Order Code RS20988
Updated January 30, 2003

CRS Report for Congress
Received through the CRS Web

The Child Tax Credit After the Economic Growth and Tax Relief Reconciliation Act of 2001

Gregg Esenwein
Specialist in Public Finance
Government and Finance Division

Summary

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) increases the child tax credit from its prior law level of $500 to $1,000. This increase is phased in gradually over a 10-year period. The 2001 Act also makes the credit refundable for all families and changes how the refundability of the credit is calculated. Finally, the 2001 Act allows the child tax credit to be taken in full against both an individual's regular and alternative minimum tax.

The EGTRRA tax cuts are scheduled to expire at the end of calendar year 2010. In the 107th Congress, the House passed several bills that would have extended the EGTRRA tax cuts beyond 2010. The Senate did not adopt these bills. It is likely that the 108th Congress will revisit the issue of making the EGTRRA tax cuts permanent.

Additionally, in response to continued sluggish economic performance, President Bush unveiled a new tax stimulus plan in early January 2003. As part of his stimulus plan, President Bush has proposed accelerating the phase-in of some of the EGTRRA tax cut provisions. The President's proposal includes increasing the child tax credit to $1,000 effective in 2003. The Treasury Department estimates that the 10-year revenue cost of these change would be $91 billion.

This report will be updated as legislation action warrants.

Background

The child tax credit was initially enacted as part of the Taxpayer Relief Act of 1997. Congress passed the credit because it believed that the tax structure did not adequately reflect a family's reduced ability to pay taxes as family size increased. The decline in the real value of the personal exemption over time was cited as evidence of the tax system's failure to reflect a family's ability-to-pay. Congress believed that the child tax credit would reduce families' tax liabilities, would better recognize the financial responsibilities of child rearing, and would promote family values.[1]

For tax year 1998, families with qualifying children were allowed a credit against their federal income tax of $400 for each qualifying child. For tax years after 1998, the credit increased to $500 per qualifying child.

When first enacted, the child tax credit was refundable only for families with three or more qualifying children. The maximum refundable child tax credit was limited to the extent that the taxpayer's Social Security taxes and income taxes exceeded the taxpayer's earned income tax credit.[2]

The 2001 Act

The Economic Growth and Tax Relief Reconciliation Act of 2001 (H.R. 1836) was approved by both chambers of Congress on May 26, 2001 and signed by President George W. Bush on June 7, 2001 (P.L. 107-16). The Act made three major changes to the child tax credit.

First, the Act gradually increases the child tax credit to $1,000 between 2001 and 2010. For calendar years 2001 through 2004 the credit will be $600; for calendar years 2005 through 2008 the credit will be $700; for calendar year 2009 the credit will be $800; and for calendar year 2010 the credit will be $1,000.

Second, the 2001 Act makes the credit refundable for all families (under prior law, the credit was refundable only for families with three or more children), and changes how the refundability of the credit is calculated.

Under the 2001 Act, for families with less than three qualifying children, the maximum refundable credit cannot exceed 10% of a taxpayer's earned income in excess of $10,000. For instance, in 2001, if a taxpayer had $17,000 of earned income and one qualifying child, then the taxpayer would receive a refund of the full amount of the child tax credit of $600. This is because the taxpayer's earned income in excess of $10,000 is $7,000 and 10% of this amount is $700, which is equal to or greater than the $600 credit.

For families with three or more children, the maximum refundable child tax credit is limited to the extent that the taxpayer's Social Security taxes and income taxes exceed

---

[1] U.S. Congress, Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in 1997*, December 1997.

[2] A refundable tax credit means that even if you do not owe any federal income taxes, you are still entitled to the credit (within certain limits). For example, in tax year 2000, a taxpayer with three qualifying children, $26,350 of income, and filing a joint return would have had a federal income tax liability, before any tax credits, of $750. The taxpayer would have been entitled to an earned income tax credit of $1,011 and child tax credits of $1,500. If the taxpayer paid $2,016 of Social Security taxes, then the taxpayer's Social Security taxes and income taxes combined would have equaled $2,766 and would have exceeded the taxpayer's earned income tax credit by $1,755. Hence, the $1,500 in child tax credits would have been fully refundable for this taxpayer even though he would have paid no income taxes.

the taxpayer's earned income tax credit (the same rules as prior law) or to the extent of 10% of their earned income in excess of $10,000. In these cases, the taxpayer can use whichever method results in the largest refundable credit for which the taxpayer is eligible. For calendar years 2005 and later, the applicable percentage is raised to 15%. The $10,000 threshold is indexed for inflation starting in 2002.

The Act's third major change would permanently allow the child tax credit to offset a taxpayer's alternative minimum tax (AMT) liability. The interaction of the child tax credit and the individual AMT has been an area of growing concern.

Usually, personal tax credits are limited in that they cannot be used to reduce regular income tax liability below an individual's AMT. For example, consider the case where a taxpayer has a regular income tax liability, before credits, of $600, is eligible for a $600 child tax credit, and has an AMT liability of $350. Under prior federal income tax rules, the taxpayer would be allowed to use only $250 of the child tax credit to reduce his regular income tax to $350 (the same but no lower than the AMT).

Under the 2001 Act, the taxpayer will be allowed to apply the full amount of the child tax credit against both his regular income tax and his AMT. Using the example above, the taxpayer would take the full $600 child tax credit and hence eliminate all of his income tax liability.

The Joint Committee on Taxation has estimated that these changes to the child tax credit will reduce federal revenue by $61.4 billion over the fiscal year period 2001 through 2006 and $171 billion over the fiscal year period 2001 through 2011. The total cost of the child tax credit, including the 2001 Act modifications, will approach $173 billion over the fiscal year period 2001 through 2006.

However, all of the changes in the Economic Growth and Tax Relief Reconciliation Act of 2001(including the increase in the child tax credit) will expire (sunset) after 2010. Congress included the sunset in EGTRRA to avoid a Byrd rule violation in the Senate. The Byrd rule prohibits "extraneous matter" in reconciliation legislation. Under the rule, extraneous matter includes, among other things, language that would cause an increase the budget deficit (or reduce budget surpluses) in a fiscal year beyond those covered by the reconciliation legislation. As a result of the Byrd rule, EGTRRA contained language providing for the expiration of all of its provisions at the end of calendar year 2010.

Other Child Tax Credit Provisions

The 2001 Act did not change the prior law provision regarding who qualifies for the child tax credit or the provision that phases out the credit for upper-income taxpayers.

To qualify for the credit, the child must be an individual for whom the taxpayer can claim a dependency exemption. That means the child must be the son, daughter, grandson, granddaughter, stepson, stepdaughter, or an eligible foster child of the taxpayer. The child must be under the age of 17 at the close of the calendar year in which the taxable year of the taxpayer begins.

The child tax credit is phased out for taxpayers whose adjusted gross incomes (AGIs) exceed certain thresholds. For married taxpayers filing joint returns, the phaseout begins at AGI levels in excess of $110,000, for married couples filing separately the phaseout begins at AGI levels in excess of $55,000, and for single individuals filing as either heads of households or as singles the phaseout begins at AGI levels in excess of $75,000. The child tax credit is phased out by $50 for each $1,000 (or fraction thereof) by which the taxpayer's AGI exceeds the threshold amounts. These phaseout thresholds are not indexed for inflation.