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Advancing Refundable Tax Credits: Policy Considerations

Many policymakers have expressed interest in having the Treasury "advance" refundable tax credits in installments (potentially monthly or quarterly). This approach is an alternative to providing the credits as an annual lump sum (i.e., as a tax refund), which may help households better meet their ongoing needs. In the American Rescue Plan Act of 2021 (ARPA; P.L. 117-2), Treasury is directed to advance half of the temporarily expanded child credit during the last six months of 2021.

There are four general considerations that policymakers may face when designing advance payments of refundable tax credits for families:

- the lack of data on all eligible households;
- the lagged nature of available annual data;
- changes in households' circumstances; and
- whether and how households would be required to reconcile (and perhaps repay any excess) advance payments when taxes are filed.

The term *household* as used in this In Focus refers to the individuals who are or would be listed on a federal income tax return (if it were filed); it is used interchangeably with *taxpayer* and *tax filer*. Other analyses may refer to a household as a tax unit.

This In Focus discusses these considerations in the context of the advance child credit ("ARPA child credit"). Policymakers may choose different approaches when considering advancing tax credits for families in the future.

Lack of Data on Eligible Households

The federal tax system does not include data *on all households* potentially eligible for an advance credit. Hence, unless "eligible non-filer" families manually provide that information to the IRS, they will generally not receive a payment. A 2017 CBO analysis estimated that of 292.6 million individuals who could be included on a federal income tax return (as the taxpayer, spouse, or dependent), 251.9 million were actually included—representing about 86% of all individuals. The study estimated that the greatest share of non-filers were lower-income households who are generally not required to file a federal income tax return.

The IRS could provide a means for families to provide this information (like the non-filer portal used for the stimulus checks). If a tool were made available, some eligible households might not use it. For example, this was the case in October 2020, when five months after the stimulus check non-filer portal was created, an estimated 9 million to 12 million eligible non-filing households had not received a check.

In September and October 2020, the IRS, on behalf of Treasury, sent notices to approximately 9 million taxpayers that were potentially eligible for the first round of stimulus checks. According to data provided to CRS by the IRS, between September 19, 2020 (the date notices were first released) and November 21, 2020 (the date the non-filer portal closed), approximately 1.2 million returns were accepted. It is unclear exactly how many of the 9 million notice recipients were ultimately eligible, nor is it clear the extent to which the notices increased use of the non-filer portal. Nonetheless, this may be indicative of the number of households who were eligible for the first payment, but did not receive it in 2020.

ARPA Child Credit: ARPA directs the Treasury to create a portal to allow households to modify information related to potential advance payments of the child tax credit. It is unclear if otherwise eligible non-filers will be able to use this portal to provide new information, or whether the portal will only allow tax filers to update existing tax return information. If new information cannot be provided on the portal, the "application" for the advanced credit will be a 2020 income tax return.

Lagged Nature of Available Annual Data

Federal tax law assesses taxes on *annual taxable income*. Thus, the federal income tax system collects data via tax returns on *annual income* and *annual family structure* (i.e., marital status and number of children). For example, a 2020 income tax return will include a household's total income in 2020, as well as their marital status (e.g., filing a joint tax return indicates two adults are married) and the number of children they claim for various child-related tax benefits in 2020.

Tax filing status for a given year depends on whether a taxpayer is married or unmarried and whether or not the taxpayer has dependents. Marital status is determined as of the last day of the calendar year. For example, if a couple is married on December 31, 2020, they are considered married for all of 2020 for tax purposes. (There are exceptions to this general rule.) Most married taxpayers file their returns jointly. Taxpayers with dependents may file using the head of household filing status. For most tax benefits, children must live with the taxpayer for more than six months out of the year to be considered a "qualifying child" (something that may only be clear at the end of the year for some households.) In addition to annual income and family structure data, households often provide a street address and bank account information on their tax return.

Tax data generally do not include information about within-year fluctuations in income and family structure. This may limit the ability to structure a tax benefit to respond to monthly or quarterly fluctuations in these factors. In other words, any monthly or quarterly advance credit will not be based on income and family structure in that given month or quarter—rather, it will be based on annual measures that are equally prorated.

