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IMPACT OF THE TAX CUTS AND JOBS ACT ON FAMILIES WITH YOUNG CHILDREN

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ABSTRACT

The Tax Cuts and Jobs Act (TCJA) would reduce tax revenue by nearly $1.5 trillion over the 10-year budget window from FY2018 to FY2027. Analysis by the Tax Policy Center shows that the tax cuts would tilt heavily toward the highest fifth of the income distribution, largely the result of cuts to the corporate income tax, other reductions in taxation of business income, and reductions in the estate tax. Very few tax-lowering changes in the bill are targeted at families with children—and none at families with very young children. This approach seems to ignore research emphasizing that early childhood lays the foundation for lifelong skills, behaviors, and health. In the early years of the TCJA, on average, families with children receive only modest benefits from the tax bills. By 2027, families with children in the lowest two-fifths of the income distribution would owe more tax under the House version of the TCJA than under current law, and families in the middle income quintile would receive only a very small average tax cut. By 2027, all but the highest income families would owe more tax under the TCJA than under current law. Similar results characterize the Senate version of the TCJA.

The House and Senate have each passed their own versions of the Tax Cuts and Jobs Act (TCJA).[1] As estimated by the Joint Committee on Taxation, the bills would result in net revenue losses of about $1.5 trillion over the 10-year budget window from 2018 to 2027 (Joint Committee on Taxation 2017a, 2017b). The bills alter both the federal individual and corporate income tax; the Senate version also includes changes to the Affordable Care Act.[2] Previous analyses from the Tax Policy Center show that both bills would reduce taxes on average for all income groups in the years right after the legislation (TPC Staff 2017a, 2017b). The largest cuts, in dollars and as a percentage of after-tax income, would accrue to higher-income households. While the House bill would reduce taxes, on average, for all income groups in both 2018 and 2027, the Senate bill would increase taxes modestly in 2027 for the lowest income group, result in small changes for middle-income groups, and decrease taxes for high-income taxpayers. By 2027, the Tax Policy Center estimates that 24 percent of taxpayers would pay higher taxes under the House bill and 50 percent would pay higher taxes under the Senate bill. This brief analyzes the TCJA's effects on families with children—particularly families with very young children, who may struggle more than families with older children and for whom investments may be particularly important.

The House version of the bill affects families with children in three major ways:

- In 2018, when tax cuts are largest, families with children in the lowest income quintile would see only very small average annual tax cuts ($30). Families with children younger than age 3 in this income group would see even smaller average annual tax cuts ($10).
- In the bottom two income quintiles, expiring provisions in the House bill would result in average tax increases by 2027. Families with children in the second income quintile would see their taxes rise—on average—by $400 per year; families with children under 3 would see a larger tax increase ($450).
- All families with children and families with children under 3 in the middle and fourth income quintiles would see much smaller tax cuts in 2027 than in 2018.

The Senate version of the bill affects families with children in three major ways:

- In 2019, families with children in the lowest income quintile would see their annual taxes fall, on average, by $110. Families with children younger than age 3 in this income group would see smaller tax cuts ($70).
- Almost all changes to the personal income tax expire after 2025 in the Senate bill. As a result, in 2027, families with children would see their annual taxes rise, on average, by $120 (lowest income quintile), $200 (second income quintile), $80 (middle income quintile), and $70 (fourth income quintile).
- Families with children under 3 would see even larger average tax increases in 2027 in most income quintiles. These families would see an average tax increase of $140 (lowest income quintile), $300 (second income quintile), $80 (middle income quintile), and $100 (fourth income quintile).

SUBSIDIZING FAMILIES WITH VERY YOUNG CHILDREN

A growing body of research demonstrates that changes in family income during childhood have observable effects on children's educational achievement, as well as on longer-term health and behavioral outcomes. In 2016, 2.3 million, or 19.6 percent, of the nation's infants and toddlers lived in poverty. By comparison, poverty rates were 17.8 percent for children ages 3 to 17, 11.6 percent for adults ages 18 to 64, and 9.3 percent for adults ages 65 and older.[3]

Poor children enter school less ready to learn than other children, and there is good evidence that family income affects children's development even after controlling for parental characteristics (Brooks-Gunn and Duncan 1997; Duncan, Morris, and Rodrigues 2011). Low income makes it harder for parents to secure the resources needed for healthy development, such as nutritious meals, high-quality child care, and living in neighborhoods free of crime and air and noise pollution (Becker 1981; Evans 2004). Economic hardship also affects parental stress and emotional well-being, possibly leading to harsh and less supportive parenting (Chase-Lansdale and Pittman 2002; McLoyd 1990). Finally, poverty-related stress, particularly during the earliest years, can affect environment-gene interactions that, in turn, affect the development of the central nervous system and related functioning of the young child (Evans, Brooks-Gunn, and Klebanov 2011; Shonkoff 2010).

