TAX POLICY CENTER
URBAN INSTITUTE & BROOKINGS INSTITUTION

REFORMING THE CHILD TAX CREDIT: AN UPDATE

Elaine Maag and Elena Ramirez

October 2016

The child tax credit (CTC) provides a subsidy to families of up to $1,000 per child under age 17. The Urban-Brookings Tax Policy Center (TPC) estimates the credit will deliver $57 billion to 35 million families in 2017, reaching nearly 70 percent of all families with children.[1] Garfinkel et al. (2016) estimate that the CTC lifted nearly 2 million children out of poverty in 2013. The credit starts to phase out once a family's income reaches $75,000 for single parents – $110,000 for married couples. As a result, even children in families with moderately high incomes benefit from the credit.

Legislation passed at the end of 2015 made permanent a temporary provision of the credit that allowed very low-income families with earnings to benefit from the credit, but it did not end the debate on the future of the CTC.[2] Since that time, multiple credit reforms have been proposed. We analyze seven options for reform that would (1) make the CTC more consistent with other parts of the tax code; (2) target additional benefits to young children; or (3) broadly increase the credit for most current recipients. This analysis updates previous estimates (Maag 2015) to incorporate the 2015 legislation. Brief summaries of the proposals, including cost estimates and the distributional impact, are listed below.

[1] The estimates include both the refundable and nonrefundable portions of the child tax credit (CTC). Families with children are tax units that claim an exemption for a child at home or away from home, including children ineligible for the current CTC. Ineligible children include those who are over age 16, including full-time students ages 19 – 24 who often qualify for a dependent exemption. For ease of exposition, we use the term "family" to mean "families with children".

[2] The American Recovery and Reinvestment Act of 2009 temporarily lowered the earnings threshold for the refundable credit to $3,000. Subsequent legislation extended the temporary reduction and the Bipartisan Budget Act of 2015 made the $3,000 refundability threshold permanent. Absent that legislation, the threshold was set to increase to $10,000 (adjusted for inflation starting in 2002) after 2017, which would have raised the threshold amount to about $15,000 in 2018, reducing or eliminating the credit for the lowest-income families.

1. **Make the CTC consistent with other parts of the tax code:**

- *Option 1. Eliminate the earnings threshold for refundability*: This option would remove the requirement that families earn at least $3,000 to qualify for the refundable portion of the CTC. The option would cost about $15 billion over the 10-year budget window from 2017 to 2026 and the additional benefits from the credit would go almost exclusively to families in the lowestfifth of the income distribution[3]. This option has been a part of several recent congressional proposals as well as Hillary Clinton's most recent presidential campaign proposal (Auxier et al. 2016).

- *Option 2. Increase the child age limit to include 17- and 18-year olds*: Raising the age limit so 17- and 18-year-olds could benefit from the CTC would align the definition of child more closely with other child-related provisions of the tax code. This option would cost $72 billion over the 10-year budget window and benefits would be distributed similarly to the current CTC: a large share of families in all but the highest fifth of the income distribution would benefit.

- *Option 3. Index the credit for inflation*: Indexing the credit for inflation would keep the credit from losing value over time as prices increase. Many provisions in the tax code are already indexed for inflation including the earned income tax credit (EITC). This option would cost $97.8 billion over the 10-year budget window. Families in the highest two-fifths of the income distribution would receive about half of all benefits from this proposal.

- *Option 4. Raise the phaseout threshold for married couples:* The CTC already phases out at higher incomes for married couples than for single parents ($110,000 vs. $75,000). This proposal would increase the phaseout threshold for married couples to be twice the amount for singles. That increase would reduce the higher income tax liability that some married couples with children incur because they are married. This option would cost $56.3 billion over the 10-year budget window. Benefits would be split to be roughly equal between families in the highest two fifths of the income distribution.

- *Option 5. Combine options 3 and 4, index the credit for inflation, and raise the threshold for married couples:* Indexing most CTC parameters and setting the phaseout threshold for married couples at twice that for single parents would make the CTC more consistent with other provisions of the tax code. Similar legislation was introduced in 2014. This option would cost $155 billion over the 10-year budget window. If indexing had been in place for 10 years, most benefits would have gone to families in the top 40 percent of the income distribution. Indexing the credit, without making other changes to the credit, would cost 98 billion over the 10-year budget window.

[3] Income quintiles are based on the income distribution for the entire population and contain an equal number of people, not tax units. The incomes used are adjusted for family size by dividing by the square root of the number of people in the tax unit. The resulting percentile breaks are (in 2015 dollars): 20 percent, $17,188; 40 percent, $32,014; 60 percent, $53,189; 80 percent, $87,736.

