Implications of Various Child Tax Credit Reforms

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April 11, 2016

The child tax credit (CTC) provides a subsidy of up to $1,000 per child under age 17. Parents with little or no tax liability may receive a refundable credit of 15 cents per dollar of earnings over $3,000 – until they reach the full $1,000 per child credit. (The refundable portion of the credit is officially known as the additional child tax credit – ACTC.) Once a parent's adjusted gross income reaches $75,000 ($110,000 if married) the credit starts to phase out at a rate of 5 percent. As a result of this relatively broad eligibility range, roughly 80 percent of all families with children benefit from the credit.

Not all CTC reforms are created equal; some reforms would increase benefits for low-income families and others would focus benefits on higher income families. We estimate the cost of six reforms that have been proposed in Congress or discussed in recent literature (figure 1) and show how the benefits from those reforms would be distributed across each income quintile (figure 2). In general, very low-income families can only get more assistance from the CTC if the credit phases in at a higher rate or starts to phase in with the first dollar of earnings. Indexing the credit for inflation or eliminating marriage penalties would benefit higher income families.

Reduce refundability threshold to $0. This option would allow families to receive their child credit starting with the first dollar of earnings. Because most children who qualify for the CTC have parents who earn enough to receive the full credit, only low-income families not receiving the full credit would benefit. The cost of this option over the ten year budget window from 2016-2025 is relatively small, $17 billion. Eighty-five percent of benefits would accrue to families in the lowest fifth of the income distribution, and less than two percent of benefits would accrue to families in the top three income quintiles.

Double the maximum credit to $2,000 per child. Providing a larger credit – without also increasing the eligible population or increasing the credit phase-in rate – would target benefits to families who have more income than is necessary to claim their full credit under current law. It would cost about $500 billion over the 10-year budget window. Only a small portion of benefits would go to families in the lowest income quintile, while 87 percent of benefits would go to families in the middle three income groups, who have high enough incomes to benefit from the larger credit size but not income so high that the credit would be phased out. It would also take longer for the higher credit to phase out than the existing credit, which benefits families in today's phase-out range and just beyond.

Provide an additional $1,500 credit to families with children under age 3 with all other credit rules the same as the existing CTC. Because this is a new credit rather than an add-on to the existing credit, it would aid families with low- and middle-incomes. Few benefits extend to families in the highest income quintile, just as under current law, because their incomes are above the phase-out range of the credit. This option would cost about $230 billion over the 10-year budget window.

Increase the maximum age for eligibility for the credit from 16 to 18. This option would align CTC benefits more closely with other child benefits. Like the previous option, this reform would expand the pool of eligible children, and benefits would be distributed similarly to current benefits. Families with children in the lowest income quintile would receive almost 16 percent of benefits and almost all other benefits would be received by families in the second through fourth income quintiles. This proposal would cost about $70 billion over the 10-year budget window.

Index all CTC parameters for inflation. This would prevent the maximum CTC benefit from being eroded by inflation and make the CTC more consistent with other parts of the tax code including the earned income tax credit (EITC), dependent exemption, and tax bracket thresholds. Only households who would claim the maximum credit under current law would benefit from this expansion. Over 40 percent of benefits of an indexed credit would go to households in the fourth income quintile, and almost 6 percent would go to households in the highest income quintile. This stems, in part, from the higher phase-out points of the credit that would result from indexation. Few benefits (less than 10 percent) would be directed to households in the lowest income quintile because families in this group do not have enough earnings to take advantage of the higher credit. About 20 percent of benefits would be directed to households in each of the second and third income quintiles, as they would be eligible to benefit from higher credit amounts. This reform would cost about $84 billion over the 10-year budget window.

