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Opportunity at Hand: Revising the Child Credit

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Document date: April 30, 2001
Released online: April 30, 2001

Compared to a total tax bill likely to cost about $1.4 trillion over 10 years, any child credit provision in that bill will be far from the most expensive item. As I have noted previously, child credits are not currently indexed for inflation, so their long-term cost will decline significantly relative to the cost of most other major provisions. Child credits, nonetheless, provide a unique opportunity to fix up a variety of problems affecting and moderate-income taxpayers.

The House of Representatives recently voted to double the child credit for middle-income families and to extend its availability to some income families who do not currently benefit from it. The Senate is likely to accept much that the House did, as well as to increase the number of families receiving the child credits especially as a way of reaching a compromise across political parties.

If it is done right, a child credit revision has a chance to achieve bipartisan support. First, it can increase the amount of the tax cut available to those with moderate incomes between, say, $13,000 and $32,000. Second, the particular way the House bill amends the administration's current proposal would add considerably to the complexity of tax filing for lower-income individuals. That problem needs to be avoided. Finally, an amended child credit can be used to reduce the very large marriage penalties faced by moderate-income individuals.

When the House recently agreed to stretch the availability of the child credit beyond those with income tax liability, it followed the logic of an existing provision currently available only to families with three or more children. The notion is that the credit would be "refundable" that is, available to those with no income tax liability to the extent that they pay social security taxes. For that purpose, only the employee share of social security taxes is considered. Of course, the earned income tax credit is already refundable in those ranges, so the search for a rationale should not override the need to come up with a provision that is workable and understandable. The House bill essentially would extend the existing privilege for families with three or more children to families with any number of children.

Despite its progressive aspects, this new credit still would provide little or nothing to those with income levels below $25,000 (for example, a single parent with two children earning $25,000 would get only about $100 in the House bill compared with $2,000 of the child credit available to most middle-income families). Isabel Sawhill and Adam Thomas of the Brookings Institution calculate that families made up of about one-third of the nation's children would receive nothing at all.

The legislative process has not yet had time to digest another aspect of the child credit debate: administration. Under current law, the so-called "additional child credit" the credit that can offset social security taxes for those with insufficient income tax liability is claimed on a special Form 8812.

Believe me, this is not a simple form to fill out. It requires adding up social security taxes withheld and social security taxes payable on self-employment and farm income, calculating a potential child credit from a separate child credit worksheet, and making some additional comparisons as well to determine both eligibility and the amount of potential credit. One consequence in the case of the additional child credit is that some families apparently are not claiming the credit because of a lack of understanding. And most of the taxpayers eligible for an additional child credit have to file a separate earned income tax credit form, itself a source of much confusion.

Janet Spragens of American University Law School and others who work in tax clinics already indicate that even with professional assistance, tax filing for low-income individuals has become inordinately complex. Meanwhile, according to National Taxpayer Advocate Nina Olson, low-income taxpayers lack adequate protection from questionable practices in the return preparation marketplace. The last thing that this Congress should want to do is to add significantly to the complexity of their filing burdens.

A final reason to revise the child credit is that it can be used to reduce marriage penalties for moderate-income individuals. These penalties arise largely from the very high tax rates imposed on families with children as their income rises and they lose other benefits, such as when the EITC phases out at income levels between about $13,000 and $32,000. This is an issue that clearly cuts across party lines. For example, Wade Horn, President of the National Fatherhood Initiative (and tapped to be an Assistant Secretary of Health and Human Services) has expressed concern with these penalties for some time now.

In addition to the loss of the EITC, these same families are often the ones facing high tax rates because of the loss of food stamps and, in some cases, housing assistance. They also tend to lose Medicaid, first for themselves and then for their children (although President Bush has suggested offering them a health insurance tax credit a credit that has not yet made it into any of the tax bills). Once again, these high tax rates can make it extraordinarily difficult for a single parent to marry if he or she is working full- time at one to three times minimum wage and finds that the introduction of a spouse with earnings into the household would force the loss of all these income supplements.

The type of revision many are considering would phase in some refundable child credits starting in those income ranges in which the EITC currently phases out. The net effect would be to wipe out some of the high marginal tax rates from the EITC that are combining with all the other effective taxes on marriage and work.

Whatever approach is taken, fixing up the child credit can do much to extend benefits to those working families with modest incomes and to reduce the substantial marriage penalties they face. These revisions and the need to avoid substantial increases in complexity of tax filing are issues that can and should cut across party lines by the time a final bill is enacted.

Other Publications by the Authors

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