There is strong quasi-experimental evidence that increases in family income lead to gains in children's achievement. Whether looking at child benefits in Canada, the earned income tax credit in the United States, or results from welfare-to-work experiments, a growing body of work has found increases in cognitive skills for low-income children whose families have income supplements (Dahl and Lochner 2012; Duncan, Morris, and Rodrigues 2011; Milligan and Stabile 2011). Rigorous analyses of longitudinal data suggest that family income during early childhood affects not only school readiness and school achievement, but also adult outcomes related to health and earnings (Duncan, Ziol-Guest, and Kalil 2010).

THE CHILD TAX CREDIT COMBATS POVERTY

The child tax credit (CTC) provides an important income supplement to many low-income working parents. 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.[4] The CTC could be further expanded to help very low–income families or families with young children, as recently proposed by Senators Bennet and Brown in the American Family Act of 2017 and discussed in Maag and Isaacs (2017) and the Bipartisan Policy Center (2017), among others.

How the CTC Works

The CTC provides a credit of up to $1,000 for each child younger than age 17. The credit is reduced by 5 percent of adjusted gross income over $75,000 for single parents (or over $110,000 for married couples who file joint tax returns). If the credit exceeds taxes owed, taxpayers can receive some or all the balance as a refund, known as the additional child tax credit (ACTC). The ACTC is limited to 15 percent of earnings above $3,000. CTC rules about refundability and phasing out of the credit mean that many families cannot get the full $1,000 credit per child. Those with earnings under $3,000 cannot get any ACTC, while others have too little earnings to get the full credit. TPC estimates that in 2018, 10.3 million children live in families with at least one worker but get less than the full CTC. At the other end of the income distribution, the credit's phaseout keeps higher-income families from getting the full CTC. TPC estimates that 17.9 million children live in families with incomes too high for the full credit in 2018 (Tax Policy Center 2017).

Both versions of the bill would increase the nonrefundable portion of the CTC from $1,000 to $1,600 (House) or $2,000 (Senate) (table 1). This credit can be used to offset taxes owed. For families who do not owe federal income taxes (who often have income less than the sum of the standard deduction and personal exemptions), only changes to the refundable portion of the credit, the ACTC, can provide additional assistance to these families. The increase in the refundable portion of the credit under the House and Senate versions of the TCJA is initially much smaller than the overall increase, and would take place over many years. The refundable portion of the credit would equal the nonrefundable portion of the credit around 2038 in the House version. The small increase to the refundable portion of the CTC in the Senate version of the bill would expire after 2025, not reaching the full value of the nonrefundable portion of the credit. The Senate version of the bill would increase the CTC for many very low–income families by about $75 by reducing the income threshold used to calculate the credit.

Changes to the standard deduction and personal exemption effect how much income a family can have before owing federal income taxes. The TCJA would increase the standard deduction, but eliminate personal exemptions. Below we explain the net effect of these changes.

NET EFFECT OF THE TCJA FOR FAMILIES WITH CHILDREN

House Version

ALL FAMILIES WITH CHILDREN

All families with children would see an average tax cut (relative to current law) of between $30 (lowest income quintile) and $4,950 (highest income quintile) in 2018 under the House version of the bill (figure 1). However, those tax cuts would be relatively short-lived for the lowest two-fifths of the income distribution. By 2027, at the end of the 10-year budget window, families with children in the bottom two income quintiles would see taxes increase compared to current law, on average, by $40 (lowest fifth) and $400 (second-lowest fifth). Families with children in the middle quintile of the income distribution would see, on average, $100 tax cuts in 2027. Families with children in the top two income quintiles would see their taxes fall relative to current law—but not by as much as in the early years of the legislation. In 2027, the House version of the bill would provide tax cuts to families with children in the highest fifth of the income distribution, on average, of $2,470. This is about half the tax cut they would get, on average, in 2018.