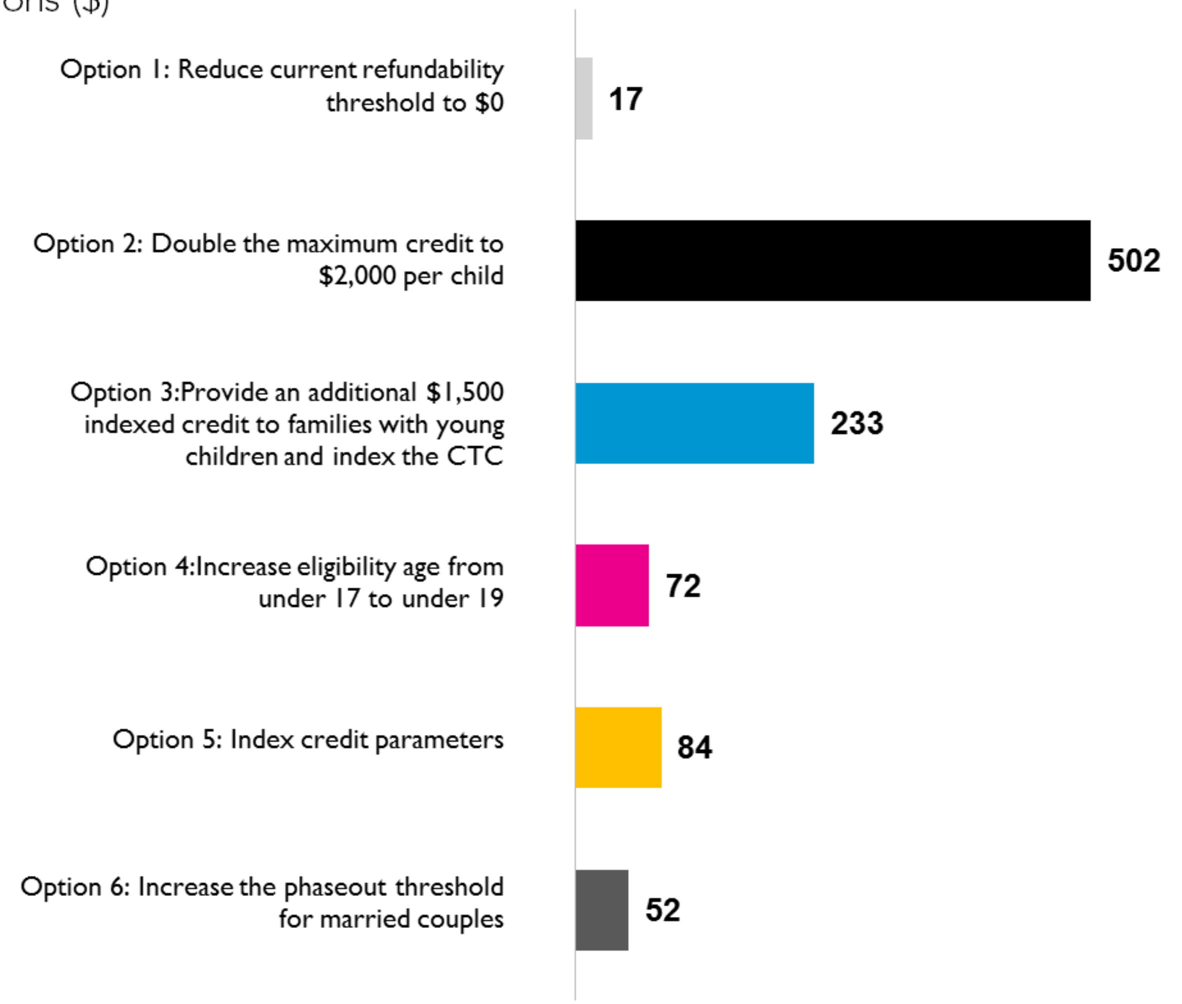
Increase the phaseout threshold for married couples to double the single threshold. Although the CTC begins to phase out for married couples at a higher income than applies to single parents, the point at which the credit begins phasing out for married couples is less than twice that of single parents. This can create marriage penalties under the CTC (married couples receive lower benefits after marriage than prior to marriage). This reform, which would cost $52 billion over the 10-year budget window, would direct benefits almost exclusively to families in the fourth and fifth income quintiles (59 and 40 percent, respectively). While it would eliminate CTC marriage penalties, this option would also create or increase marriage bonuses. For example, a one-earner couple with income of $120,000 receives a partial credit under current law if married, but no credit if single. Under the proposal, the married couple would qualify for the full credit.

