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The Child Tax Credit

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Summary

The child tax credit was enacted in 1997, as Congress addressed concerns that the income tax structure did not adequately reflect a family's reduced ability to pay taxes as family size increased.

Initially, for tax year 1998, families with qualifying children under the age of 17 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. For families with three or more children, the child tax credit was refundable. Subsequent changes in 2001, 2003, and 2004 increased the amount of the child tax credit and made it refundable for most families. These changes are to sunset (expire) in 2011. The maximum amount of the child tax credit is scheduled to decline from $1,000 per qualified child in 2010 to $500 in 2011.

The Emergency Economic Stabilization Act of 2008 (P.L. 110-343), signed into law on October 3, 2008, expanded eligibility for the refundable portion of the credit for low-income families and increased the refundable amounts. This change is effective only for the 2008 taxable year.

This report will be updated as legislative action warrants.

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Current Law

For tax year 2008, families below certain income levels are allowed a credit against their federal income tax of $1,000 for each qualifying child. 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 may be refundable under certain conditions, which are different for families with different numbers of children.[1] Families with one or two qualifying children may receive a refund of up to 15% of the taxpayer's earned income in excess of $8,500. For example, a household with income of $15,000 would be eligible for a $975 refundable tax credit.[2]

The earned income threshold amount of $8,500 is an exception authorized for a single year by the Emergency Economic Stabilization Act of 2008 (P.L. 110-343). In its absence, the threshold would have been $12,050 in 2008.[3] The threshold will increase further in 2009 due to indexation. Upon expiration of recent tax cuts in 2010, according to current law, families with one or two children will not be eligible for a refundable portion of the credit.

Families with three or more children may qualify for a more generous refund of the credit. For them, the refundable credit amount is capped by the larger of the two amounts: (1) the excess of taxpayer's Social Security taxes over earned income tax credit, or (2) the amount by which 15% of their earned income exceeds $8,500 in 2008.

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 range begins at a modified AGI of $110,000, for married couples filing separately at $55,000, and for single or head of household filers the phaseout begins at an AGI of $75,000. These phaseout thresholds are not indexed for inflation. AGI used in this calculation is "modified" from AGI reported on the tax return by adding back certain items.

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. The upper end of the phase-out range depends on the number of qualified children and the amount of the credit authorized by law in a given year. Generally, it takes $20,000 of modified AGI above the threshold to completely phaseout $1,000 of a credit.

Currently the child tax credit is allowed in full against a taxpayer's alternative minimum tax (AMT).

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[1] A refundable tax credit means that the taxpayer receives the tax credit in the form of a refund from the Treasury even if he or she does not have an income tax liability.

[2] The calculation is 15% of $6,500, which is the difference between income of $15,000 and the threshold of $8,500.

[3] If EESA had not been enacted, the earlier example would change and the calculation would be 15% of $2,950, which is the difference between $15,000 and the threshold of $12,050. Thus, the refundable tax credit amount would have been $442.50.

Legislative History

The child tax credit was enacted as part of the Taxpayer Relief Act of 1997 (P.L. 105-34). Congress established the child tax credit to address concerns 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 by more than one-third over the prior 50 years was cited as evidence of the tax system's failure to reflect a family's ability to pay. Congress acted so that the child tax credit would reduce a family's tax liabilities, would better recognize the financial responsibilities of child rearing, and would promote family values.[4]

The idea of providing the credit enjoyed broad support across the political spectrum, but specifics varied among policymakers. The final shape of the measure evolved during conference negotiations as a compromise among several competing proposals. For example, going into the conference the House, Senate, and President's versions varied in the amounts of the credit, general structure of the measure, phase-in time line, income limitations for high-income taxpayers, etc.[5] In addition, the credit was a part of a broader tax reduction package that had to meet budget rules.

One of the results of this compromise was a limitation of the age of a child eligible for the credit to less than 17 years old. This age limit is different from other tax provisions for families with children, such as dependency exemption or earned income tax credit.[6]

Initially, for tax year 1998, families with qualifying children under the age of 17 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. For families with three or more children, the child tax credit was refundable.

The Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1998 (P.L. 105-277) allowed the child tax credit, as well as other personal tax credits, to offset an individual's regular income tax in full for tax year 1998 even though the personal tax credits might be larger than the amount by which the taxpayer's regular income tax exceeded his AMT.[7]

The Ticket to Work and Work Incentives Improvement Act of 1999 (P.L. 106-170) extended, through December 31, 2001, the provision allowing individuals to offset their regular income tax by the full amount of their personal tax credits regardless of their AMT liability.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA; P.L. 107-16) made several major changes to the child tax credit. First, the child tax credit was scheduled to gradually increase to $1,000 over the 2001 to 2010 period. **Table 1** shows the actual values for the child tax credit under current law and the values as enacted under the 2001 and subsequent legislation.

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[4] U.S. Congress, Joint Committee on Taxation, JCS-23-97, *General Explanation of Tax Legislation Enacted in 1997*, Dec. 17, 1997, (Washington: GPO, 1997), p. 6.

[5] CCH, *1997 Tax Act Ready for Conference; House, Senate and Administration Versions Compared*, CCH-COMMENT, 97FED ¶48,839, accessed on subscription database at http://www.CCHGroup.com.

[6] For more information on the definition of a child for various tax benefits, see CRS Report RS22016, *Tax Benefits for Families: Changes in the Definition of a Child*, by Christine Scott.

[7] For more information on the interaction of personal tax credits and the AMT, see CRS Report RL30149, *The Alternative Minimum Tax for Individuals*, by Steven Maguire.

Table 1. The Child Tax Credit Under Current Law and as Enacted Under the 2001, 2003, and 2004 Tax Acts

	1998	1999	2000	2001	2002	2003	2004
Actual	$400	$500	$500	$600	$600	$1,000	$1,000
WFTRA (2004)	—	—	—	—	—	—	—
JGTRRA (2003)	—	—	—	—	—	$1,000	$1,000
EGTRRA (2001)	—	—	—	$600	$600	$600	$600

	2005	2006	2007	2008	2009	2010	2011
Actual/Scheduled Under Current Law	$1,000	$1,000	$1,000	$1,000	$1,000	$1,000	$500
WFTRA (2004)	$1,000	$1,000	$1,000	$1,000	$1,000	—	—
JGTRRA (2003)	—	—	—	—	—	—	—
EGTRRA (2001)	$700	$700	$700	$700	$800	$1,000	—

Second, EGTRRA extended the refundability of the child tax credit to families with fewer than three children. For tax years 2001 through 2004, the credit was made refundable to the extent of 10% of a taxpayer's earned income in excess of $10,000. Refundability was scheduled to increase to 15% for 2005 and later years. The $10,000 threshold was indexed for inflation beginning in 2002.

Finally, the 2001 act allowed the child tax credit to offset AMT liability. All of the provisions of the EGTRRA, however, are scheduled to sunset at the end of 2010.

The Jobs Growth and Tax Relief Reconciliation Act of 2003 (JGTRRA; P.L. 108-27) increased the child tax credit to $1,000 for tax years 2003 and 2004. In the summer of 2003, the $400 increase in the credit for tax year 2003 was paid, via a check from the Treasury Department, in advance to many families who qualified for the child tax credit. The checks were distributed based on information contained on taxpayers' 2002 income tax returns. The JGTRRA provisions were scheduled to expire after 2004 and the child tax credit would have reverted to its scheduled level under the EGTRRA provisions—$700 in 2005.

In September 2004, Congress passed the Working Families Tax Relief Act of 2004 (WFTRA; P.L. 108-311). This act extended the $1,000 child tax credit through 2009. For 2010, the EGTRRA provisions apply and the child tax credit will remain at $1,000. In addition, WFTRA accelerated, to 2004, the increase in the refundability of the child tax credit. For 2004 through 2010, the child tax credit will be refundable to 15% of a taxpayer's earned income in excess of the applicable threshold.

The 2004 act also contained a provision including combat pay in earned income for purposes of computing child tax credit refundability. By including combat pay into earned income for the purposes of the credit, the law allowed for larger child tax credit refunds for eligible taxpayers. Income earned by armed services members in a combat zone is generally excluded from taxation. It benefits taxpayers who have positive tax liability, but for some lower-income members of the armed forces, prior to the enactment of WFTRA, the exclusion caused reported earnings to be too low to qualify for the child tax credit refunds or reduced the refunded amounts. The change applied to 2004 and later tax years, but was subject to the EGTRRA expiration clause.

