Jain Family Institute

January 18, 2024

Bipartisan Child Tax Credit Expansion: Analysis of the Tax Relief for American Families and Workers Act of 2024

By Jack Landry

Contents

Summary

Congressional tax negotiators have announced an agreement to expand the Child Tax Credit (CTC). The proposed reform falls far short of the temporary CTC expansion in 2021—it does little to increase the size of the credit or remove harmful work requirements. However, the proposal significantly increases benefits for low-income families currently eligible for a partial CTC. This group represents the vast majority of low-income families who benefited from the temporary 2021 expansion.

The proposal would make two important reforms to the current credit's design. Under current law, many low-income families receive the same benefit regardless of how many children they have, while middle and high-income families receive a larger benefit if they have more children. The proposal would end this disparate treatment, often doubling and tripling benefits to low-income families with multiple children. Second, the agreement allows families to choose between their current or prior year's income as the basis for their CTC, which will greatly benefit low-income families who often have significant year-to-year variation in earnings.

Both changes will primarily target low-income families who currently receive a partial credit. However, by rejecting full refundability (i.e. making all low-income families eligible for the full credit, including those out of the paid labor force), the proposed reforms are far less inclusive than the temporary 2021 expansion, which some critics argue makes it ineffective at reaching most low-income children. Such criticism assumes that most low-income families have no earnings and would therefore receive no benefit under the proposed bill, which maintains a work requirement. **However, IRS data shows that the vast majority of low-income recipients of the 2021 expansion had some positive income, but not enough to receive the full credit under current law. I estimate 90 percent of these parents would see an increase in their benefits under the proposed expansion.** While families with no income—and therefore the greatest need—are largely excluded from the proposal, the reforms would still reach the vast majority of low-income children who benefited from the 2021 expansion.

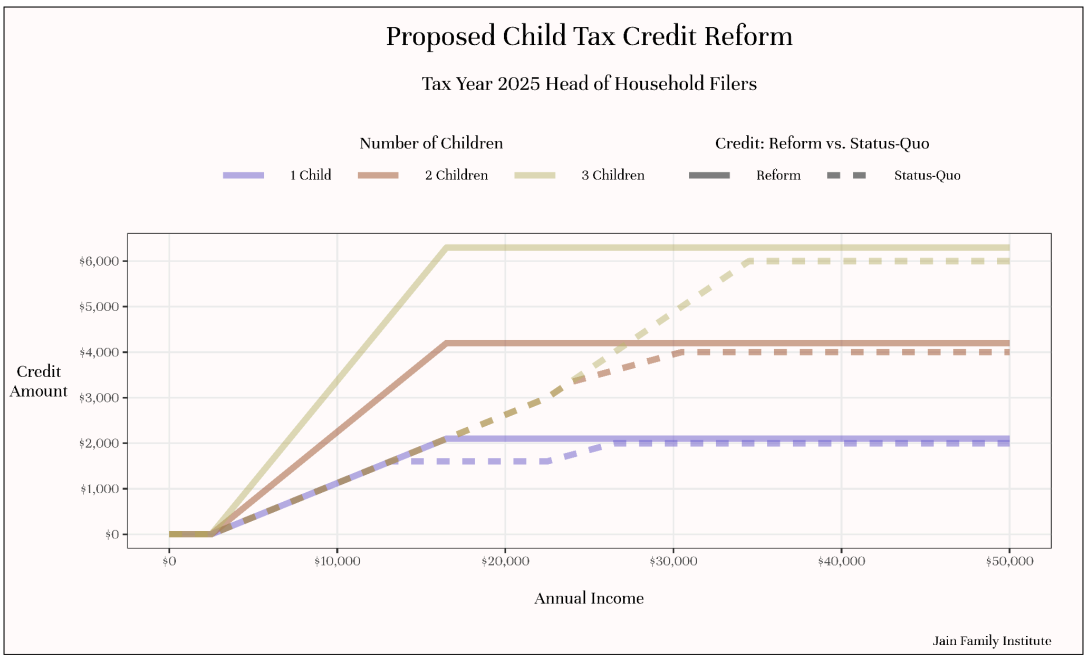
Key Takeaways

- The proposed reforms target benefits to low-income families. I estimate the largest increases in benefits will go to families with incomes between $10,000 and $15,000 per year.
- The agreement excludes families with no income, but that group represents only 4 percent of the families with incomes below $40,000 who benefited from the 2021 expansion. The bulk of low-income families claiming the 2021 credit had some earned income and would stand to benefit from the new proposal.

