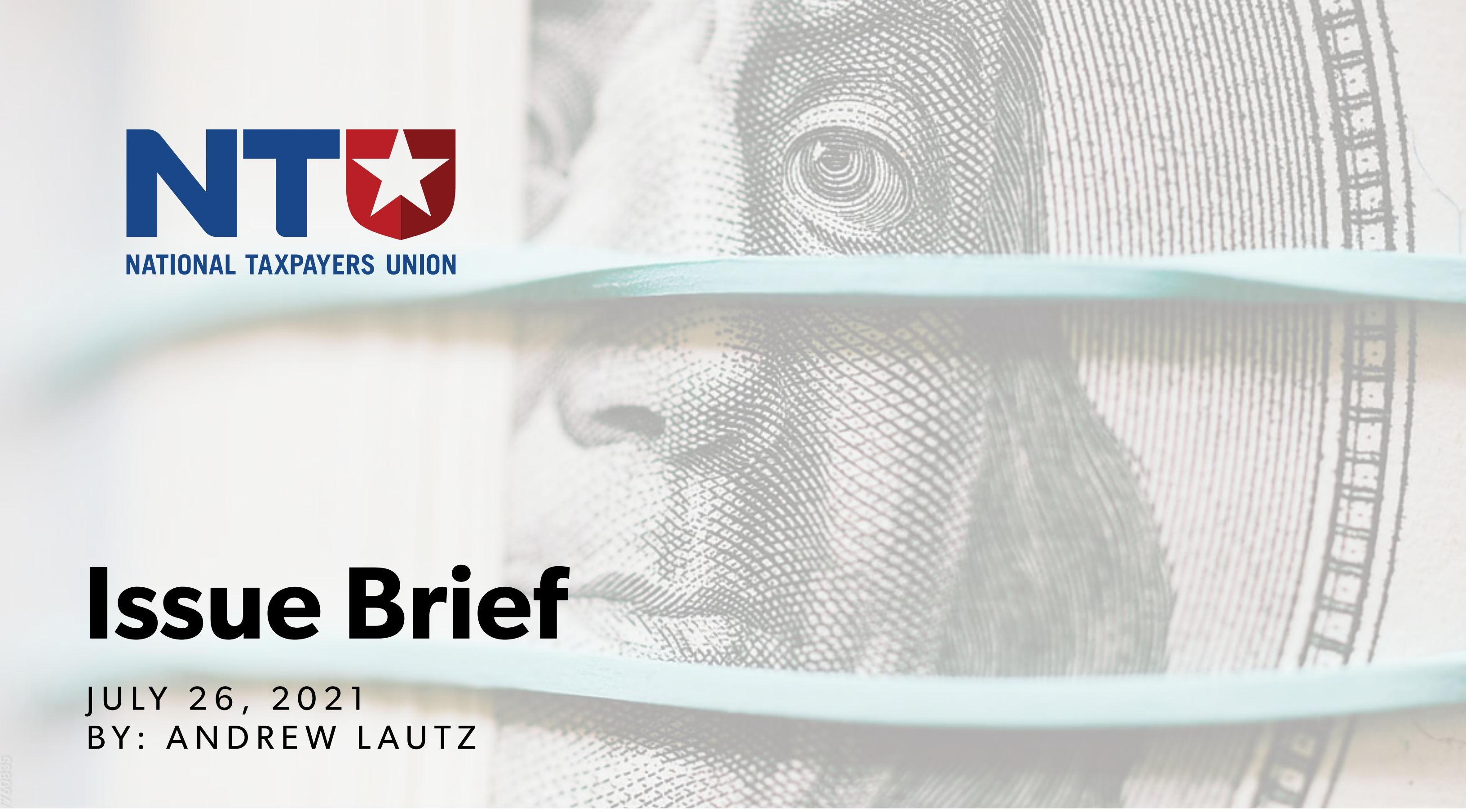

NATIONAL TAXPAYERS UNION

Issue Brief

JULY 26, 2021

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How to Make the Child Tax Credit a True Anti-Poverty Measure, While Protecting Taxpayers

With the Internal Revenue Service (IRS) beginning to send out monthly Child Tax Credit (CTC) payments to tens of millions of American families for the first time beginning in mid-July, many policymakers and public figures are discussing the potential impact of the newly expanded CTC on child poverty. As *The New York Times* put it:

> Analysts at Columbia University's Center on Poverty and Social Policy say the new benefits will cut child poverty by 45 percent, a reduction about four times greater than ever achieved in a single year.

