COMPARING EITC AND CHILD TAX CREDIT PROPOSALS

Exploring Design Changes to Retarget Tax Credits

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The earned income tax credit (EITC) and child tax credit (CTC) provide substantial benefits to working families with children. The EITC also provides modest benefits to workers without custodial children, often called "childless workers" for tax purposes. Together, the credits lift almost 9 million people out of poverty each year. In this brief, we summarize the fiscal cost and the distribution of benefits of four major Congressional proposals to expand these or similar benefits and how the share of benefits is distributed across income groups. We show how fiscal costs could be reduced and benefits better targeted to intended groups by altering key parameters in the proposals.

INTRODUCTION

Since the inception of the EITC in 1975 and the CTC in 1997, benefits from one or both credits have been expanded under almost every president. Unlike most tax benefits, both tax credits are refundable, meaning that even people who do not owe federal income taxes may be able to benefit. Before the Tax Cuts and Jobs Act of 2017 (TCJA), both Republicans (such as Paul Ryan, then Speaker of the House) and Democrats (such as President Obama) had proposed expanding the "childless" EITC (Executive Office of the President and US Treasury Department 2014).[1] The TCJA left the EITC largely unchanged, but it substantially increased the CTC to $2,000 for a child under age 17 and created a $500 nonrefundable credit for other dependents. Offsetting this change in part was a reduction of the dependent exemption from $4,050 to $0.

Various forces will almost certainly force reconsideration of these provisions. The CTC expansion and many other individual income tax changes in the TCJA are scheduled to expire at the end of 2025. For the most part, the CTC is not

[1] See also Dylan Matthews, "Paul Ryan's Poverty Plan," *Vox*, July 24, 2014, https://www.vox.com/2014/7/24/18080430/paul-ryan-poverty.

indexed for inflation, so the real value of this benefit will decline over time. The EITC, in turn, has received only limited legislated increases since 1993 and, because it is indexed for inflation, it generally has had limited or no real growth from year to year. The TCJA further slowed future growth by indexing EITC parameters to a measure of inflation that grows more slowly than the prior measure. At the same time, the COVID-19 pandemic and subsequent recession will call renewed attention to programs aimed at low- to moderate-income households, since early evidence suggests that they suffered the most from both illness and unemployment.

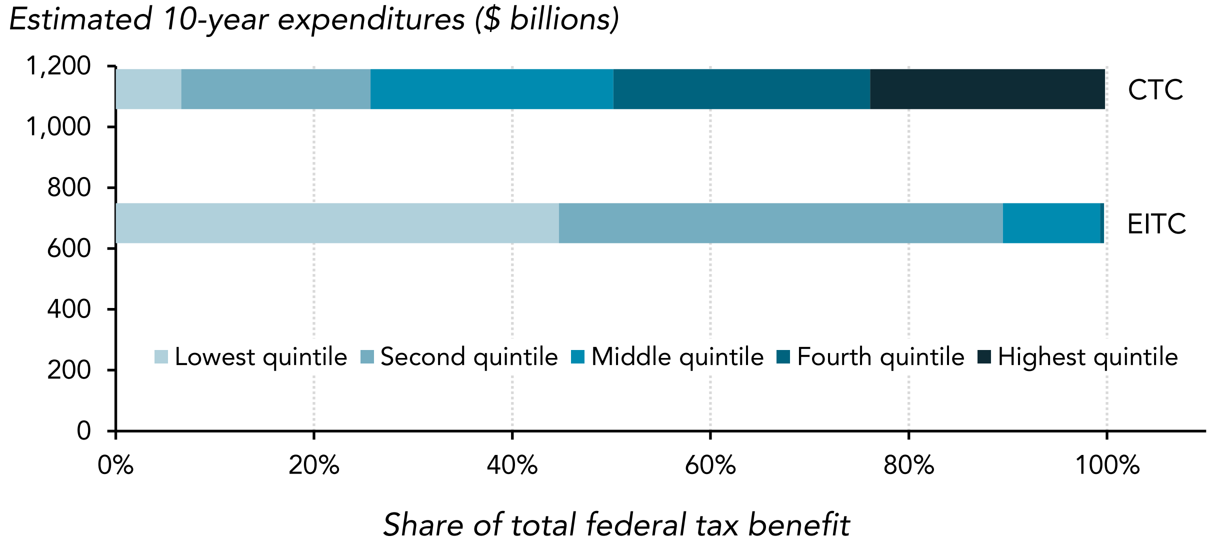
The EITC benefits low- and moderate-income working families by providing them with a tax credit equal to a fixed percentage of earnings, starting with their first dollar of earnings until the credit reaches its maximum. The credit rate varies based on the number of children in the family. For a single worker with one child, for example, the credit increases by 34 cents for each additional dollar of earnings until it reaches a maximum of around $3,500, which represents earnings of a bit more than $10,000. Benefits otherwise vary by number of children, marital status, and certain other features. For a worker with one child, any income above roughly $19,000 reduces their credit by about 16 cents for each dollar of additional income. Workers with one child receive no credit once their income reaches roughly $41,100. Married couples can earn about $6,000 more than single people before their benefits begin to phase out. Otherwise, the EITC does not vary based on marital status. Workers with two or three qualifying children have a higher credit rate and can receive a larger maximum credit. Workers with no children have a lower credit rate and much smaller maximum credit.