Key Reform 1: Equalizing Amount of Credit Per Child For Low-Income Families

Figure 1 below shows how the proposed CTC reforms would change the benefit for single parent families (head of household filers with different numbers of children at different income levels.[1] Under the status quo, many low-income families at a given income level receive the same credit regardless of how many children they have—the credit depends solely on income. At higher income levels, larger families get a larger credit: families with incomes above $40,000 receive the full $2,000 per child.[2]

Figure 1:



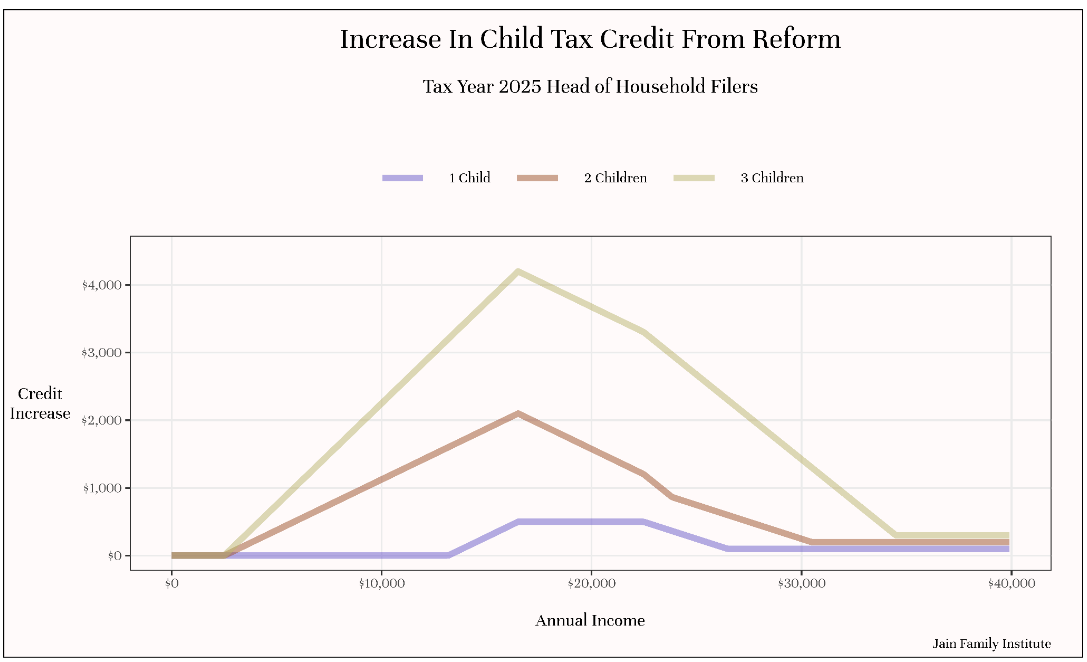
While the proposed benefit is still linked to income, it gives lower-income families a larger credit if they have more children, in the same way it does for higher-income families.[3] This results in large benefit increases for very low-income families. A filer with two children and an income between

[1] Under terms of the deal, the reform becomes somewhat more generous over time (terminating after tax year 2025), but the key provisions are the same. The reforms are also very similar for married filers. Detailed charts of the change in benefit by income level in other years and for both married and head of household filers are available in the appendix.
[2] Families with more than three children need more than $40,000 to qualify for a $2,000 credit per child.
[3] In addition to the per-child phase in, the reform uncaps the refundable portion of the credit, effectively further speeding the phase in.

$2,500 and about $16,000 would see their benefit double; families with three children in that income range would see their credit triple; four children quadruple, and so on.

Figure 2 plots the increase in the credit relative to the status quo to better demonstrate how the proposed reforms increase benefits by income level. The increase in benefits for families with multiple children is the largest for those with an income of $16,000. Above this point, the increase in benefits declines as families with more children reach a high enough income to begin to qualify for more credit than families with just one child under the status quo. Among families with one child, the modest increase in benefits accrues to families with around $20,000 of income. Moreover, I estimate that 75 percent of children who do not receive the full $2,000 credit under current law are in families with more than one child. While mostly excluding the lowest-income families by forgoing full refundability, the proposed expansion targets its benefit increases toward families with very low incomes.

Figure 2:



Importantly, further alterations to the bill could do more for the lowest income families while maintaining the proposal's basic framework. The phase-in could start from the first dollar of income rather than starting at $2,500, and phase in faster than $.15 cents per child. For instance, a recent proposal from a trio of Republican Senators called for a phase-in of $.20 cents per child starting from the first dollar of earnings.

Key Reform 2: Calculating Credit With Current Year or Previous Year Income

The second key reform enables families to choose between their current year's or prior year's income when calculating their child tax credit, often referred to as an income "lookback." If the prior year's income is larger than a family's current income, it can be used to claim a larger credit.

This provision offers important security to households across the income spectrum. Under the status quo, if a family member loses a job, they may see a reduction in their child tax credit *in addition to* their loss of employment income. Rather than serving as a safety net in times of crisis, the credit's structure pulls back support when families need it most. The proposed reform takes an important step towards correcting that dynamic, providing continued support even with a drop in income.

Applied at scale, the lookback provision can also serve as an important tool of countercyclical spending to combat future recessions. When many people lose their incomes at once, the status quo CTC benefits will also decrease, compounding the aggregate shock. The lookback provision prevents large-scale unemployment from leading to an immediate large-scale decrease in CTC generosity.