If this occurs, then it will indeed be a remarkable achievement. The American Rescue Plan Act (ARPA) increased the CTC from $2,000 per child per year to $3,000 per child per year for 2021 only (and to $3,600 per child per year under the age of six). ARPA also made the CTC fully refundable for the first time, meaning low-income taxpayers could receive the full benefit. Additionally, as mentioned above, it instructed the IRS to make monthly payments of the CTC rather than providing it as a lump sum to parents when they file their taxes once per year. This change has already created

Key Facts:

- **The newly expanded Child Tax Credit (CTC) could have a budget impact in the hundreds of billions of dollars per year if left unchanged.**
- **Lawmakers can make the CTC a true anti-poverty measure by limiting the income thresholds at which individuals can claim CTC, while retaining full refundability.**
- **Congress should offset the CTC expansion by reforming anti-poverty programs that are ineffective or prone to fraud, and by repealing the state and local tax (SALT) deduction.**

some confusion. As a taxpayer and mother from Las Vegas put it to the *Times*: “I don’t know where all that money’s coming from.”

Unfortunately, much of the money is coming from increased debt and deficits that taxpayers will ultimately be responsible for paying back to the country’s creditors. The nonpartisan Joint Committee on Taxation estimated that the one-year expansion of CTC passed in ARPA would have a budget impact of $109 billion, on top of the $115 billion budget impact that the regular CTC had even before the ARPA expansion. (When we refer to budget impact, we distinguish between the non-refundable portion of CTC, which reduces a taxpayer’s tax bill to as low as $0, and the refundable portion of CTC, which increases federal spending because it provides a taxpayer with credits even after their tax bill has been reduced to $0). Add it up and the CTC in tax year 2021 may have a budget impact of around $225 billion. If treated as a spending program, that would make the CTC the fourth-largest program in the federal government after Medicare, Social Security, and federal payments to states for Medicaid.

President Biden and many Democratic lawmakers want to extend the expanded CTC for four years. (In this piece, we refer to the CTC ‘expansion’ based on ARPA, not based on the previous expansion under the Tax Cuts and Jobs Act.) Unsurprisingly, this is also expensive. President Biden’s own Treasury Department estimated that just four years of the ARPA version of CTC would have a budget impact of $449 billion, an average of $112 billion per year. Add that to a four-year average budget impact of the pre-ARPA CTC (around $116 billion) and this fully expanded CTC would have a budget impact of $228 billion per year, on average, over the next four years. Extrapolate that budget impact over 10 years if lawmakers make the expanded CTC permanent (a crude mathematical exercise, admittedly), and the CTC would have a budget impact of nearly $2.3 trillion over the next 10 years.

A question CTC proponents should ask themselves is: could lawmakers meet the noble goal of significantly reducing or even eliminating child poverty without significantly increasing federal spending, on net? We believe the answer is yes.

In an ideal world, lawmakers would be mindful that the original rationale for the CTC, when it was first created in 1997, was that:

> ...the individual income tax structure does not reduce tax liability by enough to reflect a family’s reduced ability to pay taxes as family size increases. In part, this is because over the last 50 years the value of the dependent personal exemption has declined in real terms by over one-third. The Committee believes that a tax credit for families with dependent children will reduce the individual income tax burden of those families, will better recognize the financial responsibilities of raising dependent children, and will promote family values.

While personal exemptions were removed by the 2017 Tax Cuts and Jobs Act (TCJA), and while the TCJA also doubled the standard deduction, the CTC in any form it takes can serve several purposes: 1) to offset long-standing erosion of traditional protections of family income from tax, as envisioned by lawmakers 25 years ago, 2) to serve as a substitute for more complex anti-poverty programs (more on that below), and 3) to serve as a flexible taxpayer benefit that can be more effectively calibrated to deficit concerns than other alternatives.