2. **Target additional benefits to young children**

   Option 6. Increase the CTC for workers with young children (YCTC): This option would phase in the additional credit with earnings, consistent with the current CTC (which begins phasing in once earnings reach $3,000). A more expansive version of this proposal (6B) would give all income-eligible families with a child under age three a fully refundable $1,500 credit with neither an earnings requirement nor phase-in. Both options would phase out starting at current law thresholds. The option with full refundability would cost $162 billion over the 10-year budget window; phasing in the YCTC with earnings over $3,000 would lower the 10-year cost to $147 billion. The distribution of benefits from either proposal would be similar to that under current law: a large share of families at all income levels, except the highest income quintile, would benefit from these credits. More benefits would go to families in the lowest income quintile under the proposal with full refundability.[4]

   Clinton's most recent presidential campaign child tax credit proposal would provide a $2,000 credit to children under age 5 and would begin phasing the credit in at the first dollar of earnings. The credit would phase in for young children at a rate of 45 percent rather than 15 percent. TPC estimated the cost of this proposal over the budget period FY2016 – 2026 would be $209 billion (Auxier, et al. 2016).

3. **Increase the credit maximum**

- *Option 7. Double the maximum credit to $2,000 per child:* This option would cost $511 billion over the 10-year budget window. It shows the effect of a broad credit increase with current eligibility rules. Benefits would be distributed similarly to current benefits; the lowest-income families earn too little to get a higher credit.

This report provides estimates of the cost of and the distribution of benefits from these options to help lawmakers and activists in setting priorities for future CTC reforms. The cost of combining any of the proposals described would not necessarily be the sum of the estimates presented in this paper.

[4] These options differ slightly from that analyzed in Maag (2015) to make them more consistent with the recently introduced Young Child Tax Credit Act of 2016. The Young Child Tax Credit Act of 2016 proposes to phase the YCTC out at a rate of $75 per $1,000 rather than the $50 per $1,000 that the CTC phases out at. We do not modeled this faster phaseout. If we did, the cost of the proposal that phases the YCTC in starting at $3,000 would be reduced to $147 billion over the 10 year budget window; the cost of the fully refundable credit would be reduced to $162 billion over that same period.

SUBSIDIZING CHILDREN IN THE TAX CODE

Three objectives have guided income tax subsidies for children:

- Income tax liabilities should account for ability to pay; thus, all else equal, a larger family should pay less tax than a smaller family.
- Subsidizing children is an investment in everyone's future.
- Encouraging parents to work will ultimately benefit their children.

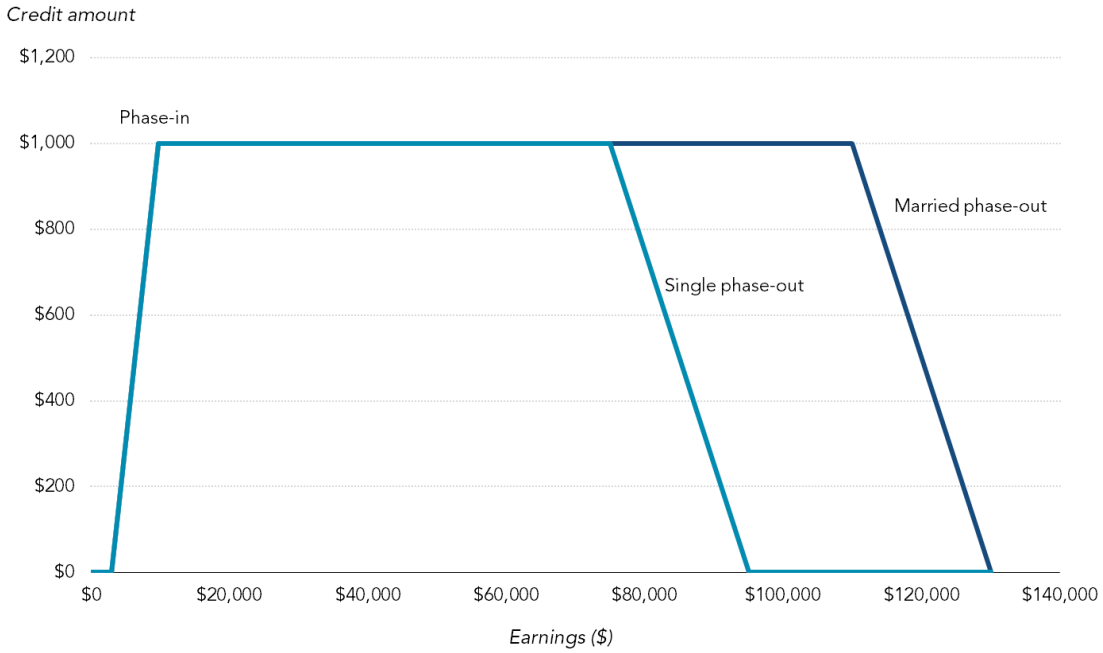
The child tax credit is consistent with all three objectives. It helps working families throughout most of the income distribution—only the poorest families and those with the highest incomes cannot benefit (Maag 2013). It is the second-largest tax subsidy focused on children, trailing only the earned income tax credit.