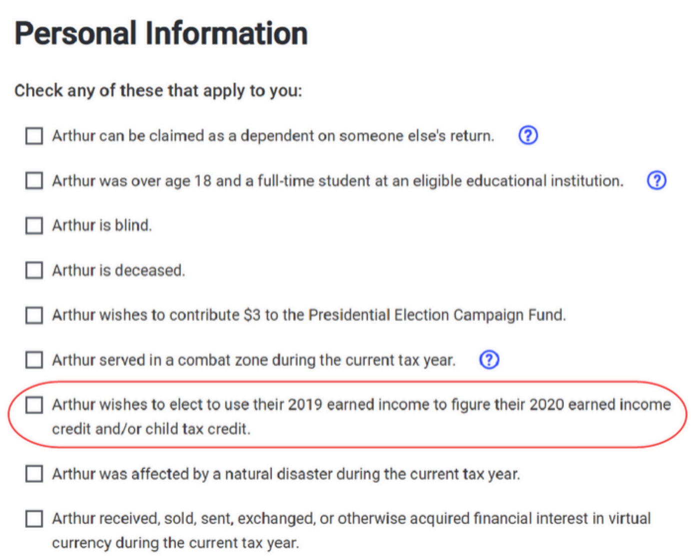
While acting as a safety net for middle- and high-income households and countercyclical spending at the macroeconomic level, the lookback will serve as a more routine way of increasing benefits for lower-income families. Under current law, if a family's income drops from $100,000 to $95,000 they will get the full CTC. In contrast, a lower-income family whose income drops from $20,000 to $15,000 could see their CTC drop by over $1,000. The lookback provision addresses this disparity, so that the lower-income family would not experience this drop in benefits.

One more factor compounds the lookback provision's benefit for low-income families. "Standard" year-to-year income variation is much greater for lower-income families than the comparably stable salaried jobs in the middle class. Many low-wage jobs are designed for extremely high rates of turnover, and lower-income families are less likely to have protected parental or sick leave. This results in far greater year-to-year income variation for lower income families relative to their higher-income counterparts.

Important Reforms For The Administration of Income Lookback Provision

While the income lookback provision can increase access for low-income families, the provision may face significant barriers to implementation. For example, a filer will need a record of their earned income from two years prior; those lacking this record may skip this option as the path of least resistance to completing their return and claiming at least some credit.[4]

Even filers who know their previous year's income may not understand that this option would increase their benefit. The figure below shows how one tax preparation software company presented the lookback option when it was last implemented for tax year 2020. Using your 2019 earned income rather than 2020 is one selection on a long list of other "personal information" options, many of which are unlikely to be applicable to the vast majority of filers. These include filling out a return for someone who is deceased, blind, or served in the military in a combat zone, and it is likely that filers will skip over the section entirely. Moreover, the prompt gives no indication as to why someone might want to use their prior year's income to claim the credit.



[4] Getting this information online from the IRS requires the use of the id.me identification verification service, which is notorious for usability problems and lax data privacy protections. That said, the IRS uses a filer's prior years' adjusted gross income as a means of identity verification for self-preparing e-filers, so many individuals will need to get their last year's return information to complete their return regardless of whether they want to claim the lookback provision. This speaks to the burdens inherent to the current system of filing a return and administering important social benefits through the tax system.

While families may not know their earned income from prior years and may be confused about how the lookback provision could benefit them, the IRS has no such burden. The IRS knows a family's prior year income from prior returns and can calculate if they would qualify for an increased benefit based on that income. With this information, the IRS should be able to automatically correct returns that mistakenly do not use the lookback provision and issue larger credits the same way the agency corrects mathematical errors on other parts of a return. There is no downside to this automatic correction: the prior year's income is only used to calculate the CTC and does not impact the rest of a family's tax return.

The recently released bill text explicitly expands the IRS's math error authority to correct lookback claims. However, the language is specific to those who elected to use the lookback provision but imputed the wrong income, failing to help filers who mistakenly did not elect to use the lookback at all—a far more likely and impactful error.[5] The bill's text should be corrected to further broaden the IRS's math error authority so that filers who stand to benefit from the lookback but did not claim it nonetheless automatically receive an increased credit.