TABLE 1

Comparing Current Law and Tax Cuts and Jobs Act

		Tax Cuts and Jobs Act	
	Current Law	**House**	**Senate**
Standard deduction	\$6,500 (single), \$13,000 (joint), \$9,550 (head of household); Indexed for inflation	\$12,200 (single), \$24,400 (joint), \$18,300 (head of household); Indexed for inflation but not indexed for 2019	\$12,000 (single), \$24,000 (joint), \$18,000 (head of household); Indexed for inflation; Sunsets after 2025[a]
Personal and dependent exemptions	\$4,150; Indexed for inflation	Repealed	Repealed; Sunsets after 2025[a]
Child tax credit	Credit equal to \$1,000 per qualifying child under 17; Phases out beginning at \$75,000 (single), \$110,000 (joint); Refundable portion equals 15% of earnings in excess of \$3,000	Credit equal to \$1,600 per qualifying child under 17; \$300 for taxpayer, spouse, and other dependents (\$300 credit expires after 2022); Phases out beginning at \$115,000 (single), \$230,000 (joint); Refundable portion equals 15% of earnings in excess of \$3,000 up to \$1,100 per qualifying child; Maximum refundable portion indexed for inflation; Requires Social Security number to claim credit	Credit equal to \$2,000 per qualifying child under 18, \$500 for other dependents; Phases out beginning at \$500,000 for joint filers; Refundable portion equals 15% of earnings in excess of \$2,500 up to \$1,100 per qualifying child; Maximum refundable portion indexed for inflation; Requires Social Security number to claim refundable credit; Sunsets after 2025[a]

Source: Joint Committee on Taxation, Description of H.R. 1, the "Tax Cuts and Jobs Act" (JCX-50-17), November 3, 2017 and Joint Committee on Taxation, Description of the Chairman's Modification to the Chairman's Mark of the "Tax Cuts and Jobs Act" (JCX-56-17), November 14, 2017.
(a) Provisions revert to current law in 2026. Inflation indexed tax parameters are computed using the chain-weighted consumer price index.

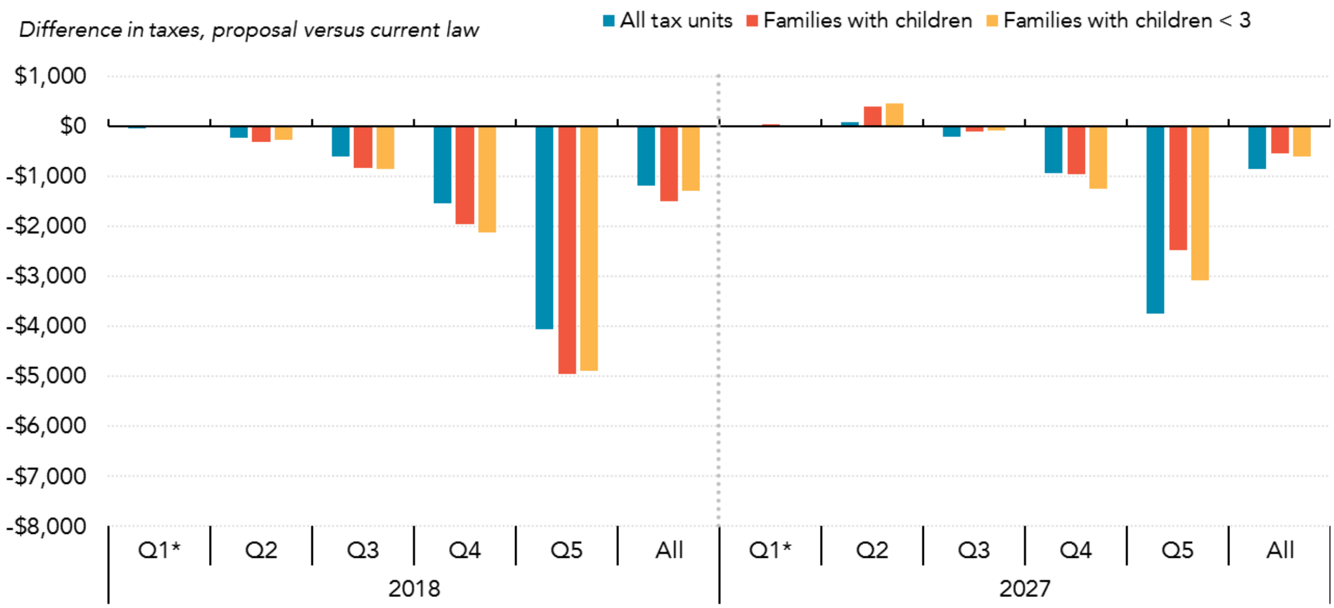
FAMILIES WITH CHILDREN UNDER 3

In almost all income groups, families with children under 3 would receive—on average—smaller tax cuts than all families with children. Similar to the situation for all families with children, families with children under 3 in the lowest two-fifths of the income distribution would see their taxes rise—on average—in 2027. Families in the second fifth of the income distribution would experience an average tax increase five times larger than the average increase in this quintile for all taxpayers ($450 rather than $90). The middle fifth of the income distribution would see very small average tax cuts ($80) in 2027. Higher-income families would see sizable cuts in both 2018 and 2027.