The CTC provides a tax credit of up to $2,000 for each child under age 17 who is a citizen. Typically, the child must reside with the taxpayer, though this rule has some exceptions. The CTC is partially refundable: if the credit exceeds taxes owed, taxpayers can receive up to $1,400 per child of the balance as a refund, known as the additional child tax credit (ACTC) or refundable CTC. Benefits of the ACTC are calculated as 15 percent of earnings above $2,500. For the most part, the CTC is not indexed for inflation, so the real value of this benefit will decline over time. The amount of the credit that can be received as a refund is indexed for inflation. The credit is reduced by 5 percent of adjusted gross income above $200,000 for single parents and $400,000 for married couples.

Over the 10-year budget window, the current-law EITC will deliver about $700 billion in benefits. Almost 90 percent of benefits from the EITC go to workers in the bottom 40 percent of the income distribution (figure 1). The current-law CTC will deliver about $1.1 trillion in benefits over the same 10-year budget window. Less than 10 percent of all benefits go to families in the bottom 20 percent of the income distribution, and almost half of all benefits from the CTC go to families in the top 40 percent of the income distribution (figure 1).

FIGURE 1

Distribution of Total EITC and CTC Benefits, 2019
By income quintile



Source: Tax Policy Center microsimulation model version 0319-1, Tables T19-0026 (EITC) and T19-0062 (CTC).
Note: Expenditures estimated over fiscal years 2019-2028. Each quintile represents families in a 20 percent segment of the income distribution. Income for quintiles is defined as expanded cash income.

PROPOSALS

We examine four Congressional proposals that would expand on these benefits for children and workers:

- the Working Families Tax Relief Act, or WFTRA, introduced by Senators Bennet (D-CO), Brown (D-OH), Durbin (D-IL), and Wyden (D-OR);
- the LIFT (Livable Incomes for Families Today) the Middle Class Act, or LIFT Act, introduced by Senator Harris (D-CA);
- the American Families Act, or AFA, introduced by Senators Bennet (D-CO) and Brown (D-OH) and Representatives DelBene (D-WA) and DeLauro (D-CT); and
- the Cost-of-Living Refund Act, or CLR, introduced by Senator Brown (D-OH) and Representatives Khanna (D-CA), and Watson Coleman (D-NJ).

These proposals essentially focus on four choices: increasing the child tax credit, which focuses on alleviating relatively poor economic outcomes for lower income children; increasing the EITC for households with children, which focuses on reducing income inequality for working families with children; creating a new worker credit for most workers, without regard to marital status or the presence of children, which focuses on broad support for workers generally; and increasing the EITC for childless workers, which focuses on reducing income inequality for a portion of the population largely excluded from current tax benefits.

We estimate the 10-year cost of these proposals and show the share of benefits delivered to each income quintile (Figure 2). We then describe how key parameters in the proposals could be changed to reduce fiscal costs while delivering similar benefits to households in the lowest income quintile and to families with children. These distributional and revenue results reveal some of the types of trade-offs every proposal must consider.