Comparing the Reform Who Benefited From The 2021 Temporary CTC Expansion

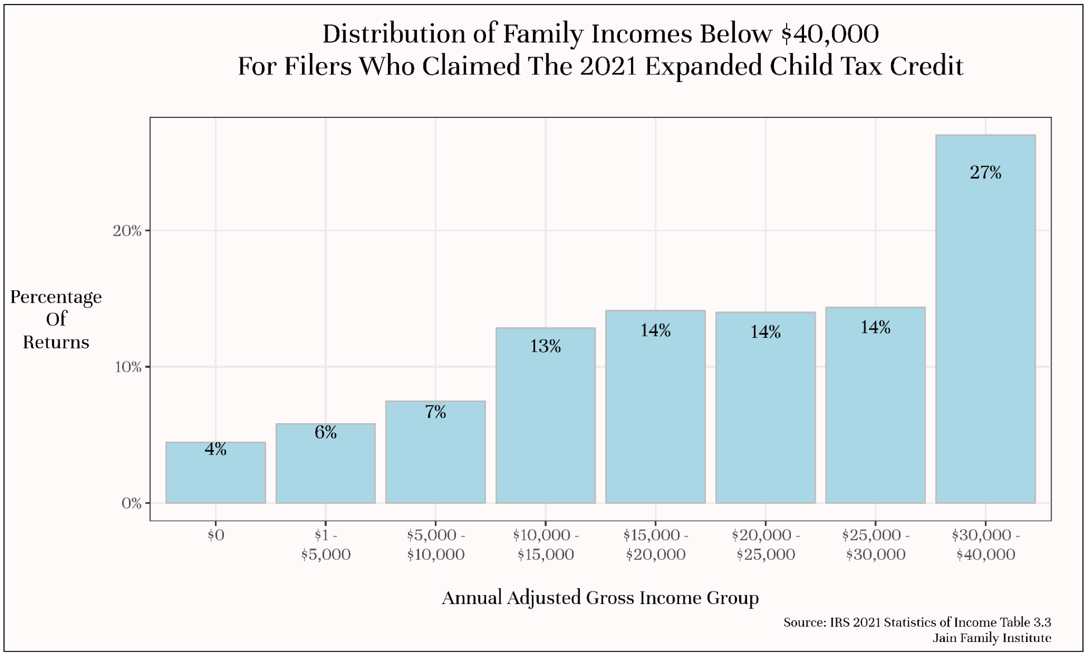
These two key provisions of the proposal increase CTC benefits for low-income families. However, the credit excludes most families with no income by forgoing full refundability. This major omission neglects the lowest-income families with the highest needs. To evaluate the weight of this omission to the overall deal, we must consider: how many families are excluded? And how do they compare to the low-income families that the benefit does reach?

The best way to evaluate this question is to use IRS data on the incomes of families that claimed the 2021 expanded credit.[6] The graph below displays the percentage of filers who claimed the 2021 CTC with an income of $40,000 or less in particular income categories broken down into $5,000 increments.[7] Among families who claimed the credit with an income of $40,000 or less,

[5] The key section states: "(W) in the case of a taxpayer electing the 4 application of section 24(h)(6)(B) for any taxable year [refers to lookback provision], an entry on a return of earned income pursuant to such section which is inconsistent with the amount of such earned income determined by the Secretary for the preceding taxable year."
[6] This data comes from the 2021 Statistics of Income Table 3.3, which tabulates how many tax returns claimed the 2021 Child Tax Credit on their end of year return at each income level.
[7] In the appendix, I show the percentage of filers in each income band across the full income distribution.

four percent of claims were of families with no income. In contrast, families with incomes between $10,000 and $25,000 who stand the most to benefit from the new agreement represent over a third of claims of the 2021 expansion for families with incomes below $40,000.

Figure 3:



This data should not be read to diminish the importance of providing sorely needed poverty relief to the children of families without income. But it does help us see how the proposed compromise—while less ambitious than many advocates hoped—will provide relief to the large majority of low-income families who previously benefited from the temporary expansion in 2021. Combining the IRS data with a microsimulation model of the benefits for families at different income levels, I estimate that in 2025, 90 percent of children who do not receive the full $2,000 credit under current law would benefit from this proposal.[8] This estimate is notably larger than others, likely because I rely on the IRS data on claims of the 2021 credit to compute the number of children who would benefit rather than survey data, rather than survey data which tends assume complete take-up by all eligible families.[9]

[8] The exact income required to receive the full $2,000 credit under current law varies by marital status and the number of children eligible.
[9] In other analysis, I dive into the discrepancy between survey and IRS data in more detail. There are other explanations besides incomplete take-up for the discrepancy between IRS returns and survey data.

Conclusion

The Child Tax Credit expansion in the Working Families Tax Relief Act takes important steps towards a more generous and inclusive safety net for low-income families. Despite maintaining harmful work requirements, the proposed reforms manage to substantially increase benefits for low-income families who are currently excluded from the full $2,000 per child credit given to middle- and high-income families.

The legislation calls for phasing in the credit on a per-child basis, ensuring that low-income families receive a benefit that accounts for the added costs of raising additional children rather than providing the same credit to families at a given income level with different numbers of children. The proposal also allows families to use their prior years' income in order to receive a larger benefit. This provision helps the credit serve as a safety net for low-income families more likely to face income instability, instead of withdrawing support when families need it most.

Although the proposed reforms are targeted almost exclusively toward low-income families, by failing to make the credit fully refundable, the proposal rejects the best and most inclusive way of ensuring benefits for all low-income families. This omission limits the benefits for the lowest-income families most in need. Analysis of the temporary 2021 CTC expansion, however, shows that most low-income families who claimed the fully refundable credit had some positive income. While full refundability is the best system, an expansion without it can still benefit the vast majority of low-income families. IRS data shows that 96 percent of families who claimed the 2021 expanded credit with an income of $40,000 or less had some income. Overall, I estimate that in 2025, the proposal would benefit 90 percent of families with children who do not receive the full $2,000 credit under current law.