FIGURE 1

Average Tax Change of the House-Passed TCJA

by income quintile, 2018 and 2027



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0217-1). Tables T17-0259 and T17-0252. Quintiles adjusted for family size.
Note: Income quintiles *Q1 = lowest income quintile (1/5 of the income distribution)

Senate Version

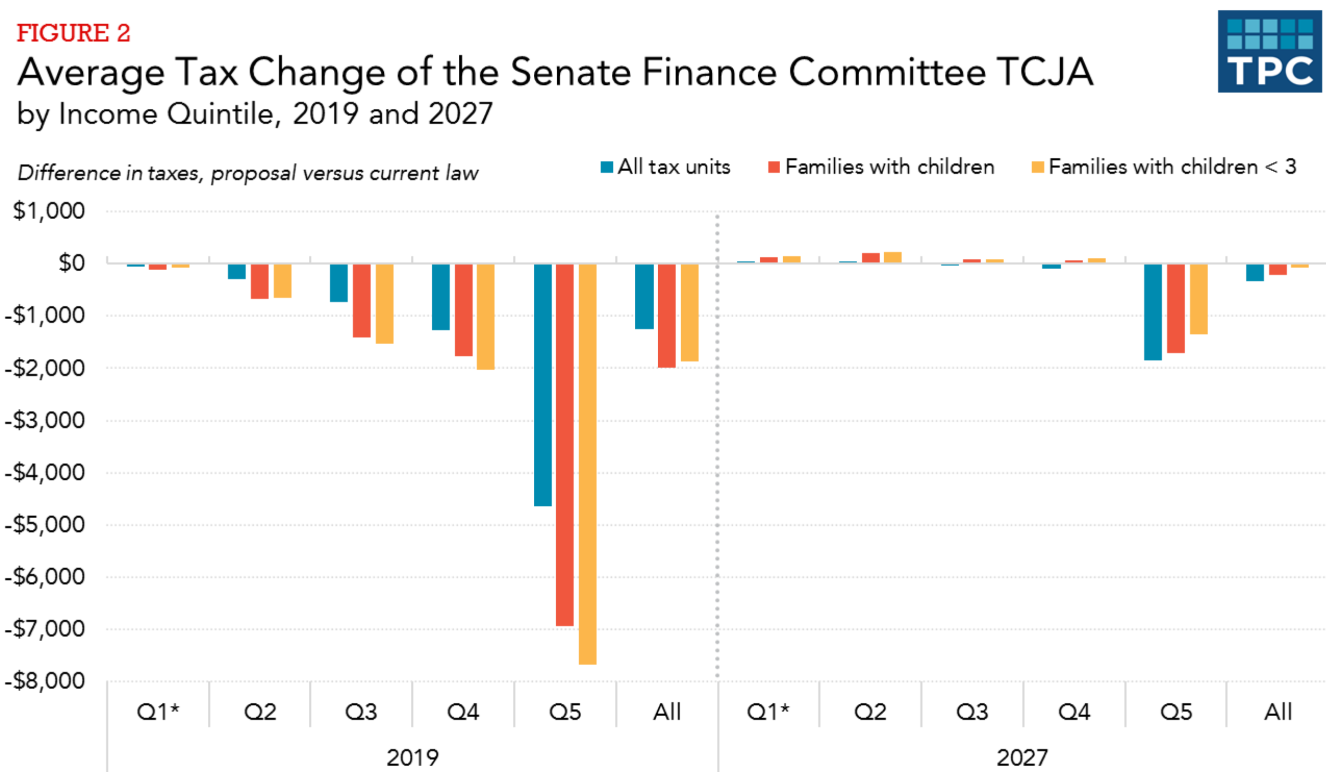
ALL FAMILIES WITH CHILDREN

As under the House version of the bill, on average, families at all income levels would see a tax cut under the Senate's TCJA in 2019. Families in the lowest income quintile would see average tax cuts of $110, about twice as much as all taxpayers ($50) (figure 2). By 2027, those tax cuts disappear (as do almost all changes to the individual income tax), and families with children in the lowest two income quintiles, on average, would pay more tax under the proposal than they would under current law. The average increase for families with children in the second fifth of the income distribution would be $200—five times the average tax hike faced by all taxpayers in this group ($40).