HOW THE CTC WORKS NOW

Taxpayers can claim a CTC of up to $1,000 for each child under age 17. The credit is reduced by 5 percent of adjusted gross income over $75,000 for single parents and over $110,000 for married couples. Neither the credit amount nor the phaseout threshold is indexed for inflation. If the credit exceeds taxes owed, taxpayers may receive some or all of the balance as a refund, known technically as the additional child tax credit (ACTC) or refundable CTC. The ACTC is limited to 15 percent of earnings above $3,000 (figure 1).

FIGURE 1

Child Tax Credit - 1 Child



Source: Urban-BrookingsTax Policy Center.
Notes: Assumes all income comes from earnings and that the child is under 17 and meets all tests to be a child tax credit qualfiying child.

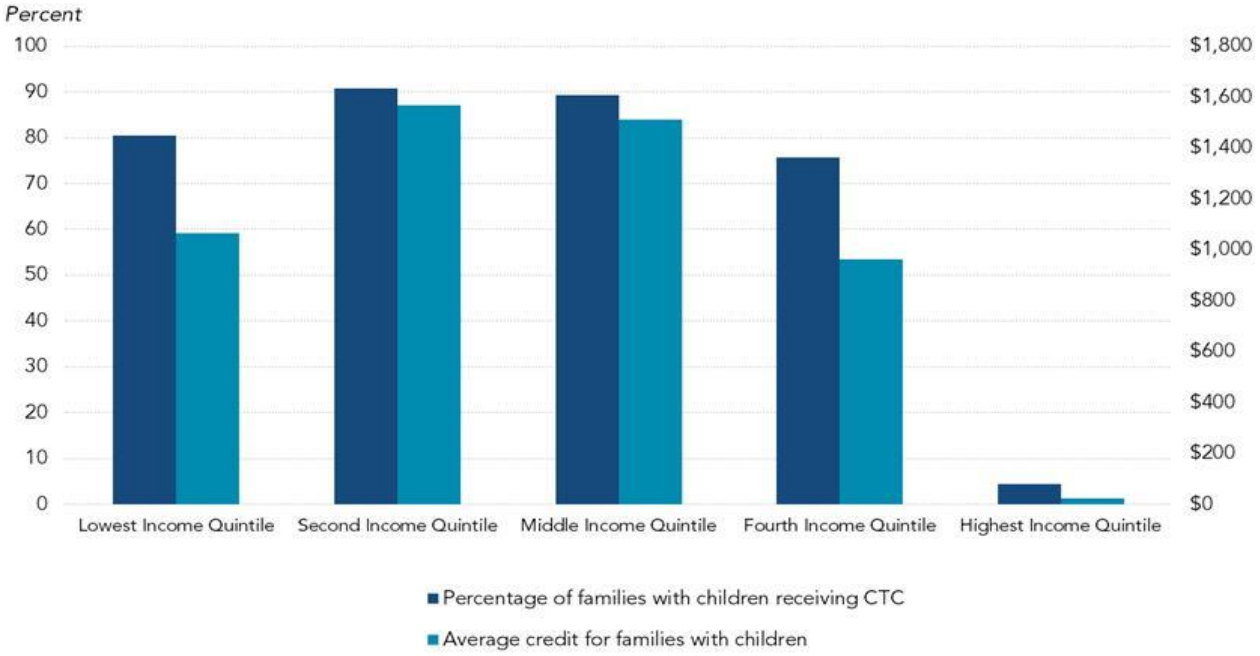
An estimated 70 percent of all families with dependent children benefit from the credit.[5] Although eligibility for the CTC is spread across all income groups, recipiency rates vary by income. Just over 80 percent of families in the lowest income quintile will benefit from the credit in 2017 (figure 2). Families in the lowest income quintile who will not benefit typically have earnings under $3,000. About 90 percent of families in the second and third income quintiles and three-fourths of those in the fourth quintile will benefit from the credit. Because of the phaseout, only 5 percent of families in the highest quintile will receive the CTC. Among otherwise eligible children, 10.4 million children will receive less than the maximum CTC in 2017 because their families' earnings are too low and another 16.1 million children will get less than the maximum because their family's income is too high. Average credits also vary among income groups mostly because of the earnings and income phase-in and phaseout thresholds. Under current law, average credits range from almost $30 for families in the highest income quintile to $1,570 for families in the second income quintile (figure 2)[6].

[5] Families, for purposes of this analysis, include all families claiming a dependent exemption for a child living at home or away from home. The main groups of children included in this definition but not currently eligible for CTC benefits are children ages 17- 18 or ages 19 - 24 and a full-time student in at least five months of the year.
[6] The average credit for families actually receiving the credit will be higher; these estimates include families that receive no credit.

