



Analysis of a Young Child Tax Credit

Providing an Additional Tax Credit for Children Under 5

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Early childhood is a critical period of development, laying the foundation for lifelong skills, behaviors, and health. Yet many families with young children have low incomes, and parents struggle to balance employment with care for young children. The child tax credit (CTC) provides substantial benefits to families with children, but the credit provides the same \$1,000 maximum benefit for both younger children and older children. In recognition of the importance of early childhood for healthy development, as well as the financial strains families with young children face, we propose a new young child tax credit (YCTC) that would provide an additional benefit of up to \$1,000 for each child under age 5. If enacted in 2017, the YCTC would add \$18 billion in benefits to the \$57 billion the CTC will already provide.

To ensure that the benefits of the proposed YCTC reach children in the neediest families, we propose that the credit be separate from the existing CTC and that it have a more generous phase-in rate that would allow most very low-income families to qualify for the full credit. The credit would be refundable for families with earnings, which means even families that do not owe federal income taxes could receive the credit.

- The current CTC provides families with children younger than 17 a refundable credit of 15 cents per dollar earned over \$3,000, up to \$1,000 per child. The poorest families do not receive the maximum benefits of the CTC because their earnings are too low to be eligible for the full credit. For example, a family earning less than \$3,000 would get nothing, and a family with \$4,000 in earnings would get a credit of only \$150, not the full \$1,000 per child.

- The YCTC analyzed here would provide families with children under 5 an additional \$1,000 credit per child, structured so that even very low earners could qualify for the maximum credit. Research suggests that family income boosts have the strongest association with childhood cognitive skills at the lowest incomes (Duncan and Brooks-Gunn 1997).

We also explore three variations that would all direct benefits toward families with young children but differ in their cost and progressivity.

This brief offers a rationale for adding a supplemental tax credit, reviews how the current credit works, describes the proposed YCTC in more detail, and estimates the costs and distributional effects of four YCTC options.

Reasons to Provide a Young Child Tax Credit

Early childhood is a critical time in human development. Experiences during early childhood shape young children's evolving brains and biochemistry, laying a foundation for achievements during their school years and influencing longer-term socioemotional and health outcomes (Shonkoff and Phillips 2000). Family economic conditions during early childhood have more effect on children's skills and achievements than family income during adolescence (Duncan and Brooks-Gunn 1997; Duncan, Ziol-Guest, and Kalil 2010). Moreover, family income during early childhood affects not only school readiness and school achievement, but also adult outcomes related to health and earnings (and other measures of labor market success) (Duncan, Ziol-Guest, and Kalil 2010). As economist James Heckman and colleagues have argued, "skill begets skill," and so early interventions before kindergarten can have a higher rate of return than public investments later in life (Cunha et al. 2006).

Parents with young children tend to have lower incomes than other families. In an analysis of 2013–15 Current Population Survey data, Traub, Hiltonsmith, and Draut (2016) report that median household income for families with children under 5 was \$59,271 in 2014, compared with \$71,049 for families whose youngest child was between 5 and 17, and that this difference is driven by several factors. Parents of young children are often younger themselves (median age 33 years versus 43 years for parents of older children) and at an earlier stage in their careers. Parents often struggle to balance earning income and caring for children. This balancing act is particularly tough in the years before children enter kindergarten. Traub, Hiltonsmith and Draut find families with children under 5 have even lower incomes than would be expected, given their age, education, race, and partnership status, largely because caring for children reduces both work hours and experience. For households with two adults, they estimate that the presence of a child under 5 was associated with having \$14,850 less in annual income compared with childless households, even after controlling for age and other demographic characteristics. Single women with young children incur an even larger drop in annual income of \$16,610. With lower incomes, and higher costs associated with additional household members, many parents with young children fall into poverty; their poverty rate was 19.2 percent, compared with 12.4 percent for parents of older children and 12.7 percent for adults without children. As a nation, we are faced with the problem that family incomes tend to be low in the most critical years for child development.