Appendix

Methodological Notes

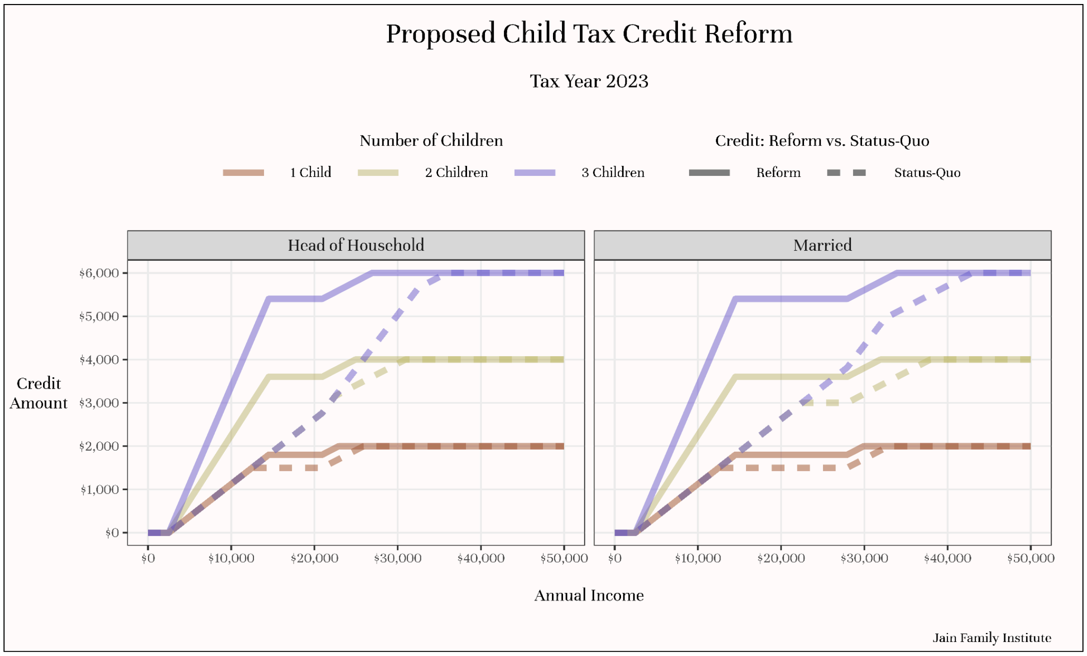
My general approach to model the reform relies on the Census Bureau's 2023 and 2022 Current Population Survey, IRS Statistics of Income Data, and the Tax Calculator open-source microsimulation model, details of which are explained in prior reports.

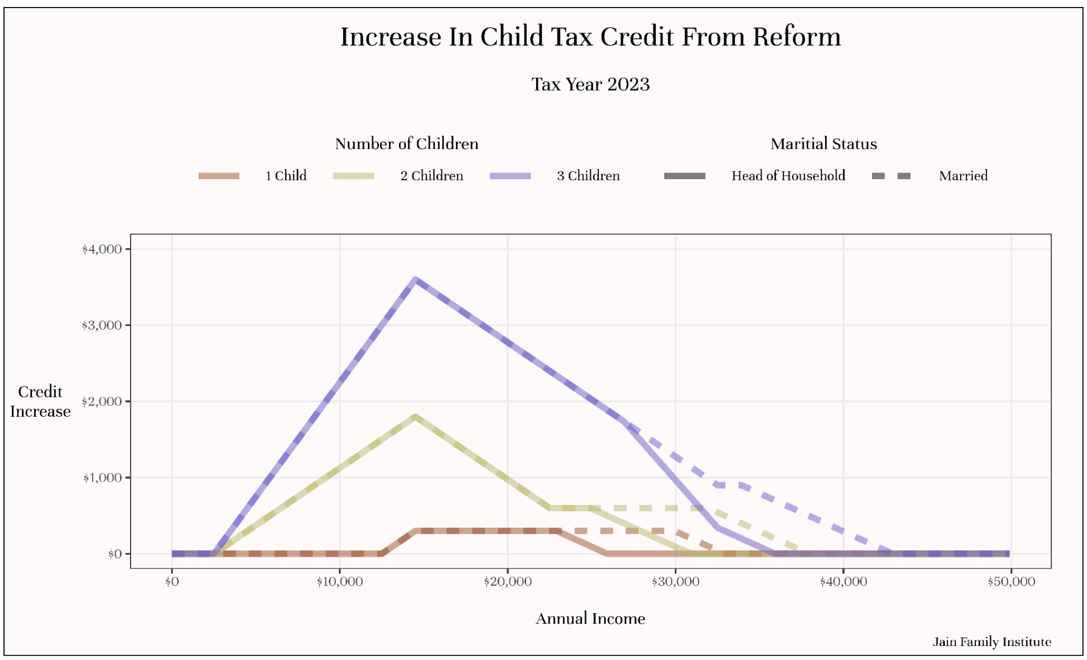
One unique challenge for this analysis concerns modeling the lookback provision, which involves two years of data instead of one. The Current Population Survey interviews some households one year apart, and their responses can be linked together to compute the benefits of the provision. However, households will only be interviewed twice if they live in the same place both years. Low-income families who move more frequently will be less represented. Moreover, some responses to the income questions are imputed based on a statistical model. This works well for analysis of any given year, but research shows it greatly overstates income instability over time. Linking households over time without addressing these issues will lead to inaccurate results.