FIGURE 2

Child Tax Credit for Families, 2017

Current Law, by Income Quintile



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0516-1).
Note: Families with children are those claiming an exemption for a child at home or away from home.

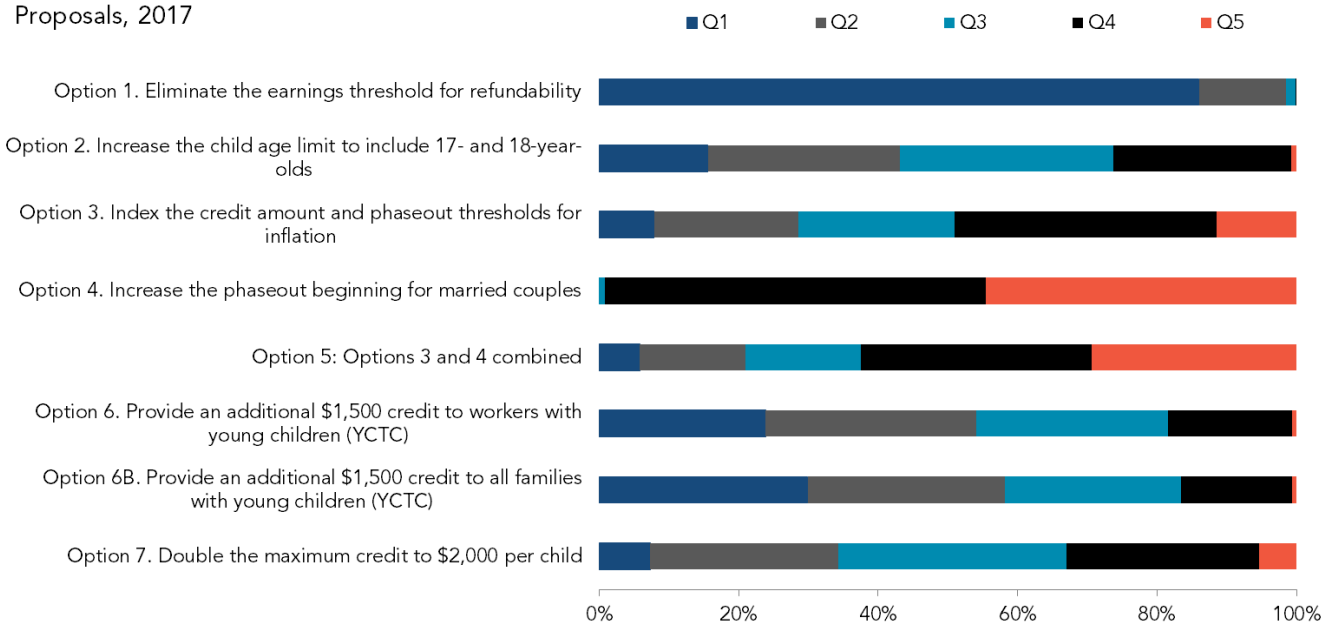
CTC Reform Options

Three approaches could increase CTC benefits: (1) make the CTC more consistent with other parts of the tax code; (2) target benefits to young children; and (3) broadly increase the credit for most current recipients. Changes to the CTC examined here differ in terms of the distribution of benefits across income groups (figure 3) and the share of families in each group that would get larger benefits (figure 4). The relatively broad reach of the CTC means that minor changes to the credit can redirect benefits dramatically.

FIGURE 3

Proportion of Child Tax Credit Increase Delivered to Each Quintile under Various Reform