A growing body of research demonstrates that higher family incomes during childhood could improve children’s educational outcomes. For example, a quasi-experimental study of child benefits in Canada found greater child achievement (e.g., higher vocabulary scores) among children whose families received larger income supplements (Milligan and Stabile 2011). A study examining changes in the level of the federal earned income tax credit (EITC) during the 1990s found increases in reading and math skills associated with larger tax credits, with the biggest achievement gains among children of more disadvantaged mothers (Dahl and Lochner 2012). An analysis of seven random assignment experiments of welfare-to-work programs found programs that increased parental income and employment improved children’s math and reading skills, but programs that only increased employment did not (Duncan, Morris, and Rodrigues 2011). Finally, other analyses suggest strong associations between increases in the EITC (measured by increases in the federal credit over time or by variation in state supplemental credits) and improvements in health outcomes, including birth outcomes and infant and adult health and mortality rates (Hoynes, Miller, and Simon 2015; Muennig et al. 2016).

Income supplements can improve children’s outcomes in at least three ways. From an economic perspective, additional income allows parents to acquire more resources needed for healthy development, such as nutritious meals, enriched home environments, and high-quality child care, and allows them to live in neighborhoods free of crime and air and noise pollution (Becker 1981; Evans 2004). A psychological perspective would emphasize the role of stress and the negative effects of income loss and poverty on parental depression and anxiety and how they can result in harsh and less supportive parenting (Chase-Lansdale and Pittman 2002; McLoyd 1990). More recently, neuroscientific and epidemiological research has revealed how environment-gene interactions early in life can affect the development of the central nervous system and other biological systems; this research emphasizes the negative effects of poverty-related stress, particularly during sensitive years, on human development (Evans, Brooks-Gunn, and Klebanov 2011; Shonkoff 2010).

Neither neuroscientific nor economic research reach clear scientific consensus as to the exact boundaries of the “sensitive” period of early childhood. We have chosen to focus on children under age 5 because the cost of caring for children, whether through reduced parental employment or purchase of child care services, declines when children enter school. By age 5, most children (87 percent) are enrolled in kindergarten or prekindergarten, and most of these programs are public (85 percent) and full day (78 percent).¹ Many 4-year-old children (67 percent) are also enrolled in preschool, but these programs are often private and half day. We therefore propose to boost the development of young children and reduce the financial strain on their parents through a young child tax credit for children under 5.

How the Child Tax Credit Works

The federal income tax system currently offsets taxes owed with a credit of up to \$1,000 for each child under 17. 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, which equals 15 percent of earnings above \$3,000. The credit is reduced by 5 percent of adjusted gross income over \$75,000 for single parents (or over

\$110,000 for married couples). Unlike many other tax provisions, the CTC is not indexed for inflation.² The credit was last increased in 2003 to a maximum of \$1,000, where it remains today.

About 70 percent of families with children claim the CTC each year. Although eligibility for the CTC is spread across all income groups, reciprocity rates vary by income. Three-quarters of families in the lowest and fourth income quintiles will benefit from the credit in 2017, compared with almost 90 percent of families in the second and third income quintiles. Families in the lowest income quintile that do not benefit are generally those with earnings under \$3,000 or whose children are ages 17 and older.³ Less than 5 percent of families with children in the highest income quintile benefit because the credit phases out. If the credit were counted in the official estimate of poverty, 2.8 million fewer people, including 1.6 million children, would have fallen below the federal poverty level in 2015 (Center on Budget and Policy Priorities 2016).

The average benefit for families that receive the CTC will be about \$1,500 in 2017. The amount is affected by both earnings and number of children. Recipient families in the second and third income quintiles will get the largest benefits—an average credit of \$1,700. For families that claim the credit, the average will be almost \$1,400 in the lowest income quintile and about \$1,300 in the fourth income quintile. The few families with children in the highest income quintile that benefit will get an average credit of \$500. In 2017, about 10.8 million working families will get less than the full credit for which they would otherwise qualify because their earnings will be too low.