In addition to limitations associated with using *annual data*, policymakers interested in advance payments of refundable credits may consider the *lagged nature* of data available to the IRS. When advancing a refundable credit to a household, it might be useful for the IRS to have real-time information about the household. However, income tax returns (which represent the IRS's primary source of information on households' income and family structure) provide *retrospective* data on the household for the previous year. As a result, the IRS has information on what a household's situation *was* in prior years but no information on what a household's situation *is* in the present. For example, at the beginning of 2021, the IRS had generally processed 2019 income tax returns. The IRS began accepting 2020 income tax returns on February 12, 2021, and taxpayers generally have until May 17, 2021 (the usual deadline is April 15) to file their 2020 returns. These deadlines provide taxpayers with flexibility when completing income tax returns, but also create delays in when the IRS receives the most recent tax information. If the IRS were to require taxpayers to file tax returns earlier, it could use more current data when administering an advance credit. However, doing so could place additional burdens on households filing income tax returns.

ARPA Child Credit: ARPA directs the Treasury to issue *half of the expected 2021 credit* in periodic payments beginning after July 1, 2021 (these periodic payments will generally be equal in amount). Taxpayers will claim the remaining half of the total 2021 credit when filing their 2021 income tax return in early 2022. The *expected 2021 credit* amount is the total amount the taxpayer would be expected to receive in 2021 (and not just the amount of the credit that exceeds income taxes owed). The 2021 advance payment amount is estimated based on 2020 income tax data or, if unavailable, 2019 income tax data; hence it may not reflect households' current situations in 2021. The law directs Treasury to create a portal so that families can manually update their information.

Changes in Household Circumstances

In the absence of real-time data on households' situations, policymakers may consider whether to allow households to proactively (i.e., manually) report changes to their income or family structure. Under this approach, the IRS or other government agency would design a system that allows households to report changes in factors that may affect eligibility for refundable credits (particularly income, marital status, and number of qualifying children). The IRS could then determine a household's advance payment using this more up-to-date data. In other words, if a household's situation changed, it could alert the IRS to the change and receive an adjusted advance payment that more accurately reflects its current situation and eligibility. One potential model for this sort of system is the non-filer portal the IRS created to administer stimulus checks. As previously discussed (see "Lack of Data on Eligible Households"), it is unclear if most households experiencing changes in circumstances would update this information.

ARPA Child Credit: ARPA directs the Treasury to create a portal to allow households to modify information related to potential advance payments of the child tax credit. It also allows households to opt out of receiving the advance payment.

Whether and How Households Would Reconcile

When credit amounts are advanced, it is likely that some households will receive more (or less) in advance payments during the year than they are eligible for when tax returns are filed. (A system allowing individuals to report changes to the IRS might partially, but is unlikely to fully, address this issue.) Absent specific reconciliation rules, taxpayers who received more in monthly payments than they were due (overpayments) would generally have to pay back the difference; those who received less (underpayment) would receive the difference when filing their tax return. Repayment may either reduce a tax refund or result in the taxpayer being required to remit payment to the IRS.

Reconciling estimated payments with what a household is actually eligible for ensures that households receive the correct amount of a credit. Reconciling may also discourage taxpayers from strategically deciding when to report information to the IRS. However, reconciliation—especially paying back an overpayment—may result in additional hardship among low- and moderate-income households. The three rounds of "stimulus checks" enacted in 2020 and 2021 included reconciliation rules whereby taxpayers generally *do not need to pay back an overpayment*, but can claim an additional amount on their tax return if they received less than they are eligible for. In contrast, among households that receive the advance of the health insurance premium tax credit (which is advanced monthly to health insurers), 58% had an overpayment of the advance which generally does need to be paid back, although there are protections for lower-income households. Prior research suggests the majority of households who repay the premium tax credit do so in the form of a reduced refund.

ARPA Child Credit: Under the advance payment provision of the child credit in ARPA, if a household received *less* in monthly payments than it was due, the household would receive the additional amount when filing its 2021 tax return. However, if the household received *more* in monthly payments than it was due, it would generally need to repay the difference. In cases where an incorrect amount of the advance payment is *due to net changes in the number of qualifying children*, up to $2,000 per child of the advance payment is protected from repayment (the "safe harbor" amount) for lower-income taxpayers. This safe harbor amount gradually phases down as income increases.

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