LIFT (Livable Incomes for Families Today) the Middle Class Act Focus: all workers, regardless of number of children. Senator Kamala Harris (D-CA) proposes the only credit uniquely focused on workers alone, regardless of the presence of children. It would raise the incomes of working families through a new tax proposal called the LIFT (Livable Incomes for Families Today) the Middle Class Act, which would add a new worker credit on top of the existing EITC. This new refundable tax credit would match up to $3,000 of earnings for single people and $6,000 for married couples who are at least 18 years old, while starting to phase out at $30,000 per single person and $60,000 for a couple. Unlike other credits designed to reward work (including the EITC), this new tax credit would deliver substantial benefits to workers without children at home. It starts phasing out at moderate income levels—significantly higher than the existing EITC and lower than the existing CTC.

Cost-of-Living Refund Act (CLR) Focus: expanding the current EITC. Senator Sherrod Brown (D-OH) and Representatives Ro Khanna (D-CA) and Bonnie Watson Coleman (D-NJ) have proposed an expansion of the EITC called the Cost-of-Living Refund Act (CLR). The bill would roughly double EITC benefits for families with children and increase benefits as much as six-fold for workers without children. Note that the bill would aid people with higher incomes more than does current law simply because increasing the maximum credit (while maintaining the phase-out rate) means the credit would phase out over a wider income range.

American Family Act (AFA) Focus: expanding the CTC. Senators Michael Bennet (D-CO) and Sherrod Brown (D-OH) and Representatives Rosa DeLauro (D-CT) and Suzan DelBene (D-WA) propose to expand the CTC for all children under age 17 and add a bonus for families with children under age 6. It would increase the maximum credit for children ages 6 to 16 from $2,000 per child to $3,000 per child and further increase the credit for children under age 6 to $3,600. It would also provide the full benefit to low-income families, regardless of earnings, by making the credit fully refundable. However, to save on cost, the credit for families with children under age 17 would start phasing out at a lower income threshold than under current law.

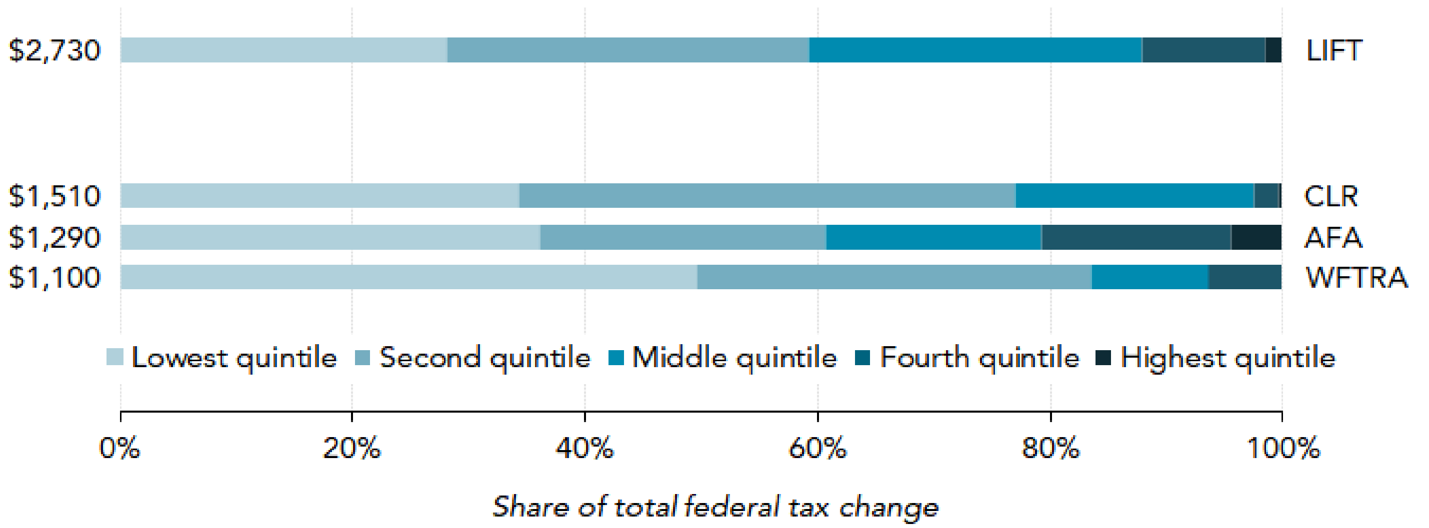
Working Families Tax Relief Act (WFTRA) Focus: expanding the EITC and CTC. The WFTRA attempts to address income inequality and relatively poor outcomes for low-income children by increasing both the EITC and CTC. Roughly speaking, the WFTRA would increase the maximum EITC for families with children by about 25 percent and quadruple the relatively small credit for workers without resident children, significantly broaden the income range over which childless workers could receive a credit, meaning they would be treated much like workers with one child, expand age limits for workers without children, increase the CTC by $1,000 for families with children under age 6 and make the CTC fully refundable.