On the second point, Sen. Mitt Romney (R-UT) has offered several sensible spending offsets for an increased CTC in his Family Security Act. In addition to repealing the regressive state and local tax (SALT) deduction, Romney would make reforms to the Earned Income Tax Credit (EITC) and Supplemental Nutrition Assistance Program (SNAP), while also repealing the unwieldy and inefficient

Temporary Assistance for Needy Families (TANF) program. We echo those suggestions below, along with additional potential offsets from the Head Start program and from undisbursed education spending in the American Rescue Plan Act. Lawmakers have a difficult task before them, one that should seek to:

- Focus the CTC as an ***anti-poverty*** measure, rather than a subsidy for middle-class or upper-middle class parents;
- Make an extension of the expanded CTC ***deficit-neutral***, compared to either a pre-ARPA baseline or, even more ideally, a pre-TCJA baseline;
- Make anti-poverty programs more ***efficient*** for beneficiaries and taxpayers, by simplifying and reforming complex programs like EITC, TANF, and Head Start in favor of a monthly, lump-sum child benefit; while
- Leaving low-income households, on net, ***better off*** financially than before, with any additional necessary offsets coming from highly regressive benefits (like SALT) or cuts to wasteful spending throughout the federal budget.

This is a significant challenge, but one NTU would like to help lawmakers meet. Here are just a few ways lawmakers can pursue both a sustained reduction in child poverty and a more fiscally responsible CTC for the future:

Significantly lower the income thresholds for CTC: The federal poverty level (FPL) in 2021 is $17,420 for a two-person household (for example, a single mother and her child) and $26,500 for a four-person household (for example, a two-parent household with two children). While there is significant debate among policymakers over how the FPL is calculated and set, it makes little sense to frame the CTC as an anti-poverty measure when a single parent making $75,000 (more than 4 times the FPL for a two-person household) or a married couple making $150,000 (more than 5 times the FPL for a four-person household) can receive the full CTC benefit: $3,000 for one child six and older, for example, or $3,600 for a child under six, or $6,000 for two children over six. It made even less sense that, before ARPA, a single parent making $175,000 (10 times the FPL for a two-person household) or a married couple making $350,000 (13 times the FPL for a four-person household) could receive a full $2,000 CTC benefit per child.

Lawmakers should lower the income thresholds for CTC to make it a true anti-poverty measure. Doing so would likely reduce tax liabilities to zero for most if not all households in the bottom 20 percent of income earners in the country, and in so doing primarily guard low-income households against the regressivity of the payroll tax. The size of the new CTC would also make a significant portion of the benefit refundable for many low-income households, which would increase federal spending relative to a *pre-ARPA* baseline, but below we propose several offsets to ensure such a proposal would ultimately be deficit-neutral (or would even reduce deficits).

As for designing new income thresholds, there are countless ways to do so, but one possible model is as follows:

- The full CTC benefit ($3,000 per child, $3,600 per child under age six) begins to phase out for single filers making more than $25,000 (1.43 times the FPL for a two-person household) and for joint filers making more than $50,000 (1.89 times the FPL for a four-person household).
- The benefit is reduced by $50 per $1,000 earned by single filers (and $2,000 earned by joint filers) above those thresholds, through $50,000 and $100,000 for single and joint filers, respectively. After that, the benefit is reduced by $70 per $1,000 earned by single filers and per $2,000 earned by joint

filers, until the $75,000 and $150,000 thresholds for single and joint filers, respectively. Finally, the benefit is reduced by $100 per $1,000 earned for single filers (and $2,000 earned by joint filers) until the benefit reaches $0.

- Under the above scenarios, the benefit for a single parent with one child six or older would begin to phase out at $25,000 and would completely phase out at $75,000. The benefit for married parents with one child six or older would begin to phase out at $50,000 and would completely phase out at $150,000.
- The benefit for a single parent with *two* children six or older would begin to phase out at $25,000 and would completely phase out at $113,000, while the benefit for married parents with two children six or older would begin to phase out at $50,000 and would completely phase out at $226,000.
- The benefit for a single parent with two children *younger than six* would begin to phase out at $25,000 and would completely phase out at $125,000, while the benefit for married parents with two children younger than six would begin to phase out at $50,000 and would completely phase out at $250,000.

This has the potential to significantly reduce the budget impact of the current CTC benefit. The nonpartisan Congressional Research Service (CRS) estimated that in 2020 (before the ARPA expansion) nearly 40 percent of CTC dollars (or around $45 billion) went to households making more than $100,000 per year. This compares to just 31 percent of CTC dollars (or around $36 billion) going to households making $50,000 per year or less.