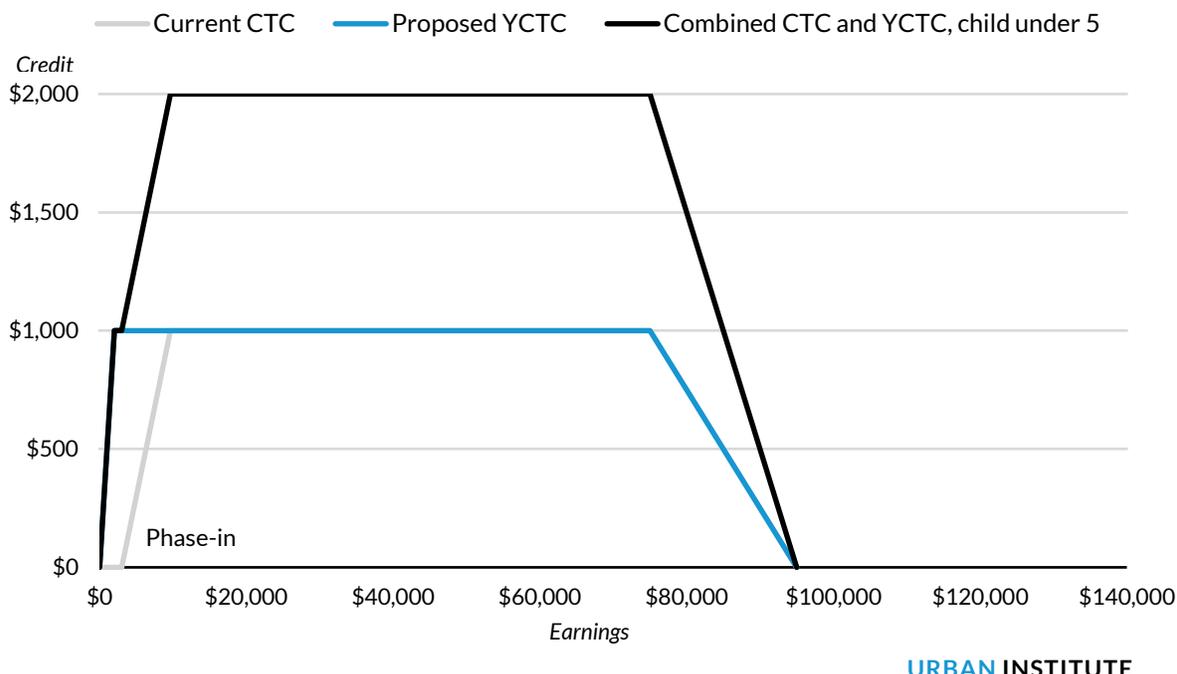
A New \$1,000 Young Child Tax Credit

We propose to maintain the existing child tax credit and provide an additional \$1,000 credit to families with children under age 5: the young child tax credit. (We chose a \$1,000 credit to match the CTC but examine the alternative of a \$1,500 credit below.) The credit would phase in at a rate of 50 percent—for every dollar of earnings, families would receive 50 cents until they reach their maximum credit. This would allow even very low-income families with children under 5 to qualify for and receive the full YCTC. This rate is high but not unprecedented; the EITC phases in at a rate of 45 percent for families with three or more children. To target benefits to those most in need while limiting costs, we phase the credit out at a rate of 15 percent on income in excess of \$75,000 (or \$110,000 if married), consistent with the existing CTC.

Because research shows the value of boosting income for low-income families with children, our main option would phase in with the first dollar of earnings. This is consistent with recent legislation proposed by Representative Rosa DeLauro (D-CT), Senator Michael Bennet (D-CO), Senator Tammy Baldwin (D-WI), and Senator Cory Booker (D-NJ).⁴ A family with one child under 5 would thus receive a \$500 credit if earning \$1,000 and the full \$1,000 credit if earning \$2,000 or more (figure 1). Parents with two children under age 5 would receive the full YCTC once they earn \$4,000. An alternative option that would apply the same \$3,000 earnings threshold as the existing CTC would benefit fewer low-income families (see table 1, option 2 on page 7).

FIGURE 1

Child Tax Credit and Proposed Young Child Tax Credit for Families with One Child, 2017



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Source: Urban-Brookings Tax Policy Center.

Notes: CTC = child tax credit; YCTC = young child tax credit. Assumes all income comes from earnings and that the child meets all tests to be a child tax credit qualifying child. CTC values based on current law, 2017. Proposed YCTC provides a maximum credit of \$1,000 per child under age 5. Proposed YCTC adopts same phaseout rules as CTC. Children under 17 qualify for the CTC; children under 5 qualify for the YCTC and the CTC.

