



More Can Be Done to Expand the Child Tax Credit

The Obama Plan and Full Refundability

By Joy Moses | April 2009

Many Americans scrambled to complete their tax day filings this week, while some looked forward to refunds and imagined how they would use them. For low-income families, a refund translates into household necessities—perhaps making it easier to pay a future light bill, feed their children, or put gas in the car to get to work. As President Barack Obama correctly pointed out yesterday, the tax breaks included in his recovery plan and the subsequent legislation passed by Congress have minimized such financial burdens on working families. The expansions of the Child Tax Credit, or CTC, in particular benefited 13 million low-income children, lifting an estimated 1 million of them out of poverty. However, these measures were only temporary and it's time to move forward with permanent expansions of the CTC to help fulfill its potential to reduce financial burdens on families and help prevent child poverty.

The credit has recently been undergoing incremental changes in a positive direction. The American Recovery and Reinvestment Act of 2009 lowered the credit's minimum earnings level from \$12,550 to \$3,000 in tax years 2009 and 2010. And in his 2010 federal budget blueprint, President Obama recommended making these expansions permanent. In the coming months, Congress will decide whether to grant his request.

Congress' decision should be guided by the knowledge that historically the lowest-income families have been denied the benefits of the credit or have received less value than many middle-income families. This type of outcome—in which those with the greatest need receive the least financial benefit—is philosophically unsound, counterintuitive, and lacks equity. Most importantly, it hinders the role that the Child Tax Credit is able to play in reducing child poverty. Future legislation and remaining budget debates will provide opportunities to ensure that the Child Tax Credit is designed to help the families who need it most.

As explained below and in Center for American Progress' report, "[From Poverty to Prosperity: A National Strategy to Cut Poverty in Half](#)," the best policy approach to

accomplish this goal is for the CTC to be made fully refundable so children in households without positive personal income tax liability can benefit. A second critical change would be to scale back the current restriction on the credit that requires a minimum earned income level before the credit is available.

How the Child Tax Credit works

The Child Tax Credit provides tax-based assistance to families with children. It allows households to reduce the amount they owe in federal taxes by up to \$1,000 per child under the age of 17. Under certain circumstances some families can also get a payment back if the credit amount is more than the taxes owed. The credit provides families with additional funds that can help them cope with the financial strain associated with maintaining a household and raising children. This is especially important during a recession defined by more parents losing jobs and experiencing reductions in their work hours.

Let's look at a hypothetical example to see how the credit works: the Joe and Clair Jones family. Like many couples, Joe and Claire sit down to do their taxes on April 14. At the end of the process, they note that they owe the federal government \$2,000. Joe is writing out the check when Claire suddenly notices that they could have claimed the child tax credit but failed to do so. They have two children, and so they can use the CTC to reduce the amount they owe by exactly \$2,000, or \$1,000 per child. Since the Joneses can reduce their \$2,000 tax obligation by \$2,000, they realize that they owe nothing to the Internal Revenue Service and instead decide to help stimulate the economy by taking the family on vacation.

The Joneses are able to receive the Child Tax Credit's maximum value. In order for a family to receive this maximum value, it must have an income level that is high enough to require them to pay an amount in taxes that is at least equal to the maximum CTC benefit (\$1,000 per child).¹ But many poor families have so little income that their federal income tax payment is much smaller than the Joneses. Some are not even required to pay any federal income tax. Importantly, they still must pay payroll, sales, state, and local taxes that may also impact their finances.

For some of these lower-income families, a portion of the CTC is "refundable," which means families can get a tax refund even if they don't owe any tax. Benefit levels for families receiving the refundable portion of the credit fall along a sliding scale that is tied to earnings—as the amount of family earnings goes down, the value of the CTC benefit goes down. In order to even qualify for the refundable portion of the credit, a family must have a minimum annual earnings level that changes from year to year. In 2009, the minimum level is \$3,000. The refundable credit typically provides a partial benefit, which means families receive a value that is less than \$1,000 per child. The value equals 15 percent of all earnings above the minimum earnings level.

Expanding the CTC

At the beginning of 2009, Congress passed the American Recovery and Reinvestment Act, or ARRA, which temporarily lowered the Child Tax Credit's minimum earnings level from \$12,550 to \$3,000 in 2009. This lowered level will also apply to tax year 2010.

President Obama's [2010 budget blueprint](#) calls for making this expansion permanent. But in tax year 2011, the minimum earnings level will again increase to a level that is above \$12,000 if Congress does not heed his request and pass appropriate legislation.