Of course, the proposed thresholds and phase-outs mentioned above come with a trade-off: a likely increase in filing complexity, as taxpayers and the Internal Revenue Service (IRS) seek to figure out (and even predict ahead of time) just how much a taxpayer will receive in CTC benefits for a given year. A slow phase-out like the one proposed above increases complexity but reduces the chance for "cliffs" that expose taxpayers to significant marginal tax increases and distort taxpayer decision-making. Quicker phase-outs would be less complex to calculate and administer, but would also subject taxpayers to the aforementioned cliffs. On the whole, we believe taxpayers are better served by a slower phase-out, but Congress could explore an overpayment safe harbor similar to the one enacted by ARPA. Congress could also harmonize the safe harbor thresholds with the phase-out thresholds, whereas under ARPA they are currently misaligned.

Curtailing the benefit for six-figure households presents an opportunity to make the CTC more fiscally responsible for taxpayers while maintaining the newly expanded CTC's character as a child poverty reduction measure.

Keep the refundability and regular payments: Two features of the expanded CTC have inspired much debate in policy circles, beyond just the increased amounts: 1) full refundability, meaning individuals with little or no tax liability can collect the full $3,000 (or $3,600) per-child benefit rather than a partial benefit under previous law; and 2) the monthly payments of CTC ($250 per month for a child six or older and $300 per month for a child younger than six), whereas under prior law the CTC was a lump-sum benefit provided when a parent (or parents) filed their taxes.

Some conservative lawmakers have opposed the refundability and/or monthly payment structure in the new CTC, while some conservative lawmakers have leaned toward supporting the effort. The central tenets of the opposition, though -- that a monthly and/or refundable CTC will discourage parents from working -- should be put into context.

First, research that the Niskanen Center's Samuel Hammond has analyzed suggests that the CTC can actually *encourage* work rather than discouraging it. Hammond notes that a CTC "phase-in range," where the value of the CTC increases when a parent has additional earnings can, up to a point, encourage work. But he also notes an "alternative possibility" due to the unique challenges that parents in poverty face:

> An alternative possibility, however, is that the income effect of the CTC is actually positive at low levels of household earnings. This could arise given the severe liquidity and credit constraints facing very poor families, as illustrated by their greater reliance on "payday loans" and other expensive short-term lending options. A small amount of unconditional income support could thus relax those constraints, allowing a single mom to, for example, hire a babysitter while handing out resumes.

And the Tax Foundation estimates infinitesimal economic impacts from making the CTC fully refundable, at the rate of less than five one-hundredths of a percentage point decline in GDP and the wage rate. (Two notes: 1) this is based on making the $2,000 CTC benefit fully refundable, not the $3,000 or $3,600 benefit; 2) it is unclear based on the analysis if the declines in GDP and wage rate are tied to fewer people working than to some households seeing "slight increases in their marginal tax rates due to the eliminated phase-in and the longer phaseout.")

Policymakers could be fairly confident that the reductions in CTC spending from lowering the income thresholds as specified above would significantly outstrip the cost to taxpayers of making refundability and monthly payments permanent, but in any case NTU offers a bank of offsets for permanently extending aspects of the expanded CTC below.

Making the benefit monthly also better aligns the CTC with *actual* child care costs incurred by parents. As any parent knows, most essential costs associated with their child(ren) -- health care, food, babysitters, day care -- aren't assessed once per year but on a regular basis. It makes little sense, then, for the lump-sum CTC to act as a (potentially surprising) windfall to low-income parents at tax filing time. Some policymakers have expressed concern about the government providing the CTC as a monthly benefit rather than an annual windfall, but research has demonstrated that payments designated for children are more likely to be spent *on children* than "benefits not designated for children." Monthly payments also make it easier to distinguish the CTC from a score of other tax credits or deductions a taxpayer might receive during their annual filing.

Pay for the expansion with reductions to wasteful spending and/or regressive benefits: Compared to the tax year 2021 baseline for CTC, limiting payments for six-figure households while retaining the $3,000 per child per year, refundable, distributed monthly ARPA benefit, as specified above, could reduce the net budget impact of CTC by tens of billions of dollars. The picture is murkier for a tax year 2022 baseline when, absent further action by Congress, the CTC would go back to a $2,000 per child benefit. Would limiting income thresholds be enough to offset the increased costs of both refundability and of increasing the benefit from $2,000 per child to $3,000 or even $3,600 per child? Absent a formal cost estimate, the answer is unclear.