Costs and Distribution of Proposal Benefits

Our basic proposal would provide credits totaling about \$18.4 billion to 14.5 million families with children in 2017. Because the credit phases in very quickly, almost all working families with children under age 5 would receive the full \$1,000 YCTC per child. Families getting less than the full credit would likely be those with very low incomes and more than one child under age 5.⁵

The proposed YCTC would cost \$175 billion over the 2017–26 budget window (table 1, option 1), roughly one-third the cost of the CTC. For about the same amount of money, the CTC could be increased from \$1,000 to \$1,330 for all currently eligible children (not shown). However, that change would not target benefits to families with the youngest children or the lowest incomes, for whom additional resources would be most likely to yield measurable improvements in children’s outcomes.

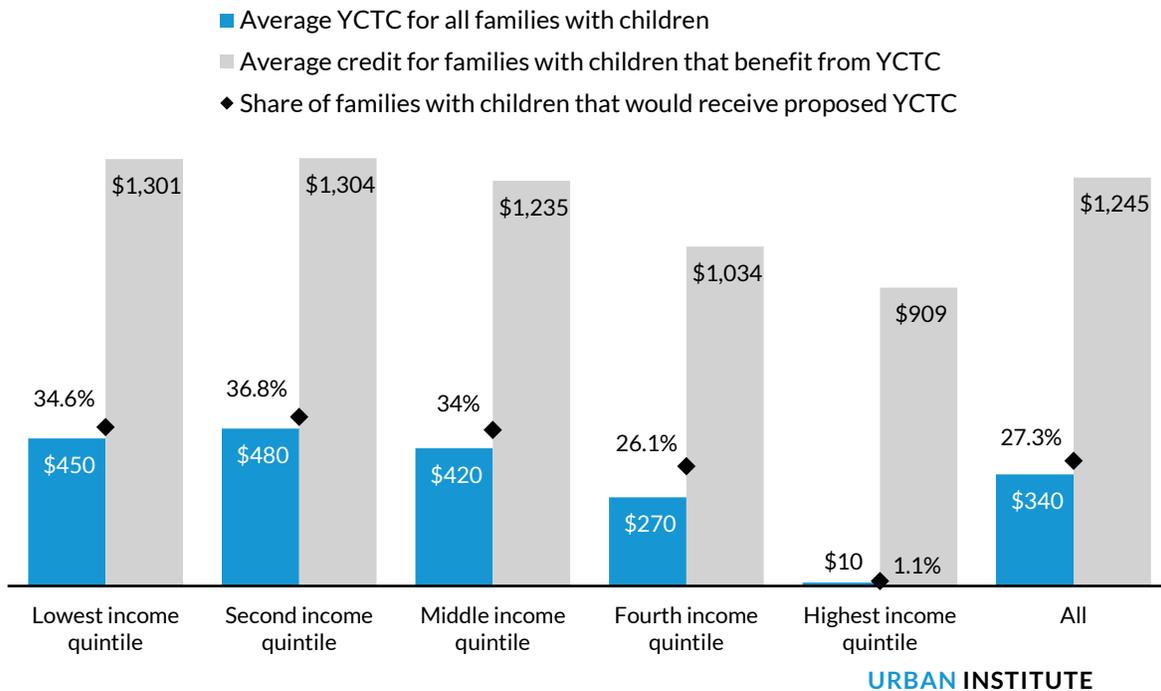
The proposed YCTC would benefit roughly one-third of families in the lowest 60 percent of the income distribution and just over one-quarter of families in the fourth income quintile. Because the new YCTC would phase out like the existing CTC, few families in the top quintile would benefit.

Among families with children who would benefit from the proposal, those in the lowest two income quintiles could expect to see an average YCTC of just over \$1,300 (in addition to any CTC they already receive). Benefits would drop slightly for higher-income families because they tend to have fewer young children (figure 2).

FIGURE 2

Young Child Tax Credit for Families, 2017

By income quintile



Source: Urban-Brookings Tax Policy Center Microsimulation Model, version 0217-1.

Alternative Proposals

We explore three alternatives to the basic YCTC presented above, showing the effect of changing various parameters of the credit. The 10-year revenue estimates of the primary proposal (option 1) and the alternatives (options 2–4) are found in table 1.