Proposals, 2017



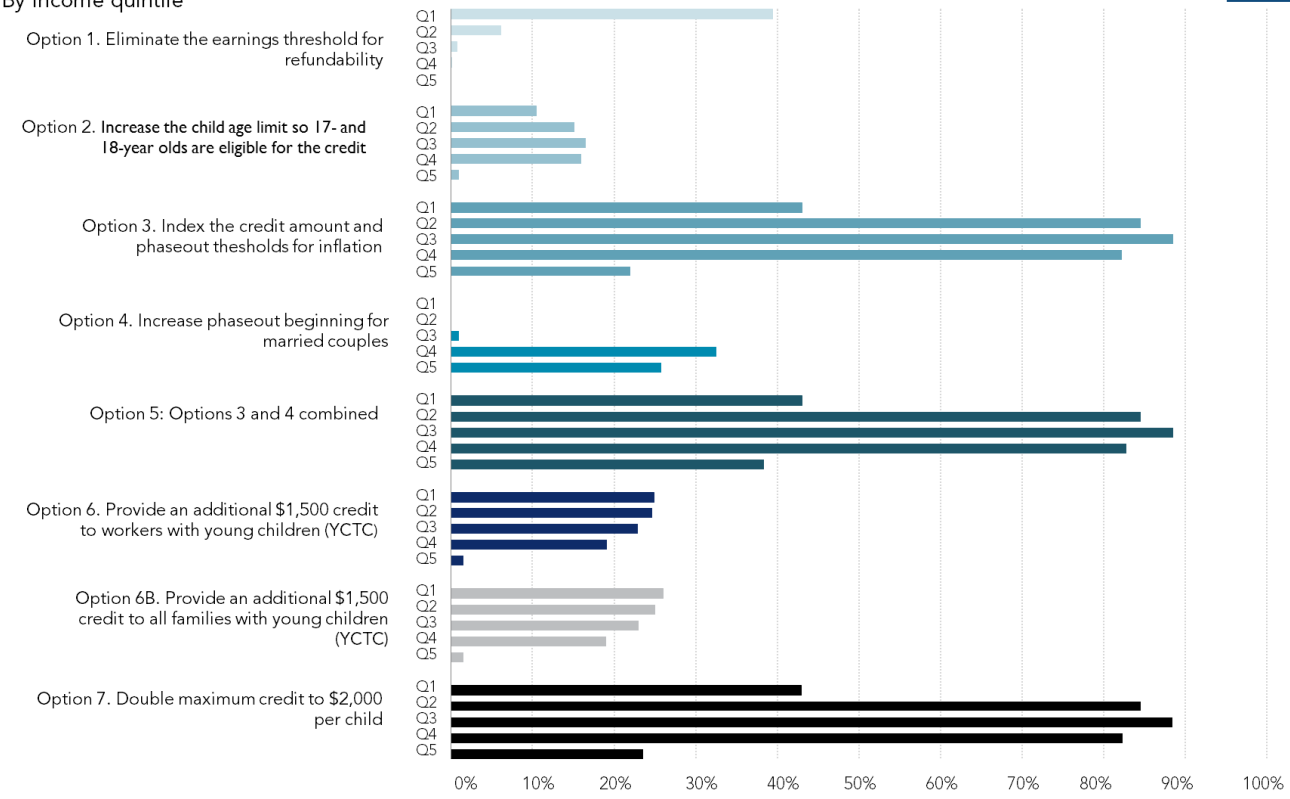
Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0516-1).
Notes: Options indexing the credit assume the credit has been indexed for the past 10 years in 2017.
Q = quintile. Quintile 1 is the lowest income quintile; quintile 5 the highest.

The cost of the options we analyze varies (figure 5), but in most cases, benefits could be scaled up or down to meet a particular cost target. While that would change average benefits, it would generally have little effect on the distribution benefits. For example, increasing the credit from $1,000 to just $1,500, instead of $2,000, would distribute benefits in roughly the same way as under today's credit (or the $2,000 proposed credit). Roughly the same share of people in each income group would gain. The proposal's cost would be reduced.

FIGURE 4

Share of Families Whose Child Tax Credit Would Increase under Various Reform Proposals

By income quintile



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0516-1).

Notes: Options indexing the credit assume the credit has been indexed for the past 10 years in 2017; Q = quintile. Quintile 1 is the lowest income quintile, quintile 5 is the highest.

1. Improve consistency between the CTC and other parts of the tax code

Option 1: Eliminate the earnings threshold for refundability

The refundable portion of the CTC equals 15 percent of earnings over $3,000, up to the maximum of $1,000 per eligible child. This option would eliminate the $3,000 threshold and start the phase-in with the first dollar of earnings. That change would make the credit calculation consistent with other credits, including the EITC and American Opportunity Tax Credit (AOTC). The change would target increased CTC benefits on very low-income families whose earnings are too low to get the full credit. About 85 percent of the increased credits would go to families in the lowest income quintile, and almost all remaining benefits would go to families in the second quintile (figure 3). Almost 40 percent of families in the lowest income quintile and about 6 percent of those the second income quintile would get larger child credits (figure 4).

Several recent legislative proposals would eliminate the earnings threshold for refundability, including the Young Child Tax Act of 2016 ,[7] introduced by Representatives

[7] H.R. 4693, 114th Cong. (2016).

DeLauro (D–CT), Pelosi (D–CA), and Levin (D–MI); and the Child Tax Credit Improvement Act of 2015[8], introduced by Senator Bennet (D–CO).

Option 2: Increase the eligibility age to include 17- and 18-year-olds

The tax code uses many different age limits to determine which children qualify a taxpayer for specific provisions. The dependent exemption and the EITC count children under 19 (plus fulltime students under age 24); the CTC cuts off at age 17; and the child and dependent care credit only applies to children under 13. This option would raise the age limit for the CTC to include 17- and 18-year-olds, making it more consistent with the age limit for dependent exemptions and the EITC.[9] This would be a key step towards simplifying the tax code for families (Maag 2011; Nunns, Maag, and Nguyen, forthcoming).

Benefits would be distributed similarly to current CTC benefits, with about 80 percent of the increase going to families in the middle three quintiles. About 15 percent of families in those quintiles and about 10 percent of those in the lowest income quintile would see their benefits rise.