However, in addition to lowering the income thresholds, we wish to offer a number of potential offsets lawmakers could turn to later this year if they would like to make an expanded, refundable, and monthly CTC permanent:

- **Repeal the state and local tax (SALT) deduction, as proposed in Sen. Mitt Romney's (R-UT) Family Security Act**: The SALT deduction is highly regressive, and as noted by CRS nearly

89 percent of the current benefit goes to six-figure households. Before the Tax Cuts and Jobs Act capped SALT deductions at $10,000, the benefit was even more regressive, with 93 percent of the benefit going to six-figure households and 71 percent of the benefit going to households making more than $200,000 per year. Repealing the SALT deduction would generate tens of billions of dollars in additional revenue per year, and likely hundreds of billions over a ten-year window, even if one assumes lawmakers extend the $10,000 SALT cap rather than allowing the cap to expire in 2026. Sen. Romney estimates the "annual savings" from eliminating SALT at around $25 billion per year. If lawmakers allow the cap to expire, then for budget scoring purposes the savings from repealing SALT will be even greater.

- **Explore changes and reforms to the Earned Income Tax Credit (EITC)**: Sen. Romney has also proposed EITC reforms that, based on the Senator's estimate, would reduce the annual budget impact on the EITC by about $45 billion per year and would reduce improper payments in the program. The EITC is a notoriously buggy program that the IRS has struggled to administer properly. Nearly 10 percent of *all* improper payments made across the federal government in fiscal year 2019 were under EITC, a total of $17.4 billion, according to the Government Accountability Office (GAO). GAO also found in April of this year that the Treasury Department lacks "timely data on the true root causes of EITC improper payments." Sen. Romney proposes simplifying the benefit, eliminating marriage penalties, and slowing benefit cliffs. Low-income families would still, on net, be better off than they were prior to the ARPA expansion of CTC and EITC.
- **Explore eliminating the Temporary Assistance for Needy Families (TANF) program**: Another Romney proposal is to eliminate TANF, with savings of $16.5 billion per year that (again) still leave low-income families better off, on net, than before the ARPA expansion of CTC. Even the left-leaning Center for American Progress has panned TANF, noting it "does little to mitigate poverty and hardship."
- **Explore spending reductions to other inefficient, duplicative, or overlapping programs**: As a way to pay for CTC expansion, lawmakers could explore additional anti-poverty programs that may have similar or overlapping missions as CTC but have been ineffective or even counterproductive to broader anti-poverty efforts in the U.S. One such example is Head Start, a decades-old program of mixed efficacy that -- under current policy -- the Congressional Budget Office (CBO) has said overlaps with some state universal preschool programs. Eliminating Head Start, according to CBO, would reduce spending by $95 billion over the next decade, while "[m]ost of the children currently enrolled in Head Start in such states would instead be enrolled in the state-sponsored program." To achieve similar spending reductions, lawmakers could also claw back $110 billion in COVID relief funding for schools that is not supposed to be spent until after September 2022, hopefully well after the COVID-19 public health emergency is over.
- **Cut spending elsewhere**: NTU, NTU Foundation, and peer organizations have offered hundreds of billions of dollars in potential cuts to mandatory and discretionary spending through initiatives like "Toward Common Ground" (a partnership with U.S. Public Interest Research Group (U.S. PIRG) Education Fund identifying $800 billion in 10-year deficit reduction options) and our "Budget Control Act of 2021" paper ($3.6 trillion in 10-year deficit reduction options, which includes the $800 billion identified by Toward Common Ground). While NTU prefers that these spending cuts go toward deficit reduction, they could also serve as a way to fully offset the budget impact of a newly expanded CTC.

Conclusion

Proponents of the newly expanded CTC have focused on the CTC's promise for cutting child poverty in 2021. They have also used those promising possibilities to advocate for a four-year extension of the credit. If lawmakers truly want to make the CTC an anti-poverty measure, though, they can significantly narrow its scope by focusing on low- and middle-income parents, rather than six-figure households. And they can fully pay for the CTC by cutting wasteful spending elsewhere in government, and/or by eliminating regressive tax benefits like SALT that almost exclusively go to the wealthy.

About the Author

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