- Option 2: Impose an earnings threshold for the refundable YCTC.** Phasing in the refundable YCTC starting at \$3,000 of earnings would reduce costs, but more very low-income families would not get the full credit—and 100,000 fewer families would receive any YCTC at all. However, because this option would match the CTC in this respect, this limitation might be more politically feasible than the primary proposal. For families in the lowest income quintile that still receive the credit, average benefits would drop by a small amount, but benefits for all other families would not be affected. This option would reduce the proposal’s cost by \$300 million in 2017 and by \$2.5 billion over the 10-year budget window.

- **Option 3: Increase the maximum credit.** Increasing the maximum credit for the YCTC to \$1,500 would boost benefits for most recipient families. Providing the larger credit would increase the cost by roughly 50 percent, or about \$28 billion in 2017 and \$270 billion over 10 years.
- **Option 4: Lower the age limit for eligible children.** Restricting the YCTC to families with children under 3 (rather than under 5) would cut the cost but sharply reduce the number of recipient families. The cost of this alternative would be about three-fifths the cost of our main plan, or about \$11 billion in 2017 and \$107 billion over 10 years. The lower cost is the primary rationale for this option.

TABLE 1

Estimated Costs of Young Child Tax Credit Options, 2017–26

Billions of dollars

	Calendar Year										
	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2017–26
Option 1: \$1,000 YCTC for children under 5; phases in at 50 percent rate for all earnings	18.4	18.3	18.2	17.9	17.7	17.5	17.3	17.0	16.6	16.4	175.3
Option 2: \$1,000 YCTC for children under 5; phases in at 50 percent rate for earnings over \$3,000	18.1	18.0	17.9	17.7	17.5	17.3	17.1	16.7	16.4	16.1	172.8
Option 3: \$1,500 YCTC for children under 5; phases in at 50 percent rate for all earnings	28.0	27.9	27.6	27.3	27.1	26.8	26.5	26.0	25.6	25.2	268.0
Option 4: \$1,000 YCTC for children under 3; phases in at 50 percent rate for all earnings	11.2	11.1	11.1	10.9	10.8	10.7	10.5	10.3	10.1	9.9	106.5

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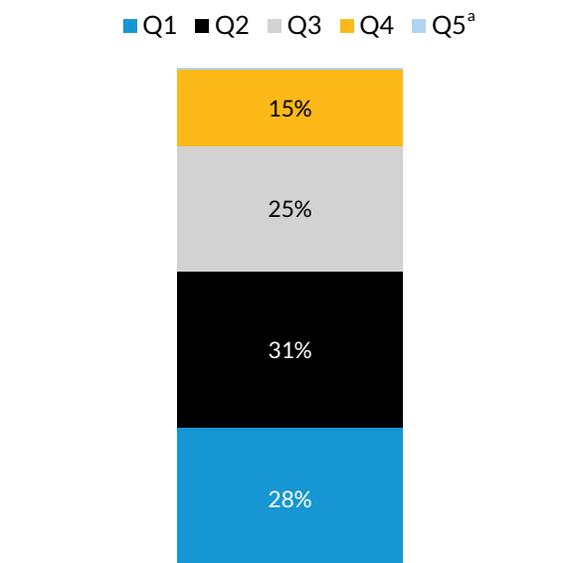
Source: Urban-Brookings Tax Policy Center Microsimulation Model, version 217-1.

Notes: Effective January 1, 2017. All options phase out at a rate of 5 percent for earnings over \$75,000 (single parent) or \$110,000 (married). The existing child tax credit would not be affected by the proposed young child tax credit, which is intended as a stand-alone addition and not a replacement.

The base proposal, along with options 3 and 4, would be slightly more progressive than the current CTC because families could begin receiving benefits with their first dollar of earnings, rather than having to earn more than \$3,000 to receive any CTC. Because option 2 would impose the same \$3,000 refundability threshold as the CTC, it would be slightly less progressive than the base proposal. All four YCTC options we discuss would increase credits for young children. And in all cases, the lion’s share of benefits would go to families in the lowest 60 percent of the income distribution (figure 3).

FIGURE 3

Share of Young Child Tax Credit Benefits Delivered to Each Quintile, 2017



Option 1: \$1,000 YCTC for children under 5; phases in at 50 percent rate for all earnings

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Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0217-1).

Notes: Q = quintile; YCTC = young child tax credit. Quintile 1 is the lowest income quintile, quintile 5 the highest.