In October 2008, Congress passed the Emergency Economic Stabilization Act of 2008 (P.L. 110-343), which was signed into law on October 3, 2008. Under Section 501 of the law, the earned income threshold used in calculating the refundable portion of the credit is reduced to $8,500 from $12,050 for 2008. The change is effective for a single tax year beginning after December 31, 2007. The estimated cost of the proposal is $3.129 billion over 10 years.[8] The inflation adjustment would not apply to this lower threshold amount. In 2009, barring congressional action, the threshold would revert back to the higher amount exceeding $12,000.[9]

Policy Issues

Three main issues have dominated recent policy discussions about the child tax credit: (1) the refundability limits on low-income families; (2) the expiration, at the end of 2010, of the EGTRRA expansion of and increases to the child tax credit; and (3) concern over the effects of tax cuts on the budget deficit.

JGTRRA accelerated, to tax years 2003 and 2004, the scheduled increase in the child tax credit from $600 to $1,000. However, it did not accelerate the increase in the refundability of the child tax credit scheduled to take effect in 2005. (In 2005, the child tax credit was scheduled to be refundable to the extent of 15% of a taxpayer's earned income in excess of a specified threshold.)

As a result, many low-income families did not benefit from the JGTRRA increase in the amount of the child tax credit. For example, in 2003, a family filing a joint return with one qualifying child and earned income of $16,500 would not owe federal income taxes. They would, however, have received a refund of $600 for the child tax credit. The $600 refund would have been the same as under prior law (10% of the excess of $16,500 earned income over the $10,500 threshold). Hence, even though the 2003 act increased the child tax credit to $1,000, this family saw no increase in their refundable child credit compared to prior law. If the refundability of the child tax credit had been accelerated to 15%, then this family would have received a refundable child tax credit of $900 in tax year 2003 (15% of the excess of $16,500 earned income over the $10,500 threshold).

The fact that JGTRRA did not increase the refundability of the child tax credit caused some controversy in Congress.[10] Although additional legislation accelerating the increase in refundability was contained in bills passed in 2003 by both the House and the Senate, it was not enacted into law. Congress addressed this issue again in 2004 and, with the passage of the WFTRA, increased refundability to 15% effective in 2004.

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[8] U.S. Congress, Joint Committee on Taxation, JCX-78-08, *Estimated Budget Effects of the Tax Provisions Contained in an Amendment in the Nature of a Substitute to H.R. 1424, Scheduled for Consideration on the Senate Floor on October 1, 2008,* Oct. 1, 2008, p. 9.

[9] To date several dozen other bills affecting the child tax credit have been introduced in the 110th Congress. Among them, S. 218 (Snowe), S. 614 (Schumer), S. 816 (Brownback), H.R. 411 (Diaz-Balart), H.R. 431 (Towns), H.R. 1406 (Ellsworth), H.R. 1421 (Terry), H.R. 2126 (Carney), H.R. 2902 (Allen), H.R. 2983 (Weiner), and H.R. 3135 (Weldon).

[10] CCH, "Conference Fight Looms Over Reach Of Expanded Child Tax Credit," *Federal Tax Weekly,* No. 25, June 19, 2003, accessed on subscription database at http://www.CCHGroup.com; Reuters News, "Compromise Urged on U.S. Child Tax Credit Refunds," July 22, 2003, as reproduced on factiva.com.

A related issue concerns eligibility for the refundable portion of the child tax credit. Families with income below the earned income threshold ($8,500 in 2008, or over $12,000 thereafter) receive no tax benefits from the refundable child tax credit. In fact, some low-income families may lose their eligibility for the refundable portion if their income does not keep up with inflation. It happens because the threshold is the only parameter of the credit formula indexed for inflation and increases each year, with the exception of 2008, in nominal terms.

The desire to increase the amount and availability of the refundable child credit for lower income households led to a change enacted under the Emergency Economic Stabilization Act of 2008.[11] By changing the parameters of the formula used in calculating the refundable child tax credit, the law made families with earned incomes between $8,500 and $12,050 eligible for refunds. In addition, the amounts of the refund increased for many of those previously eligible by up to $532.50, equal to 15% of the difference between the old ($12,050) and the new ($8,500) thresholds.

The second policy issue facing Congress concerns the sunset provisions of EGTRRA and the child tax credit. All the tax provisions in EGTRRA are to sunset (revert to prior law levels) after 2010. This means that, absent legislative action, in 2011, the child tax credit will fall to $500 per qualifying child, the credit will no longer be refundable for families with fewer than three children, and the child tax credit will not be allowed in full against a taxpayer's AMT.