Changes made in the ARRA and within the president's proposed budget blueprint should be applauded. They effectively provide more low-income families with additional financial resources and thus help to reduce child poverty. But more can be done.

Currently, there are several policy options available to Congress. They include the following:

- **Do nothing:** Congress could allow the temporary expansions of the CTC to expire in 2011, dramatically increasing the minimum earnings level for the credit.
- **The Obama plan:** Congress could implement the recommendation included within Obama's budget blueprint. He proposed that the temporary expansion in the ARRA be made permanent. Recall that the ARRA lowered the minimum earnings level to \$3,000 for 2009 and 2010.
- **Previous House plan:** The original House-passed version of ARRA reduced the minimum earnings level to \$0. This would have guaranteed at least a partial credit to all families who have at least one member who worked at some point during the year. Although this option never became law, it could be revived as a method for expanding the credit.
- **CAP's plan:** CAP's [Taskforce on Poverty](#) recommends that the CTC be made "fully refundable." This means that all low- and middle-income families would always be able to receive the full benefit (\$1,000 per child). If they didn't owe that much in taxes, they would receive a refund for the balance. Full refundability would eliminate the sliding scale of benefits based on earnings. It would also provide a credit to families with no earnings—for example, those with adults who do not work by reason of unemployment, disability, or retirement.

CAP's proposal of full refundability of the CTC would maximize the benefit to the lowest-income families while still providing benefits to families who currently receive the credit. If this goal cannot be achieved in the immediate future, the previous House plan of lowering the minimum earnings level to \$0 should once again be considered and implemented.

How expanding the CTC would improve family financial well-being

Expanding the Child Tax Credit has a substantial impact on the financial resources available to low-income families because the funds can be used to help pay for the costs associated with child rearing. To help explain the differing impacts of the current policy options, the following fictional families, each with two children, will be examined:

- **Sam and Lillian Hoover.** Sam and Lillian are a married couple. Sam is an attorney and Lillian is a stay-at-home mom.
- **Richard and Sally Smith.** Richard and Sally are a married couple. Both work full time as teachers.
- **Allan and Alicia Anderson.** Allan and Alicia are a married couple. Allan is an active duty soldier in the U.S. Army. Alicia provides full-time care for their children and an ailing grandparent.
- **Ann Carter.** Ann is a single parent. She works full-time as a temporary employee, typically for minimum wage and only when she can get assignments.
- **Agatha Parker.** Agatha is a single grandmother who has been raising her son's two children since he became addicted to drugs. Her primary source of income is Social Security. Her annual earnings come from occasional temporary retail jobs.

Impact of CTC proposals on five families for tax year 2009*

CAP plan ensures lowest-income families receive benefits

Family	Do nothing (Value of credit without ARRA temporary expansion)	Obama plan (Minimum earnings level = \$3,000)	House plan (Minimum earnings level = \$0)	CAP plan (Full refundability)
Hoovers (earnings = \$105,000)	\$2,000	\$2,000	\$2,000	\$2,000
Smiths (earnings = \$60,000)	\$2,000	\$2,000	\$2,000	\$2,000
Andersons (earnings = \$16,800)	\$638	\$2,000	\$2,000	\$2,000
Carters (earnings = \$11,500)	\$0	\$1,275	\$1,725	\$2,000
Parkers** (earnings = \$2,500)	\$0	\$0	\$375	\$2,000

* Table information is based on 2009 minimum earnings levels, but relies on the 2008 tax schedule. These examples represent overly simplified tax scenarios designed to demonstrate the outcomes of varying CTC policies and proposals. For example, the scenarios presume that the families have no other income besides earnings (with the exception of the Parkers who also rely on social security benefits). The families also claim no other credits or deductions.

** Agatha Parker's taxable social security income combined with her earnings were too low to require her to pay taxes. Therefore, she could not qualify for a tax deduction under the CTC. Her earnings are too low to qualify for the refundable credit under the first two policy options since her earnings were below the \$12,550 and \$3,000 minimum earnings levels.

It is apparent that for middle-income families, the varying policies and proposals result in the same outcome—they receive the maximum value of the credit. However, for the lower-income Andersons, Carters, and Parkers, the differences between the policy options can be quite dramatic. For instance, Ms. Parker achieves a significantly better result under the full refundability scenario as compared to the other options.