^a Families in quintile 5 would receive less than 1 percent of all YCTC benefits.

Discussion

A new young child tax credit would target additional public resources where they seem to make the most difference: early childhood. It would boost income for almost all families with earners and young children, including families with one earner and one stay-at-home parent, families with two earners (or a single-parent earner), and families in which one or more parents works part time to help take care of the children. If the family has earnings of at least \$2,000 (and only one young child), the family would get the full value of the tax credit. Direct income supplements provide families with the flexibility to nurture their children as they think best.

The design of the primary option, with no earnings threshold and a 50 percent phase-in, ensures families with the lowest earnings have access to the credit. In contrast, the CTC excludes about 10.8 million children with working parents whose earnings are too low, as well as other children who have no working parents. With the YCTC, some very poor working families would also be excluded as well if an earnings threshold were made part of the credit. However, for slightly lower costs, option 2 mirrors the earnings test in the CTC. Some policymakers may view having an income threshold before refundability as an important part of the CTC. Option 2 would prevent 100,000 of the lowest-income families from receiving benefits, relative to the base proposal.

The \$1,000 credit is somewhat arbitrary, so we have presented an alternative that would increase the proposed YCTC by \$500 for a total of \$1,500. Because most families that would qualify for the new YCTC would qualify for the full credit, the cost of increasing or decreasing the credit is roughly scalable. That is, increasing the per child credit from \$1,000 to \$1,500 (a 50 percent increase) would increase the cost of the proposal by roughly 50 percent. (And as a rough proxy, one could assume that a \$2,000 credit would be roughly twice the cost of a \$1,000 credit.) The 50 percent increase in the credit we model would increase the total cost of the YCTC from about \$18 billion in 2017 to \$28 billion.

Credit costs could be limited by reducing the age of the eligible population. Some past legislation has suggested targeting only children under 3 (H.R. 4693 during the 2015–16 Congress), limiting extra assistance to the very earliest years, when family incomes are likely lowest and child care costs highest. This would, indeed, reduce costs by about one-third, but many children not yet eligible for public schools would be left out of the benefit.

Our proposal builds on the success of the CTC, which annually lifts about 3 million people out of poverty, half of them children. The credit has been in place in some form or another since 1997, though the maximum credit has not changed since 2003. Roughly the same amount of money could be spent to increase the CTC from \$1,000 to \$1,330 for all currently eligible children. Yet focusing on young children targets resources to families with relatively high expenses and often lower-income parents.

The YCTC does not depend on having all parents in the home working, nor does it depend on having child care costs. As a result, families with one worker and one stay-at-home parent would be eligible for the credit, as would families with two earners or a single-parent earner, even if their jobs are intermittent or part time. Like other tax credits that provide low-income parents with cash, the YCTC we propose empowers parents to make their own choices for their children.

Early childhood represents a critical period of development. Past research suggests that income boosts during this time correlate with positive lifetime effects. This proposal represents one way to lift incomes for families with very young children, building on current and past legislative efforts.

Notes

1. “Enrollment of 3-, 4-, and 5-Year-Old Children in Preprimary Programs, by Age of Child, Level of Program, Control of Program, and Attendance Status: Selected Years, 1970 through 2015,” National Center for Education Statistics, accessed July 27, 2017, https://nces.ed.gov/programs/digest/d16/tables/dt16_202.10.asp?current=yes.
2. For simplicity, we refer to both the additional child tax credit and the child tax credit as the CTC.
3. Families with children are defined as those families with a child receiving the EITC, the CTC, or a dependent exemption. EITC benefits and the dependent exemption are available for families with children under 19 or dependents ages 19 to 24 who were full-time students at least five months of the year.
4. These include H.R. 821, the Child Tax Credit Improvement Act; S. 1371, the Working Families Tax Relief Act of 2017; and S. 3231, the Stronger Way Act. Though not introduced as legislation, 2016 presidential candidate Hillary Clinton proposed doubling the CTC for families with children under 5, phasing the credit in faster for these families, and removing the minimum earnings requirement for all families (Auxier et al. 2016).

5. A family with more than one child under 5 would qualify for a \$1,000 YCTC for each child. A family with two children under 5 would need to earn at least \$4,000.

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