FIGURE 2

Distribution of 2019 EITC/CTC Proposals

By share of net benefits distributed by income quintile

Estimated 10-year expenditures (billions)



Source: Urban-Brookings Tax Policy Center Microsimulation Model version 0319-2, Tables T20-0079, 0081, 0083, and 0085, 0087, 0088, 0090, and 0092.
Note: EITC = the earned income tax credit; CTC = the child tax credit; AFA = American Family Act; CLR = Cost of Living Refund Act; LIFT = Livable Incomes for Families Today Act; WFTRA = Working Families Tax Relief Act. Proposal cost estimated over fiscal years 2019–2028.

Share of Proposal Benefits, by Income Quintile

The cost of each proposal and the distribution of benefits by quintile of the income distribution is shown in Figure 2. The CLR delivers the largest share of benefits to the bottom two income quintiles (bottom 40 percent of the income distribution) and the smallest share of benefits to the highest income quintile (top 20 percent of the income distribution). The AFA delivers roughly equal shares of benefits across all but the top income quintile. Generally speaking, the more a proposal concentrates on the CTC as its base structure, the less progressive it will be, and the more it focuses on the EITC, the more progressive it will be, since the EITC phases out more quickly than the CTC.

Modifying and Comparing Proposals

We vary key elements of each proposal and find options that allow the modified plan to meet a goal at least as well as another plan, without costing more. We analyze multiple options in Maag, McClelland, and Steuerle (2020), but highlight four below (tables 1 through 4).

The CLR, WFTRA, and AFA all have similar costs (figure 2), but provide different levels of benefits to target groups. Among these three plans, if the goal is to reduce income inequality, the CLR ranks as best because it both provides the highest average benefit to people in the lowest income quintile and almost no benefit to people in the top income quintile (Maag, McClelland, and Steuerle 2020). But variations of other plans could provide more benefits to target groups at the same or slightly lower costs.

For instance, WFTRA could be altered so that the childless EITC phases in at 30 percent per dollar of adjusted gross income rather than the proposed 20 percent and the overall EITC phases out at a 10 percent faster rate. This combination effectively concentrates the total benefits more to lower-income families. It also allows the WFTRA, as amended, to provide about the same level of average benefits to families in the lowest income quintile at lower cost than CLR (table 1).

If the goal is oriented toward benefits to families with children, the CLR again performs well, relative to the WFTRA and AFA, providing the largest average benefit to families with children. But adding $600 to the CTC for children under 6 would result in the modified AFA costing about $30 billion less than the CLR, while increasing average benefits to families with children by close to $45 (table 2).

The LIFT Act, due to its relatively higher cost, provides relatively larger benefits to many groups of people. But variations of other plans can provide more benefits to target groups at the same or lower cost. For instance, the CLR can be made more generous to families in the lowest quintile by phasing in its EITC twice as quickly and applying a 50 percent higher phase-out rate. This variation costs about the same amount as the LIFT Act but provides an additional $100 in average annual benefits to families in the lowest income quintile (table 3).