Options 3: Index the credit for inflation

Unlike many parts of the tax code, the child tax credit is not indexed for inflation. As a result, over time the credit's real value falls and the credit begins to phase out at lower real income levels. Indexing the credit would maintain the credit's real value over time and would make sure middle-income families did not lose the credit as their incomes rise with inflation. Recent proposals that have included provisions to index parts of the CTC include Senator Brown's (D-OH) introduced Working Families Tax Relief Act of 2015 [10]and Representative Jenkin's (R-KS) Child Tax Credit Improvement Act of 2014[11]..

The proposal's effects would be small at first but would grow over time as inflation cumulates. If the credit had been indexed over the 2008-2017 decade, CTC benefits in 2017 would have been larger for more than four-fifths of families in the middle three income quintiles. Families in the fourth income quintile would have gotten about a third of the additional credits and those in the second and third quintiles would each have gotten about a fifth of the additional credits. Families in the lowest and highest fifths of the income distribution would get smaller shares of benefits than others.

[8] S. 2264, 114th Cong. (2015).
[9] Because understanding student status can be complicated for both the IRS and families claiming benefits, this option would not extend to full-time students ages 19 – 24 eligible.
[10] S. 1012, 114th Cong. (2015).
[11] H.R. 4935, 113th Cong. (2014).

Option 4: Index the credit for inflation and increase the phaseout beginning for married couples

The Child Tax Credit Improvement Act of 2014 would have raised the phaseout threshold for married couples from the current $110,000 to $150,000, twice that for single parents.[12] That increase would reduce the higher income tax liability that some married couples with children incur because they are married. About 55 percent of increase in credits would go to families in the fourth income quintile and almost all of the remainder would go to families in the highest income quintile. About a third of families in the fourth income quintile and about a quarter of those in the top quintile would receive larger credits under a plan to index the phaseout threshold for married couples.

Option 5: Combine options 3 and 4, index the credit for inflation and increase the phaseout beginning for married couples

Indexing the credit amount and phaseout threshold and raising the phaseout threshold for married couples to twice the level for single parents (i.e., combining options 4 and 5) would tilt the increase in CTC benefits towards higher-income families: over 60 percent of the benefits would go to families with children in the top two income quintiles. More than 80 percent of families in the middle three income groups would get larger credits, as would about 40 percent of those in the highest and lowest quintiles.

2. Target benefits to younger children

Option 6: Provide an additional $1,500 credit to workers with young children

A steady stream of research has shown that a child's early years are critical in determining success later in life (Duncan, Morris, and Rodrigues 2011). Even relatively small boosts in family income can lead to better outcomes later in life. Bolstered by this research, advocates have proposed providing an additional $1,500 refundable credit for working families under age three. The additional credit would phase in with earnings. If the additional credit were modeled on the current refundable CTC, about 75 percent of the added benefits would go to families in the middle three income quintiles in 2017. About a quarter of families in the bottom three quintiles would qualify for the additional credit, compared with roughly 20 percent of those in the fourth quintile and just 2 percent of those in the highest quintile.

Option 6B: Provide an additional $1,500 Credit to all families with young children

To provide more benefits to very low-income families, West, Boteach, and Vallas (2015) proposed making the new young child tax credit fully refundable. A similar proposal was later

[12] The change would have made the CTC more consistent with the standard deduction (which is twice as large for married filers is as for single filers) and the lowest two tax brackets (which are twice as wide for married couples as for single taxpayers).

introduced by Representatives DeLauro (D-Connecticut), Levin (D-Michigan), and Pelosi (D-California) as the Young Child Tax Credit Act of 2016[13]. That legislation would also have indexed the CTC and phased the credit out at a slightly faster rate. A fully refundable young child tax credit would allow all families with children under age three to receive the full credit even if their parent had no earnings. About 30 percent of such a credit would go to families in the lowest income quintile and roughly 28 percent would go to those in the second quintile. Credits would increase for about a quarter of families in each of the bottom two quintiles. This new credit could present an administrative challenge to the IRS because families that do not currently file tax returns would have to do so to get the credit. Because families would not need to have earnings to qualify for the credit, the credit would be unlike any existing tax credit—it would effectively be a straight transfer to all qualifying families, delivered through the tax code. It would therefore help the poorest families, even though they would still not qualify for the current CTC because they earn too little. Removing the credit phase-in also removes the encouragement to work inherent in the current credit structure.

3. Increase the maximum credit

Option 7: Double the maximum credit to $2,000 per child

A simple way to target additional benefits toward current beneficiaries would be to increase the value of the credit. That would not help families whose credit is limited by the earnings phase-in, but nearly 95 percent of current CTC recipients would get bigger credits. Doubling the maximum credit would increase CTCs for 65 percent of all families in 2017 (only slightly less than the 69 percent of such families that will receive the CTC in 2017 under current law). More than 80 percent of families in the middle three quintiles would see their credits rise, and they would get more than 80 percent of the total increase in credits. Compared with current law, about five times as many families in the top quintile would get some of the credit—25 percent versus about 5 percent—because the larger credit would phase out over a bigger income range and thus be at least partially available to higher-income families. Nearly half of families in the lowest quintile would get larger credits but only about 7 percent of additional credit dollars would go the those families.

