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INSIGHT

Factors Affecting the Cost of Extending the Expanded Child Tax Credit

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As Congress has considered legislation extending the expanded child credit, questions have arisen about the potential budgetary effects of such legislation and the factors that affect its projected cost.

The Congressional Budget Office (CBO) and the Joint Committee on Taxation (JCT) provide Congress with information about the projected budgetary effects of specific legislative proposals, typically in the form of cost estimates. These estimates are required to measure the budgetary effect of a legislative proposal in relation to projections of revenue and spending levels that are assumed to occur under current law, typically referred to as the *current-law baseline*. Changes to refundable tax credits can affect both revenue and outlays. The portion of a refundable tax credit that reduces taxes owed (i.e., reduces positive tax liability) is scored as a decrease in revenue, while the portion of the credit that is greater than taxes owed (i.e., increases negative tax liability) is scored as an increase in outlays.

A variety of factors could affect the estimated budgetary effects of legislation that extends the expanded child credit, including

- the details of the policy being extended,
- the duration of the extension,
- other changes to the tax code that could affect child credit payments, and
- economic and demographic projections.

Each is briefly discussed below.

The Details of the Policy Being Extended

The estimated budgetary effects of a proposal depend in part on what is being extended. For example, is the legislation extending the 2021 child credit or is it extending a modified version of the 2021 credit? Some modifications—like those that expand eligibility—would increase the cost of the extension, all else being equal. Other modifications—like extending a smaller credit, limiting or eliminating full refundability, or reducing the income level at which the credit begins to phase out—would reduce the cost of an extension.

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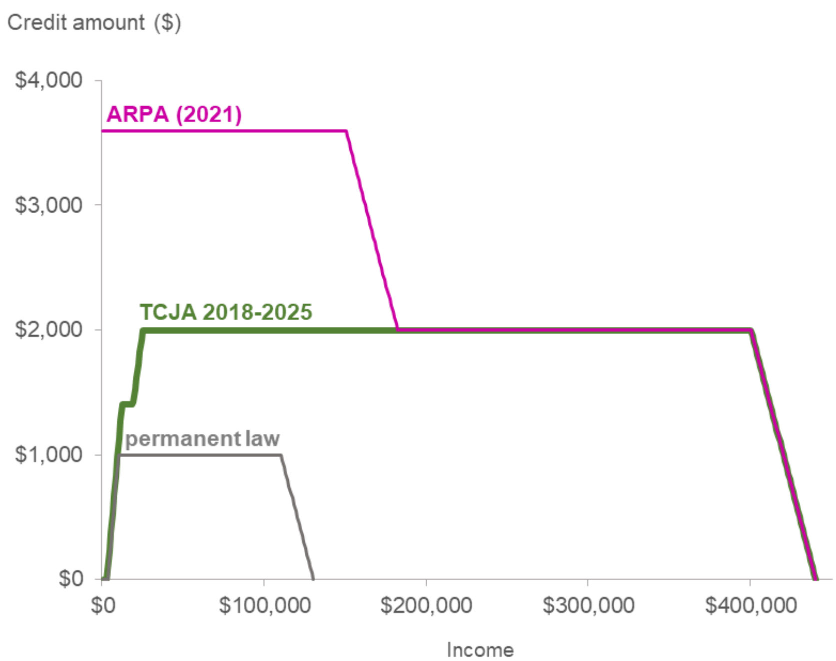
The Duration of the Extension

A shorter extension would generally be expected to have a lower budgetary cost than a longer extension. A longer extension's cost may also be affected by temporary tax provisions that, after they are scheduled to expire, would no longer be considered part of the current-law baseline.

This may be especially relevant to an expanded child credit extension, because the expanded credit is the result of temporary changes made by two laws which were *both in effect* in 2021—the Tax Cuts and Jobs Act (TCJA; P.L. 115-97) and the American Rescue Plan Act (ARPA; P.L. 117-2). (For more information on these changes, see Table 1 in R45124, *The Child Tax Credit: Legislative History*.) Each law temporarily expanded the credit, in terms of both the amount of the credit and eligibility, compared to the credit amounts under permanent law, as illustrated below.

