive the EITC use it to pay back bills, especially rent and utilities, purchase retail goods for themselves and their children, and save for future events or expenditures (Smeeding, Philips, and O’Connor 2000; Center for Community Capitalism 2005). Most of this activity occurs early in the tax season, when a majority of EITC claimants file and receive their tax refunds. Thus, while the initial benefits of the EITC may be spread more widely and thinly, those benefits can generate concentrated economic impacts in several sectors due to their lump-sum delivery method.

### Working family credits in rural America—opportunities and challenges

This paper has presented evidence on how the federal tax code has become a crucial vehicle for American social policy, and why rural leaders should devote increased attention to the power and potential of the code to assist rural families and communities. This final section outlines possible areas for further study and focus regarding the connections between working family tax credits and rural America, and highlights attendant challenges and opportunities that deserve consideration as such efforts take shape.

Further research could more completely describe the myriad, interrelated ways that the federal tax code currently supports rural places. First, researchers might probe the spatial distribution of recipients of the various working family credits in rural America, and the

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size of tax benefits claimed. To date, it has been possible to examine the EITC in this way (Berube and Tiffany 2004), and new IRS data should expand the number of provisions that can be investigated at sufficient levels of geographic detail. Second, these inquiries could provide first-order clues as to where gaps exist in working family tax credit participation. While it is not possible to derive accurate local estimates of these rates, researchers could compare, for instance, receipt of the ACTC or Saver’s Credit across communities with similar EITC claim rates to identify places where such receipt is lower than might be expected. Third, better estimates are needed as to the secondary and tertiary effects of tax expenditures in rural areas. The few economic analyses of these expenditures that have been conducted have focused on metropolitan areas (Jacob France Institute 2004; Texas Perspectives Inc. 2003) and consequently may have ignored the economic dynamics that characterize smaller, more remote places. Case study work, in particular, could reveal a great deal about the spending patterns that accompany receipt of working family credits in different types of rural areas.

These research efforts would aim, in the end, to give policymakers and leaders in the rural arena information regarding the importance of tax expenditures for low-to-middle-income families in their places. This information could spur new federal, state, and local activity to improve the utilization of these credits among eligible families, as has occurred in hundreds of cities across the U.S. in recent years (National League of Cities 2004). It could also lead to greater focus on protecting and enhancing the value of working family credits in federal and state tax codes. Such activities must, however, take account of several challenges and opportunities that characterize the current political and economic landscape:

Local capacity. Highly successful efforts have taken shape in cities and urban counties nationwide over the last few years, often led by mayors and other public executives, that inform eligible families about the existence of the EITC and other working family credits, and provide those families with access to free and low-cost assistance in claiming those credits. In urban areas with dense concentrations of eligible families and strong community capacity, achieving “bank for the buck” is arguably easier than in rural areas with dispersed populations, more diffuse local leadership, and limited access to philanthropic and community-based resources. Similar efforts in rural America might look to successful statewide initiatives like North Carolina’s, which shares financial and human resources across that state’s rural counties to connect eligible lower-income families to tax benefits.9

Access and awareness. Coupled with the challenge of mounting significant efforts to increase rural participation in working family credits, the profile of rural working families themselves may complicate such efforts. First, the ethnic profile of lower-income rural residents is changing dramatically, with more immigrant workers moving to rural communities in search of employment and affordable housing. Of the more than 1,500 U.S. counties whose Hispanic populations at least doubled in the 1990s, three-quarters were located outside metropolitan areas (Johnson 2004). Some of these workers are ineligible for the EITC because they lack valid Social Security numbers for

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9 www.eitc-carolinas.org
themselves or their children, though they may be eligible for the ACTC and other tax benefits. Second, self-employment is a more important income source in rural/micropolitan areas than in cities and suburbs. Because most self-employment income is received outside the withholding system, nonfiling and under-reporting rates among these workers are higher (National Taxpayer Advocate 2003). Consequently, audit rates are higher for taxpayers reporting self-employment income (Burman 2003a). The combination of these factors may make it more difficult to raise participation in working family credits in rural areas, even if most low-income workers could benefit financially from entering the tax system.