The proposals have very different price tags and distributional effects. The right option, if any, depends on budget constraints and policymakers' goals.

FIGURE 1

10-Year Budget Cost of Various Reform Proposals to Child Tax Credit (2016-2025)

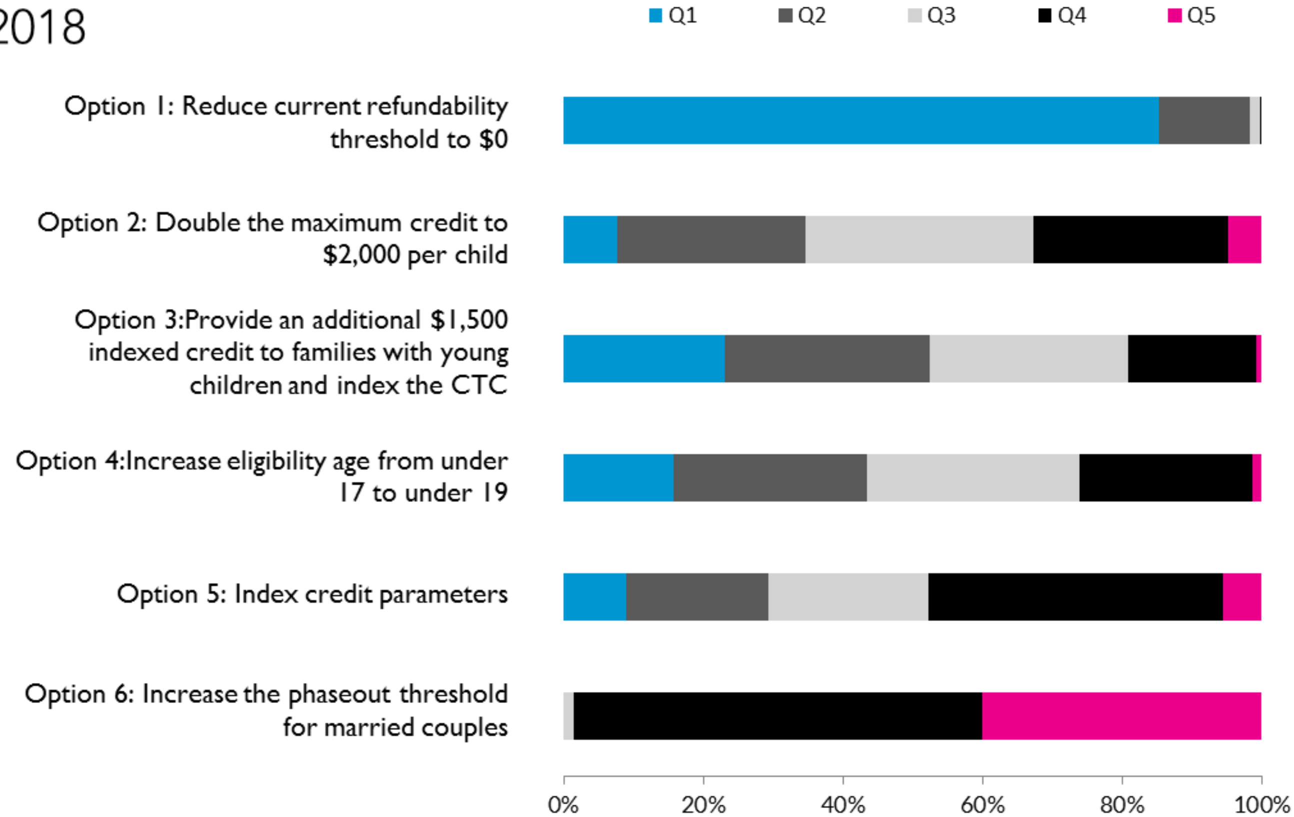
Billions ($)



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0515-4).

FIGURE 2

Proportion of Child Tax Credit Increase Delivered to Each Quintile under Various Reform Proposals, 2018



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0515-4).
Note: Q = quintile. Quintile 1 is the lowest income quintile, quintile 5 the highest

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