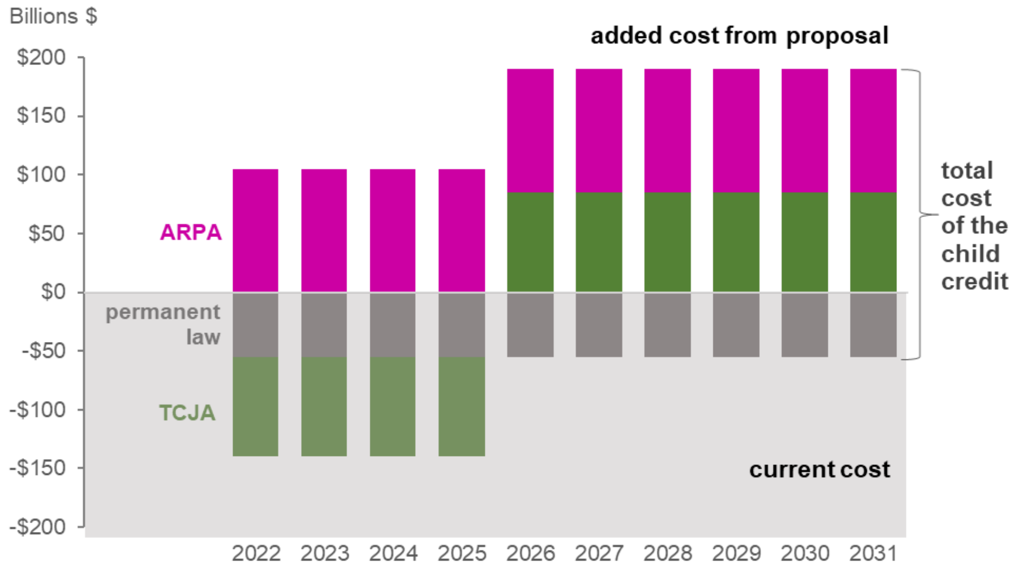
Child Credit Amount by Income and Law
Married Joint Filer with One Young Child (0-5 years old)



Source: CRS calculations based on Internal Revenue Code Section 24.
Notes: All household income is assumed to be from earned income (i.e., adjusted gross income=earned income) and taxpayers are assumed to only claim the standard deduction.

Upon the expiration of the ARPA expansion at the end of 2021, the credit has reverted back to levels under current law, as expanded by the TCJA, through the end of 2025. Beginning in 2026, the TCJA changes are scheduled to expire and the credit will revert to its permanent-law levels. In other words, if the expanded child credit in effect in 2021 were to be extended permanently, the annual budgetary cost in 2026 and beyond would appear higher than the annual cost through 2025, since the changes made by the TCJA were already assumed in the current-law baseline through 2025 (i.e., "current cost"), as illustrated in the figure below.

Estimated Cost of Child Credit with a Permanent Extension of the 2021 Expanded Credit



Source: CRS estimates based on IRS Statistics of Income data, Joint Committee on Taxation JCX 71-18 and JCX 14-21, and Congressional Budget Office letter to Senator Graham and Representative Smith dated December 10, 2021.

Notes: This is a stylized example to illustrate how expiring provisions can affect the cost of a proposed permanent extension of the expanded child credit. It does not reflect an actual budgetary score of the proposal. Notably, for this figure, fiscal years and calendar years are assumed to be the same. In reality, budgetary scores are usually calculated by fiscal year, while administrative IRS data on refundable tax credits usually reflect calendar years.

The total cost of the child credit (the pink, green, and grey bars in the figure above) ultimately reflects both the current-law baseline and any applicable changes to current law in that year.

CBO estimates making the 2021 credit permanent (including both the ARPA and TCJA changes) would cost $1.597 trillion over 10 years (FY2022-FY2031). Prior JCT estimates suggest the TCJA changes to the child credit would cost about $85 billion a year if permanently extended, while the ARPA changes could cost about $105 billion per year if permanently extended. Taken together, this means that, beginning in 2026, the cost of extending the 2021 policy would score at approximately $190 billion per year, versus $105 billion per year when TCJA is part of the current-law baseline. Hence, a shorter extension of one or two years would have a lower budgetary effect not only because it is in effect for fewer years, but because it will be in effect when the TCJA changes are part of the current-law baseline.

Other Changes to the Tax Code That Affect Child Credit Payments

If other changes to the tax code were included in a legislative package extending an expanded child credit—especially those that affect a taxpayer's income tax liability—they might directly affect child credit amounts and ultimately the projected cost of an extension. This could occur, for example, if the expanded credit extension was limited for lower-income taxpayers, which some have proposed.

Under current law, the child credit is structured so that the total amount is the sum of the credit that reduces income tax liability (the nonrefundable portion of the credit) plus the amount that is greater than income tax liability (the refundable portion of the credit). The refundable portion is limited to $1,400 per child. If a tax law change were to reduce income tax liabilities, and the refundable portion was limited in a proposed extension, the overall amount of the credit could fall for some low-income taxpayers. In other words, changes to the income tax could, in certain cases, directly affect credit amounts and hence the overall cost estimate of an extension. (The Build Back Better Act [BBBA; H.R. 5376]—which would extend the expanded credit for one additional year—*does not* limit the refundable portion of the credit.)

Policymakers could also consider other changes to tax and spending provisions, which may not directly affect the costs of the child credit extension, but could offset the cost of an overall legislative package that included an extension.

Economic and Demographic Projections

The cost estimate for any child tax credit modification will also depend on projections of future economic and demographic outcomes. Relevant economic factors to a child tax credit cost estimate include (1) the distribution of household income, as a tax filer's income determines both eligibility for the credit and amounts that may be claimed; (2) projections of future inflation, which will determine the rates at which households are pushed out of full and partial eligibility for the credit; and (3) the likelihood of future negative economic shocks, which generally tend to increase credit eligibility. Demographic projections of the number of households with qualifying children will also determine the projected cost of the credit, as the population of qualifying children will change over the course of the 10-year budget window (e.g., 9- to 17-year-olds eligible for the credit in the first year of the expansion would not be eligible by the last year of a 10-year budgetary window).

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