TOTAL COSTS OF CTC REFORM

All seven options would increase the cost of the CTC, some dramatically (figure 5). Each plan could be scaled up or down to meet a particular budget target, which would change average benefits but would not necessarily alter their distribution. In that sense, the cost estimates shown below matter less than the distributional results presented earlier. The 10-year costs of the options range from about $15 billion (for eliminating the earnings threshold for the

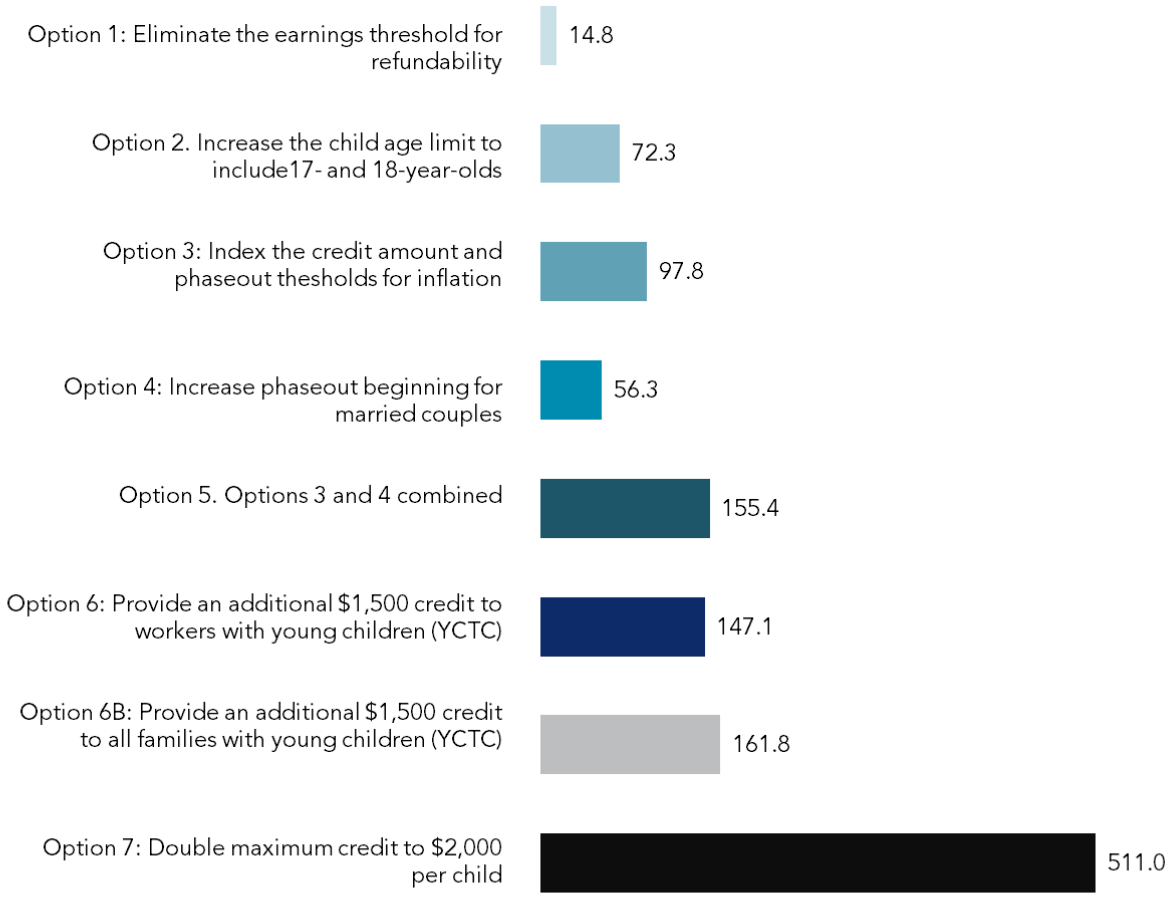
[13] H.R. 4693, 114th Cong. (2016),

refundable credit) to $511 billion (for doubling the maximum credit).[14] For context, TPC analyzed the Family Fairness and Opportunity Tax Reform Act[15] introduced by Senator Lee (R – Utah) in 2013 that included an additional, partially refundable, CTC of $2,500. The new portion of the CTC would be indexed for inflation and would not phase out at higher incomes. We estimated that would cost about $1.6 trillion over the 10-year budget window that would have started in 2014 (Burman et al. 2014). That plan also had offsetting costs to other related provisions and is not included in this analysis. None of the reforms proposed here would be nearly as large.