The Carters, the family living at minimum wage, would also experience some significant variation in the value of their credit under the various proposals. The \$1,275 additional dollars that they would benefit from under the Obama plan could be used to purchase a number of different necessities for the family. For example, \$1,275 could be used to purchase *one* of the following necessities:

- 17 weeks of childcare.²
- 11 weeks of food from the USDA's Low-Cost Food Plan.³
- 1.4 months of housing (for a two-bedroom apartment at fair market rent).

However, building on the Obama plan, the \$2,000 associated with full refundability would allow the Carters to purchase even more—for example, *one* of the following necessities:

- 27 weeks of childcare.
- 17 weeks of food from the USDA's Low-Cost Food Plan.
- 2.2 months of housing (for a two-bedroom apartment at fair market rent).

Thus, for families such as those headed by Ann Carter, a CTC expansion could provide necessary relief in helping to manage the costs of raising her two children.

Expanding the CTC to eliminate inequality in benefits

Beyond the benefits to families' well-being there are sound philosophical reasons for making the child tax credit fully refundable. Under the current system, the value of the credit varies from child to child. This variation is based on the income and earnings of families and not on any characteristics related to the children. For example, there is no reason to believe that the costs of raising Child X are more significant than those associated with Child Y simply because there is a \$3,000 difference in the earning of their families. What's more, it may be inappropriate to assign different values to different children. In essence, the current tax code says that Child A is worth \$1,000 so we will give her parents a child tax credit valued at that amount, but Child B is only worth \$500.

Even if the nation were to decide that a sliding scale of benefits was appropriate, the scale should be tilted in the other direction—toward a higher value for those with lower earnings. This would account for the fact that poor and low-income families have fewer resources to provide for the needs of their children than higher-income families. Low-income families require comparatively more CTC relief—not less.

Failing to permanently expand the CTC: Implications for low-income families

Temporary expansions of the CTC in 2008 and 2009 dramatically lowered the minimum earnings level for the credit to \$8,500 and then to \$3,000. If expansions to the credit are not made permanent, then in 2011 the minimum earnings level will once again increase to a level that is more than \$12,000. This would have a devastating effect on low-income Americans. A previously existing body of research indicates that the elevated minimum earnings levels existing prior to 2008 resulted in distinct hardships affecting the following groups:

- **Low-income families (generally).** In 2007, an estimated 10.6 million children in low-income families were ineligible for the CTC and an additional 11 million low-income children received less than the full credit amount.
- **African Americans and Hispanics.** In previous years, African-American and Hispanic children were the least likely to benefit from the CTC. Nearly 50 percent of African-American children and 46 percent of Hispanic children received no credit, or only a partial credit, because their families had low or no earnings. Only 18 percent of white children fit within that category.
- **Low-wage workers.** Historically, over half of the children who did not receive any benefits—51.9 percent—were from working families. Minimum-wage workers and those with earnings near the poverty line were likely to only qualify for a partial child tax credit.

Given these effects, and the high costs of raising children, it is clear that there should be a national commitment to promote continued expansions of the credit. This would better ensure equality of treatment to all children and families through preventing the resurgence of the higher minimum earnings levels that gave rise to the above disparities.

Conclusion

A permanent expansion of the Child Tax Credit would help families weather the storm of raising children with limited financial resources. By potentially adding new funds to household budgets, the CTC could allow for improved access to such necessities as food, child care, and housing.

The best available expansion option is to make the credit fully refundable. This would represent an important philosophical shift while also bringing the greatest possible financial benefit to families at the bottom of the economic spectrum.

If this is not possible, Congress should revisit a plan to permanently lower the CTC's minimum earnings level to \$0. This solution expands on the most recent recommendation made by President Obama, allowing some new families to collect the credit and increasing its value for others.

Additional resources

[The Center on Budget and Policy Priorities \(www.cbpp.org\)](http://www.cbpp.org)

[The Coalition on Human Needs \(www.chn.org\)](http://www.chn.org)

[The Tax Policy Center \(www.taxpolicycenter.org\)](http://www.taxpolicycenter.org)

Endnotes

- 1 Sometimes a family's income is *too high* to receive the full value, or any value, from the credit. The credit begins to phase out for upper-income families with an adjusted gross income that is more than \$110,000 for those who are married filing jointly, \$75,000 for single heads of household, and \$55,000 for those who are married filing separately. Once these thresholds are surpassed, greater incomes translate into smaller and smaller CTC values.
- 2 Child care costs are based on 2005 census data for families making under \$1,500 per month with children under the age of 15. Ann's child care costs are likely to be higher in 2009 and what she pays may not be enough to get the best possible care.
- 3 Data is based on Ann being between the ages of 19 and 50, with children aged 5 and 7.