Alternatively, the AFA could deliver more benefits than the LIFT Act to families with children at a slightly lower cost in forgone revenue (table 4) by increasing the CTC for children aged 6 and over to $5,000 and the CTC for children under 6 years of age to $6,000. Despite a lower revenue loss than LIFT, this alternative reduces taxes on average by more than $2,300 for families with children.

Of course, whenever a plan costs less than another but holds harmless one set of families, other families as a whole must receive lower benefits. In the same way, if plan A benefits a set of families more than plan B but at the same total plan cost, other families as a whole must receive lower benefits in plan A than plan B. Thus, in the Table 1 comparison, families in the first quintile receive more with an amended WFTRA plan, but those in the second and third income quintiles receive less, relative to the CLR proposal. In the Table 2 comparison, the modified AFA alternative concentrates benefits more on families in the fourth income quintile, while families in the second and top quintiles receive fewer benefits when compared to the CLR proposal.

We should note that efforts aimed at the distribution of benefits among different income groups do not necessarily deal with or resolve issues of horizontal equity or equal justice within those groups. For instance, one of the purposes of the child credit is to adjust for the ability to pay taxes as the number of children in the family increase. That concern is legitimate at all income levels. There are many ways to achieve that horizontal equity goal of treating all families with equal numbers of children the same, even at the top of the income distribution, while maintaining progressivity of the overall income tax. For instance, one can raise statutory tax rates applying to all income, as opposed to raising implicit tax rates by phasing out the benefits of the child credit for higher-income households.

TABLE 1

Modifying WFTRA to Match CLR Benefits for Bottom Quintile at Lower Costs

Modification	Raise childless EITC phase-in rate to 30 percent, phase-out EITC at a 10 percent faster rate
Saving relative to CLR in 2019	$35.2 billion
Change in average benefits for bottom quintile compared to CLR	+$1

TABLE 2

Modifying AFA to Match CLR Benefits for Families with Children at Lower Costs

Modification	Increase CTC for children under 6 by $600
Saving relative to CLR in 2019	$29.5 billion
Change in average benefits for bottom quintile compared to CLR	+$43

TABLE 3

Modifying CLR to Raise Benefits for Families in the Bottom Quintile Above LIFT at the Same Cost

Modification	Raise EITC phase-in rate by 50 percent, double EITC phase-out rate
Saving relative to LIFT in 2019	$3.5 billion
Change in average benefits for bottom quintile compared to LIFT	+$99

TABLE 4

Modifying AFA To Raise Benefits for Families with Children Above LIFT at the Same Cost

Modification	Increase CTC for children 6 and over to $5,000 and CTC for children under 6 to $6,000
Saving relative to LIFT in 2019	$17.8 billion
Change in average benefits for bottom quintile compared to LIFT	+$2,385

CONCLUSION

Policymakers have proposed several large-scale earnings and child subsidy expansions that build on the EITC and CTC. The four proposals examined here satisfy several goals, such as reducing income inequality, improving outcomes for children, and covering workers now mainly excluded from wage subsidies. In practice, all grant the largest additional benefits to families with children. By focusing on low-income workers, two proposals add modestly to benefits for childless workers, and one adds substantial benefits both to those workers and to low earners who marry other low earners. But policies that aim only to subsidize work regardless of whether children are present still tend to greatly benefit families with children because working families on average are more likely to be caring for children than are retired and other nonworking families.

All else equal, proposals that build on the existing CTC (which is nearly universal among families with children) tend to have higher costs and be less progressive than those built on the EITC because the former apply to more families, including many middle- and upper income families. On the other hand, raising benefits for both families with children and workers largely left out of the existing EITC and CTC can easily cost more than raising benefits for only one of those groups. Focusing only on childless workers can be relatively modest in cost and provide large benefits to this group. If benefits for low-income families are increased by setting the phaseout range at income levels greater than under current law, benefits can extend further up the income scale and raise overall revenue costs. Increasing benefits to one group without raising overall costs necessarily entails lowering benefits for other groups.

Trade-offs are not easy or avoidable. Legislators must ultimately decide which needs in society are most pressing and which policies, including the taxes or benefit cuts required to pay for those policies, address those needs most fairly and efficiently. This brief lays out some of those trade-offs by looking at the costs and distributional effects of four existing proposals and variations on these proposals.

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