

## Child Credits: Opportunity at the Door

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Both the White House and Congress publicly are committed to providing child credits as part of a tax bill this year. Privately many of the members of both branches express misgivings that a child credit is not the best use of federal dollars. Moreover, they feel in a bit of a trap: although they have promised a credit of \$500 per child, they know that it will be very difficult to provide such a high level of credit given the limited amount of revenue reduction made available for a budget agreement. This wishy-washy attitude toward the credit, unfortunately, leaves them looking narrowly at political constraints rather than the real economic opportunity that this credit provides.

With some moderate adjustments in the design of the credit, a significant reduction could be made in the ranks of children without health insurance. This type of redesign would represent a leap beyond the very high work and marriage penalties associated with our welfare system and the expansion of those penalties currently being proposed in many of the health reforms for children. To top it all off, these improvements in tax, health, and welfare policy could be gained at a lower, not higher, cost than the \$500 child credit.

How can all this be achieved? There are two basic steps:

1. Fold the current dependent exemption into the credit. A credit of \$900 in lieu of the dependent exemption would save money relative to a \$500 credit added on to the dependent exemption. A credit of \$700 or \$800 per child would save even more.
2. Require that those who claim the new credit must provide health insurance for their children. I have no doubt that if House Ways and Means Committee Chair Bill Archer, R-Texas, or Senate Finance Committee Chair William V. Roth Jr., R-Del., took off with this proposal, it would be declared a "winner" by almost everyone. In terms of sheer politics, there are almost no losers relative to current law. Taxpayers with children get a tax break. Liberals get a substantial reduction in children uncovered by health insurance. Conservatives create a viable alternative to government-controlled health insurance and eliminate some of the capricious tax rates hidden in welfare programs and in existing health insurance expansion proposals. Meanwhile, the proposal is creative in dealing with the very real revenue constraint that both sides face in trying to draft a total tax bill.

The proposal isn't perfect. None is. Some special consideration ideally would be given to those who fall between the cracks of the tax and welfare systems. Any new program or procedure, moreover, is going to involve some administrative costs. Still, this proposal "fits" better than almost any proposal on the table today, and is far superior to a simple add-on credit that is integrated into neither the tax nor expenditure systems of this nation.

The dependent exemption was worth \$2,550 last year and would probably grow to about \$2,700 or more by the time that any new credit is fully phased in. For a taxpayer in the 15 percent tax bracket, this exemption will then be worth a little more than \$400 ( $\$2,700 \times 0.15$ ). Add this \$400 to a \$500 child credit, and the total comes to \$900.

For a taxpayer in the 28 percent tax bracket, on the other hand, the current dependent exemption is worth about \$750 ( $\$2,700 \times 0.28$ ). If a credit of about \$900 were made available, the net cost per child would only be \$150 versus \$500 under the proposal. At \$750, there is no additional benefit, while some taxpayers in even higher brackets would lose a little. The conversion of the dependent exemption into a unified credit essentially eliminates the need for a complex phase-out and simplifies the combined dependent exemption/child credit structure currently under consideration.

Families who do not buy health insurance for their children often depend on the rest of society to cover those

costs. For low-income individuals, perhaps this is understandable. But most moderate- and middle-income taxpayers buy insurance for their children even though there are some with equally high incomes who do not. In fact, a significant portion of uninsured children live in middle-income and upper-income households. The denial of a credit to those who do not buy health insurance is nothing more than a way of recouping some of the costs that they are going to impose on other members of society.

For welfare and Medicaid recipients today, the costs of work and marriage are quite high. Even the new work requirements under welfare reform do not eliminate these penalties for many, and they certainly do not remove marriage penalties. New expansions of Medicaid only exacerbate these penalties. By phasing out benefits quickly as income rises, these programs impose very large tax costs on any recipient who marries someone who has earnings.

With a new tax credit for children, however, benefits would follow the child and be less dependent on how the income of a couple is divided or whether they marry or not. A couple who married might lose Medicaid for their children but would now be eligible for the new child credit if either member found a moderate wage job. The proposal certainly does not eliminate all work and marriage disincentives, but it moves a significant degree in the right direction.

New provisions inevitably involve some amount of administration. Under this proposal, health insurers would need to provide statements to the IRS. While this might involve some additional trouble on their part, my guess is that most private insurers would prefer this approach to the continuing tendency toward a nationalized health care system through expansion of the Medicaid system. This approach also provides a simple way to test credits or vouchers, which one day may be offered as an alternative to Medicare. Under current law, that system will soon also expand enormously when the baby boomers retire and reduce still further the percentage of the population covered mainly by private insurance.

For the first year or two, perhaps only a statement that insurance was available at the end of the year would be required to be filed by insurers. This is not a perfect system, but later it could be supplemented with further statements from insurers for other months of the year. Even if some credits were paid out inappropriately, the pressure on all credit recipients to buy health insurance soon would be quite high. Moreover, those credits would have been paid out anyway if there was no requirement to purchase health insurance. Compared to other government ways of expanding health insurance, these administrative and enforcement issues are probably minimal.

Still another step might be to take some of the savings generated by this proposal and make it available to states to cover families who might be nontaxable. Again, without a national system of providing child allowances or of health insurance, the direct expenditure system and the tax system will not form a seamless web. They never have. But this is about as close as we are going to get under current administrative structures.

There are a couple of other advantages to this proposal. Because the credit would be a flat amount, it would be quite easy to reflect in withholding. Many employers would be encouraged at least to offer insurance for sale even if they did not pay for it directly. The flat credit helps insurers also know how much is available and, therefore, it is attractive for them to seek out clients and even help them claim the credit. All these efforts, as well as the basic tax incentive, should induce many uninsured adults to buy insurance in the process of buying health insurance for their children.

This opportunity to expand health insurance so significantly and to move away from the tendency to put more and more of the middle class into a welfare-like subsidy structure, with its extraordinary hidden tax rates and marriage penalties, is extremely rare. Such an opportunity will not come along again during this administration, and by the next one we are going to be facing up to the extraordinary costs of our current promises to provide the baby boom generation retirement and health benefits for one-third of their adult lives.

In the early 1980s I did some research on the taxation of families that noted the decline in the value of the dependent exemption and its powerful effect over time of raising the relative tax burden of families with children. This research took off and in many ways served as the original catalyst for the current proposal to provide a child credit. As a parent of the child credit idea, I urge Congress to recognize that the policy goal should be to integrate any child credit into the nation's current tax and transfer schemes, not simply to provide tax relief for its own sake. When opportunity comes knocking, for goodness sake, answer the door.

## Other Publications by the Authors

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