The future of refundable credits. As discussed above, the EITC and ACTC are especially valuable credits to lower-income families because their full value may be claimed as a tax refund even if the taxpayer has no bottom-line tax liability. In contrast, the nonrefundable CDCTC, education credits, and Saver’s Credit primarily benefit moderate and middle-income families, who are not as over-represented in rural areas as lower-income families. Efforts to expand existing refundable credits, and to convert nonrefundable credits to refundable ones, have met stiffer resistance in recent years for a couple of reasons.

First, the large tax cut enacted in 2001, as well as subsequent smaller but still significant tax cuts, targeted most of their relief to higher-income taxpayers based on the argument that these individuals paid a large share of the overall federal income tax. Conversely, those at the bottom of the income spectrum, who pay payroll and excise taxes but not income taxes, were often excluded from these cuts. The 2001 tax bill did create the ACTC, but when Congress accelerated the expansion of the CTC to $1,000 per child in the 2003 tax bill, it specifically excluded the refundable portion of the credit from that acceleration. The notion that families who do not “pay into” the federal income tax system should not receive further benefits delivered through the income tax code continues to hold political sway in much of Washington’s policymaking today.

Second, Congress and the Bush Administration have focused a great deal of attention on high error rates in the EITC. IRS research (2002) finding that 27 to 32 percent of EITC dollars were paid in error in 1999 prompted the Administration to develop a new pilot certification program that requires certain EITC claimants to provide additional information to the IRS establishing their eligibility for the credit. Though legal and administrative changes since 1999 have likely reduced the EITC error rate considerably, and the IRS likely overestimated the error rate in its initial report (Greenstein 2003), the report and associated responses may have significantly dampened enthusiasm at the federal level for creating new refundable credits or expanding existing ones.

The possibility of fundamental tax reform in the next few years makes these concerns around refundable credits even more salient. Most of the reforms under consideration would seek a large reduction in tax rates in exchange for severe reductions in tax expenditures. Even if lower-income taxpayers continue to be exempted from paying

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10 In Census 2000, 8.1 percent of household income in non-core-based areas was derived from self-employment, compared to 6.5 percent in micropolitan counties, and 5.7 percent in metropolitan counties.
federal income taxes (or value-added taxes) under a reformed system, proposed reforms may nevertheless reduce the size of, or restrict eligibility for, refundable credits similar to the EITC and ACTC.

Possibilities at the state level. Even if political and budgetary factors at the federal level hold little promise for near-term expansions in working family credits, rural leaders still have important opportunities at the state level to boost investment in their families and communities through state income tax credits. In the past three years, Delaware, Illinois, Indiana, Kansas, New Jersey, New York, Rhode Island, and Virginia have enacted or expanded state versions of the federal EITC (both refundable and nonrefundable). Such credits have enjoyed bipartisan support in both boom times, when they offer a vehicle that allows lower-income families to share in the benefits of tax cuts, and lean times, when they soften the blow of tax increases and budget cuts on those families. Efforts to enact state-level versions of working family credits can represent opportunities for urban and rural legislators to practice “majoritarian politics” together, as their constituents tend to benefit disproportionately from such provisions.

Conclusion
Whatever the future holds for the federal tax code, rural leaders would do well to focus anew on the role that tax expenditures, particularly those targeting lower-income working families, play in promoting the economic and social well-being of their communities. Increased attention to the importance of these provisions for rural places could recognize the changed way in which the federal government enacts social policy, help transform the policy dialogue around “what matters” for rural America, and illuminate the need to support the growing number of low-wage workers who live there.

References


Figure 5
EITC Recipients as a Percentage of Total Returns by Zip Code, TY 2001