Finally, a counterweight to the congressional desire to provide continued tax relief to families is congressional concern over the current and projected size of the federal budget deficit. The revenue costs associated with extending the child tax credit changes beyond 2010 would cost $260.9 billion over FY2009-FY2018, or about $37 billion a year.[12]

Analysis

Economic theory does not provide an answer to the question of how the costs of child rearing should be accounted for under an income tax. Proponents of an increased child tax credit argue that the current credit is not large enough to offset the costs of raising a child. In this view, children should be considered an investment in the future and as such the costs associated with child rearing should be deducted as are other investment costs. Critics argue, however, that it was never intended that the federal income tax provide offsets for the full financial responsibility of raising children. Indeed, some even argue that the decision to have children represents a choice of how to consume one's income and therefore the costs of raising children should not be a consideration when assessing income taxes.

Historically, the federal income tax has differentiated among families of different size through the combined use of personal exemptions, dependent care credits, standard deductions, and the

[11] U.S. Congress, House of Representatives, *Renewable Energy and Job Creation Act of 2008, report together with additional and dissenting views to accompany H.R. 6049,* 110th Cong., 2nd sess., H.Rept. 110-658, online version, visited online at http://www.congress.gov/cgi-lis/cpquery/R?cp110:FLD010:@1(hr658).

[12] Congressional Budget Office, *Updated Estimates for Table 4-9, "Effects of Extending Tax Provisions Scheduled to Expire Before 2018," in The Budget and Economic Outlook: Fiscal Years 2008 to 2018,* January 2008, pp. 101-106, downloaded from https://www.cbo.gov/ftpdocs/90xx/doc9040/ExpiringProvisions.pdf.

earned income tax credit. These provisions were modified over time so that families of differing size would not be subject to federal income tax if their incomes fell below the poverty level.[13]

The child tax credit represents a departure from past policy practices because it is not designed primarily as a means of differentiating between families of different size at or near the poverty threshold, but rather is designed to provide general tax reductions to taxpayers with dependent children under the age of 17, including middle and upper income households.

On occasion, Congress has debated the merits of increasing the AGI phase out limits on the child tax credit. Increasing the AGI phase-out limits for the child tax credit would significantly expand the tax benefits of the child tax credit and provide tax reductions to much higher-income families than the original 1997 legislation.

The empirical evidence suggests that for most families with children, the overall federal tax burden, as well as federal individual income tax burden, fell between 1979 and 2005.[14] EGTRRA and subsequent legislation (with their reductions in marginal income tax rates, reductions in taxes on capital gains/dividend income, and marriage penalty tax relief) continued the trend of reducing federal taxes on families.

On the other hand, increasing the refundability percentage from 10% to 15% of earned income and the inclusion of combat pay for purposes of calculating refundability, as mentioned above, provided only modest tax benefits to taxpayers at the bottom of the income spectrum.

Enactment of the Emergency Economic Stabilization Act of 2008 expanded eligibility for the refundable tax credit for some lower-income families, but this change is effective only for a single year. Without further congressional action, the earned income threshold will increase to over $12,000 in 2009 from $8,500 in 2008. As a result, some lower-income families may lose their eligibility for the refundable credit. In addition, even in 2008, families with earned income below the threshold ($8,500) do not qualify for a refund.

Finally, differences in age limits used to define children eligible for the credit and other tax benefits cause some confusion. The child tax credit has a cutoff once a child reaches age 17, which is lower than cutoff age for many other tax benefits for families with children. For example, taxpayers may claim an exemption for a dependent child up to the age of 18, or 23 if a full-time student.

An example of recent confusion involved the qualification rules for the additional $300 per child payment under the Economic Stimulus Act of 2008 (P.L. 110-185), which piggybacked on those for the child tax credit, rather than on the dependency exemption eligibility rules. As a result, certain taxpayers who may have expected a stimulus payment to include their children did not receive that additional amount.

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[13] For more information on the tax treatment of different family types, see CRS Report 98-653, *The Marriage Penalty and Other Family Tax Issues*, by Jane G. Gravelle.

[14] Congressional Budget Office, Table 2A, *Effective Federal Tax Rates for Households with Children, by Comprehensive Household Income Quintile, 1979-2005,* accompanying *Historical Effective Federal Tax Rates: 1979 to 2005,* December 2007, downloaded at http://cbo.gov/ftpdocs/88xx/doc8885/Appendix_tables_toc.xls.

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