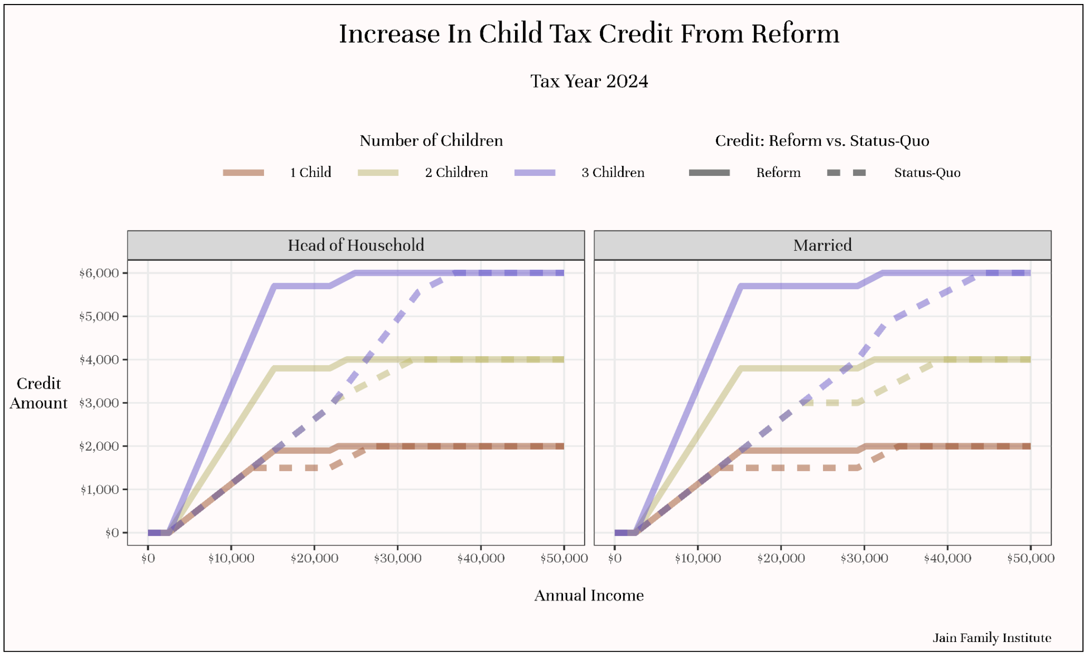
To address these challenges, I drop households from the analysis with any imputed income observations or those that do not respond to the survey in two consecutive years. To address the selection bias this sample selection imposes, I estimate a rich model predicting which households will not be linked in my criteria. I use the predictions from this model to re-weight the linked data, up-weighting households whose demographic characteristics predict they are more likely to be dropped, a process called Inverse Probability Weighting. This ensures that estimates of poverty and the number of children in various categories using the linked sample are very similar to estimates using the full sample. Academic research finds that after using this method, estimated income instability from the Current Population Survey matches estimates from administrative data.

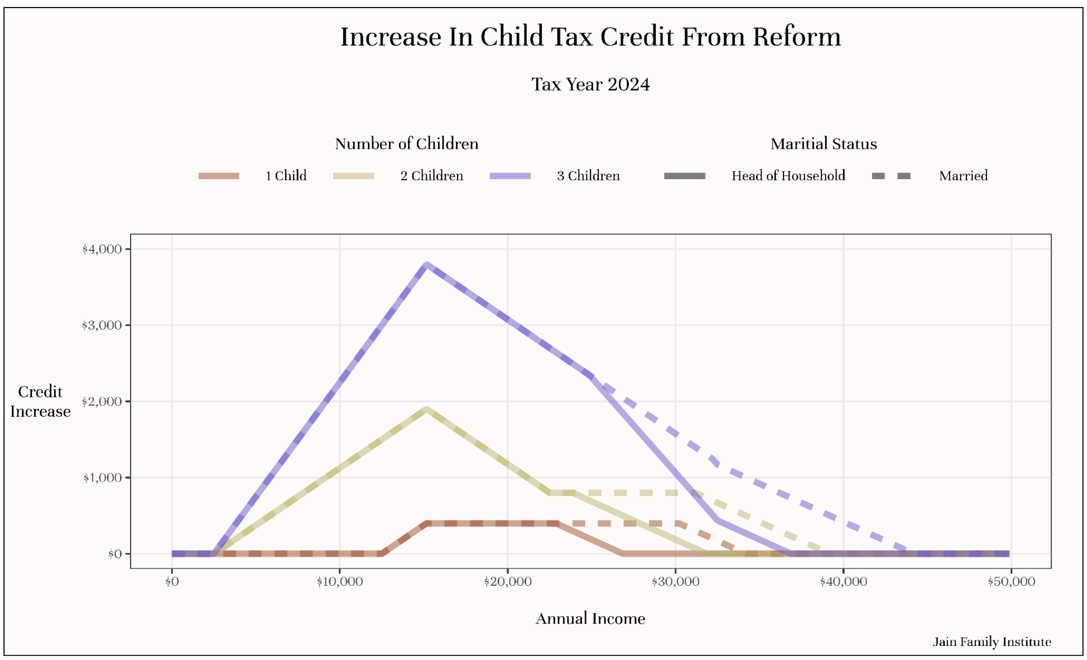
While I use the latest available survey data to estimate eligibility for various reforms, the 2021 and 2022 periods may understate the lookback provision's impact relative to other years. This period featured a rapid economic recovery from the COVID-19-related recession, where many families were likely to have significantly lower incomes than in 2022. Using earlier years of data may be more representative of the effect of the lookback during more typical year-to-year variation in economic conditions but may be less representative of more future effects because it's more dated.