By 2027, only families with children in the highest fifth of the income distribution would see a tax cut. All other groups would see an average increase in their taxes, though in some cases these increases would be modest.

FIGURE 2

Average Tax Change of the Senate Finance Committee TCJA
by Income Quintile, 2019 and 2027



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0217-1). Tables T17-0259 and T17-0252. Quintiles adjusted for family size.
Note: Income quintiles *Q1 = lowest income quintile (1/5 of the income distribution)

FAMILIES WITH CHILDREN UNDER 3

Families with children under 3 that are in the lowest two-fifths of the income distribution would see average tax cuts that are slightly smaller than all families with children in 2019. Likewise, by 2027, the average tax increases faced by families with young children in each of the four lowest income groups would be larger than those for all families with children. As with the House version of the legislation, only families with young children in the highest fifth of the income distribution would see a tax cut in 2027—and it would be smaller than the cuts received by both all taxpayers and all taxpayers with children.

DISCUSSION

Both the House and Senate versions of the TCJA deliver net tax cuts of nearly $1.5 trillion over the 2018–27 budget window. Despite this relatively large loss of revenue, most families with children would not see substantial tax cuts, and the tax cuts present in the early years of the legislation would either disappear entirely or turn into average tax increases, relative to current law, for low-income families with children.

Modest tax cuts in the early years of both versions of the legislation result from increases to the CTC, which in the House version of the bill would increase to $1,600 per child under age 17 and in the Senate would double to $2,000 per child and extend to 17-year-olds. In both versions of the legislation, the maximum value of the refundable portion of the credit increases from $1,000 per child to just $1,100 in 2018, slowly increasing with inflation until the entire credit would be potentially refundable. In the House version of the bill, the entire credit would become refundable around 2038. In the Senate version of the bill, the refundable portion of the credit would never equal the nonrefundable portion because the entire increase expires after 2025. At that point, any tax cuts for families with children caused by the increased CTC would be lost.

Both versions of the legislation would also slow the adjustment of tax parameters for overall price increases by using a less generous measure of inflation. As a result, the earned income tax credit (an important driver of tax refunds for low- and middle-income families) would be smaller in 2027 under both proposals than under current law. That largely drives the increase in taxes from the Senate version of the bill experienced by those in the bottom two income quintiles. Families higher up the income distribution would see their taxes rise under the Senate legislation as more income would be taxed at higher rates than under current law, once most of the TCJA personal income provisions expire.

Both tax bills would lose substantial amounts of revenue relative to current law—and the tax cuts would flow mostly to high-income taxpayers, the largest beneficiaries of the cuts to the corporate income tax, reductions in taxation of business income, and reductions of the estate tax. Moreover, the corporate tax cut would be permanent, although the provisions reducing taxes for low- and middle-income families would be either scaled back (in the House version) or eliminated entirely (in the Senate version).

Despite solid evidence that investments in children, particularly during the early years, can reap a lifetime of rewards, the TCJA delivers no significant benefits to families with children, including families with children younger than 3, in the lowest two-fifths of the income distribution. Under both versions of the legislation, tax cuts for these vulnerable families would be modest and then diminish or disappear entirely by the end of the budget window.

NOTES

[1] This analysis is based on the version of H.R. 1, the Tax Cuts and Jobs Act, which was ordered reported by the House Committee on Ways & Means on November 9, 2017, and the version as ordered reported by the Senate Finance Committee on November 16, 2017. Descriptions of the House bill as introduced and the Senate bill as introduced and modified are available at JCX-50-17, JCX-51-17, and JCX-56R-17 on the Joint Committee on Taxation's website.

[2] The effects of eliminating the Affordable Care Act (ACA) mandate to buy health insurance and the effect of changes to the premium tax credits are not included in this analysis.

[3] TPC analysis of "POV-34. Single Year of Age—Poverty Status," Current Population Survey Detailed Tables for Poverty, Census Bureau, last revised September 7, 2017, https://www.census.gov/data/tables/time-series/demo/income-poverty/cps-pov/pov-34.html.

[4] "Policy Basics: The Child Tax Credit," Center on Budget and Policy Priorities, updated October 25, 2017, https://www.cbpp.org/research/federal-tax/policy-basics-the-child-tax-credit.

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