FIGURE 5

10-Year Budget Cost of Various Reform Proposals to Child Tax Credit (2017-2026)

Billions ($)



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0516-1).
Notes: Options indexing the credit assume the credit has been indexed for the past 10 years in 2017.

[14] Year-by-year estimates forthcoming at www.taxpolicycenter.org.

[15] S.1616, 113th Cong. (2013).

CONCLUSION

The CTC delivers substantial benefits to families with children. As long as children remain a priority for income support programs and the tax code continues to play a key role in delivering child subsidies, policymakers will continue to debate changes to the CTC. Understanding who would be affected by various proposals is essential to developing good tax and child support policies.

Which changes to the CTC are best depends on policymakers' goals. Policies that remove the income thresholds for refundability most effectively deliver benefits to very low-income families. The cost of this reform would be relatively low and benefits would go to the neediest children. If policymakers wish to provide extra help to families with young children, a policy supported by several recent studies, creating a new credit that could go only to those families would address the goal and hold down costs. Phasing out the credit at higher amounts would target benefits towards higher income families who have their credits limited under current law. Policymakers could remove potential barriers to marriage by phasing the credit out for married couples at double the income for single parents.

Several legislative proposals have sought to expand CTC benefits. The proposals would target benefits to specific groups of people – although beneficiaries are not always obvious. For example, doubling the credit might sound like it would benefit all families, but the lowest income families would be less likely to benefit from the proposal than higher-income families. Their credits are restricted by not having enough earnings to qualify for the maximum credit.

Understanding who will benefit from the various proposals can help guide policymakers as they choose which expansions most support their policy goals.

REFERENCES

Auxier, Richard, Len Burman, Jim Nunns, and Jeff Rohaly. 2016. "An Updated Analysis of Hillary Clinton's Tax Proposals." Washington, DC: Urban-Brookings Tax Policy Center. http://www.taxpolicycenter.org/publications/updated-analysis-hillary-clintons-tax-proposals/full

Burman, Len, Elaine Maag, Georgia Ivsin, and Jeff Rohaly. 2014. "Preliminary Analysis of the Family Fairness and Opportunity Tax Reform Act." Washington, DC: Urban-Brookings Tax Policy Center. http://www.taxpolicycenter.org/publications/preliminary-analysis-family-fairness-and-opportunity-tax-reform-act.

Duncan, Greg J., Pamela A. Morris, and Chris Rodrigues, 2011. "Does Money Really Matter? Estimating Impacts of Family Income on Young Children's Achievement with Data from Random-Assignment Experiments." *Developmental Psychology* 47(5): 1263-1279.

Goldberg, Fred, Lily Batchelder, and Peter Orszag. 2006. "Reforming Tax Incentives into Uniform Refundable Tax Credits." Brookings Policy Brief 156. Washington, DC: Brookings Institution. http://www.brookings.edu/research/papers/2006/08/taxes-orszag.

Maag, Elaine. 2011. "Tax Simplification: Clarifying Work, Child, and Education Incentives." Tax Analysts, March 28, 1587–96. http://www.urban.org/research/publication/tax-simplification-clarifying-work-child-and- education-incentives.

———. 2014. "Child-Related Benefits in the Federal Income Tax." Low-Income Working Families Brief 27. Washington, DC: Urban Institute. http://www.taxpolicycenter.org//UploadedPDF/413003-Child-Related- Beneifts-in-the-Federal-Income-Tax.pdf.

———. 2015. "Reforming the Child Tax Credit: How Different Proposals Change Who Benefits." Washington, DC: Urban-Brookings Tax Policy Center. Washington, DC: Urban Institute. http://www.taxpolicycenter.org/publications/reforming-child-tax-credit-how-different-proposals-change-who-benefits/full.

Nunns, Jim, Elaine Maag, Hang Nguyen Forthcoming. "Reforming the Income Tax Treatment of Families and Work". Washington DC: Urban-Brookings Tax Policy Center.

West, Rachel, Melissa Boteach, and Rebecca Vallas. 2015. "Harnessing the Child Tax Credit as a Tool to Invest in the Next Generation." Washington, DC: Center for American Progress. https://cdn.americanprogress.org/wp-content/uploads/2015/08/11114756/ChildAllowance-report.pdf.

The Tax Policy Center is a joint venture of the
Urban Institute and Brookings Institution.

BROOKINGS

For more information, visit taxpolicycenter.org
or email info@taxpolicycenter.org

The research was funded in part by the Annie E. Casey Foundation. We thank them for their support but acknowledge that the findings and conclusions presented in this preport are those of the authors alone, and do not necessarily reflect the opinions of the Foundation.

Thanks to Lydia Austin for creating the figures in this paper. The paper was reviewed and improved in various stages by Leonard Burman, David Harris, Frank Sammartino, and Roberton Williams. All errors that remain are the authors'.