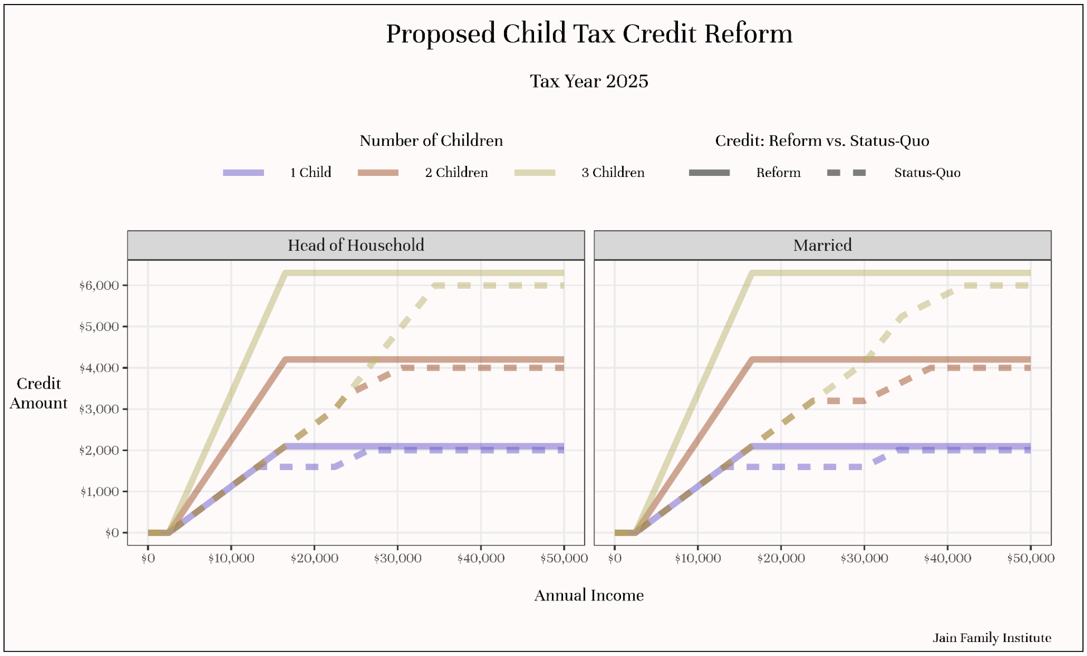
Additional Figures

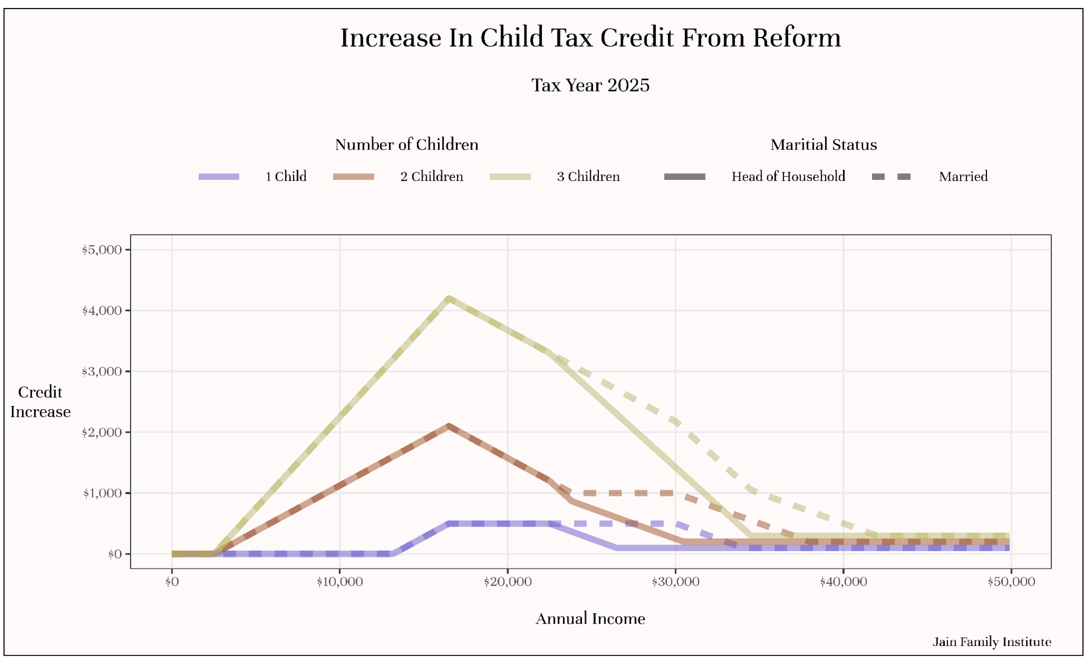


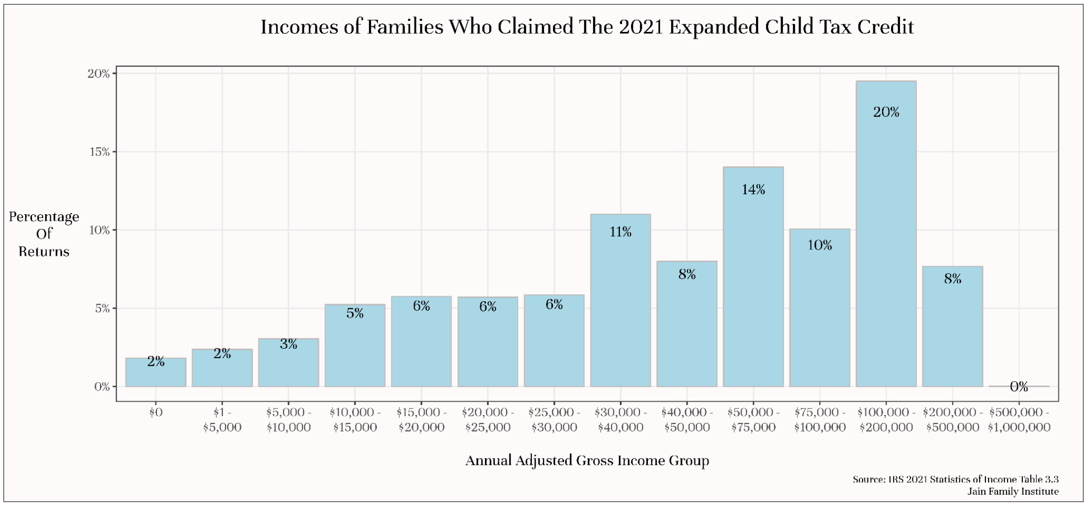



Increase In Child Tax Credit From Reform
Tax Year 2024
Number of Children
1 Child
2 Children
3 Children
Credit: Reform vs. Status-Quo
Reform
Status-Quo
Head of Household
Married
Credit Amount
$0
$1,000
$2,000
$3,000
$4,000
$5,000
$6,000
$10,000
$20,000
$30,000
$40,000
$50,000
Annual Income
Jain Family Institute


Increase In Child Tax Credit From Reform
Tax Year 2024
Number of Children
1 Child
2 Children
3 Children
Maritial Status
Head of Household
Married
Credit Increase
$0
$1,000
$2,000
$3,000
$4,000
$10,000
$20,000
$30,000
$40,000
$50,000
Annual Income
Jain Family Institute


Proposed Child Tax Credit Reform
Tax Year 2025
Number of Children
1 Child
2 Children
3 Children
Credit: Reform vs. Status-Quo
Reform
Status-Quo
Head of Household
Married
Credit Amount
$6,000
$5,000
$4,000
$3,000
$2,000
$1,000
$0
$10,000
$20,000
$30,000
$40,000
$50,000
Annual Income
Jain Family Institute


Increase In Child Tax Credit From Reform
Tax Year 2025
Number of Children
1 Child
2 Children
3 Children
Maritial Status
Head of Household
Married
Credit Increase
$5,000
$4,000
$3,000
$2,000
$1,000
$0
$10,000
$20,000
$30,000
$40,000
$50,000
Annual Income
Jain Family Institute


Incomes of Families Who Claimed The 2021 Expanded Child Tax Credit
Percentage Of Returns
20%
15%
10%
5%
0%
2%
2%
3%
5%
6%
6%
6%
11%
8%
14%
10%
20%
8%
0%
$0
$1 - $5,000
$5,000 - $10,000
$10,000 - $15,000
$15,000 - $20,000
$20,000 - $25,000
$25,000 - $30,000
$30,000 - $40,000
$40,000 - $50,000
$50,000 - $75,000
$75,000 - $100,000
$100,000 - $200,000
$200,000 - $500,000
$500,000 - $1,000,000
Annual Adjusted Gross Income Group
Source: IRS 2021 Statistics of Income Table 3.3
Jain Family Institute