The Tax Liability Red Herring: Defending Child Tax Credit Reforms

By Jack Landry

Summary

The "Tax Relief for American Families and Workers Act" currently under consideration in Congress makes modest improvements to the Child Tax Credit (CTC) that benefit low-income families. Under status-quo law, parents with low or no earnings do not receive the full $2,000-per-child credit that families with middle or high incomes receive. The legislation partially remedies this perverse structure. Specifically, it increases benefits for low-income parents who are not eligible for the full $2,000 credit while maintaining work requirements as a concession to Republican demands. This compromise ensured broad support in the House of Representatives, with over three-quarters of both Democrat and Republican members voting in favor.

Now Republicans in the Senate have voiced a new objection: that the improvements to the Child Tax Credit benefit families who do not pay income taxes. Ranking Republican member of the Senate Finance Committee Mike Crapo said that, "more than 90 percent of the bill's CTC benefits accrue to taxpayers who will not owe a single dollar of federal income tax," and represent a shift "to transform the CTC from primarily working family tax relief into a government subsidy." Reports from the Heritage Foundation and the American Enterprise Institute echo this complaint, likening CTC beneficiaries who pay no taxes to recipients of cash welfare.[1]

Objecting to the CTC reforms because they benefit families who do not pay federal income taxes is effectively an objection to providing benefits to low-income working families. **On average, a family with children will not have federal income tax liability until they earn over $60,000. If changes to the CTC must go to families who owe federal income taxes, it would prevent most low-income working families from benefiting.**

Key Takeaways

- Parents will not owe federal income taxes until they earn over $43,000—in most cases, far higher amounts. Insisting CTC improvements go to families who have federal tax liability would ensure benefits do not reach most low-income families.

- Senator Crapo has suggested that the CTC provisions go more to the working poor rather than families without tax liability, but I estimate 98 percent of children living in poverty have parents who do not owe federal income taxes.

- While most of the CTC changes benefit low-income families, the business tax provisions also included in the legislation benefit more middle-income families. According to the Urban-Brookings Tax Policy Center's modeling, the legislation as a whole provides more benefits to the 20–80th income percentiles than the 0–20th percentile.

[1] I address other objections about work disincentives and the lookback provision in a separate report.

Tax Liability and the Working Poor

Bipartisan support for important features of the U.S. federal income tax system ensure that low-income families do not have tax liability. The standard deduction for single parents in tax year 2023 is $20,800. For married parents, the deduction is $27,700. This means that families can deduct the first $20,000+ of earnings they make from their tax bill, while families that make less than this amount do not owe any income taxes. The deduction was doubled as part of the Tax Cuts and Jobs Act passed during the Trump administration.

Beyond the standard deduction, the Earned Income Tax Credit (EITC) and the Child Tax Credit provide further support to low-income families by offsetting income taxes (and the payroll tax) until higher income levels. These two credits have a long bipartisan history of support and expansion. **When accounting for the combined impact of the standard deduction, the CTC, and the EITC, families will not owe any federal income taxes until they earn at least $43,000 of income.** On average, a family with children will not owe income taxes until they earn over $60,000. The table below shows the income level for where families begin to owe taxes for different combinations of filing statuses and numbers of children. The third column accounts for both income and the employee side payroll tax, while the fourth column only considers income taxes. These figures do not account for other potential tax credits and deductions that some low-income families are eligible for which would further increase the income level at which families owe tax.

Filing Status	Number of Children	Income Level Where Families Begin To Owe Federal Taxes Accounting For Income and Payroll Taxes[2]	Income Level Where Families Begin To Owe Federal Taxes Accounting For Income Tax Only
Head of Household	1 Child	$35,000	$44,000
Married Filing Jointly	1 Child	$40,000	$51,000
Head of Household	2 Children	$45,000	$57,000
Married Filing Jointly	2 Children	$50,000	$65,000
Head of Household	3 Children	$52,000	$74,000
Married Filing Jointly	3 Children	$57,000	$82,000

[2] Values always rounded up to nearest thousand dollars.

Given that families do not have federal income tax liability until earning at least $43,000, it is not possible to provide more support to low-income families without benefiting families who do not owe federal income taxes. This fact does not appear to be well understood. For instance, Senator Mike Crapo has said that he wants more of the CTC changes to benefit the working poor. **I estimate less than 2 percent of children in poverty owe federal income taxes.** The current legislation is well targeted towards the working poor, as most of the changes benefit low-income families with earnings from work but not enough earnings to receive the status-quo Child Tax Credit. **Amending the legislation to redirect benefits to families with tax liability is incompatible with a desire to help the working poor.**

Conservatives sometimes claim tax cuts for higher-income families help the poor by incentivizing workforce participation. However, the evidence that parents are drawn into the workforce via tax incentives is very weak. To the extent this idea has any validity, it is only true of tax benefits for low-income working families similar to those proposed in the current legislation. This is because when a parent enters the workforce after not working, they typically have low earnings.[3] **A tax cut for middle-class families could not encourage a parent in a poor family to start working because if they entered the workforce, they would not earn enough to qualify as middle-class.**[4]

It is also important to note that the Child Tax Credit reforms do not remotely conform to the traditional understanding of welfare, a comparison made by researchers at the American Enterprise Institute and the Heritage Foundation as well as Senator Thom Tillis. The Temporary Assistance for Needy Families program—the stingy remnant of the cash welfare system in the U.S.—gives the largest benefits to families who are not yet working, and quickly withdraws benefits as earnings rise. The proposed Child Tax Credit reforms do the opposite. Families cannot receive benefits unless they have earnings, and the credit gets larger the more they work. **While the credit improvements do offset income tax liability, calling families who can earn upwards of $80,000 a year welfare recipients undeserving of additional assistance is a fairly radical shift of definitions.** By objecting to families with no tax liability benefiting from CTC changes, conservatives have gone from demanding families work to benefit from the CTC changes to demanding no low-income working families benefit.

Why Child Tax Credit Changes Should Be Targeted to Low-Income Families

It is reasonable to think that higher-income parents with federal tax liability are worthy of more support. Families across the income distribution may struggle with the high and rising cost of raising children. However, critics have not appreciated a number of reasons

[3] For instance, an American Enterprise Institute study finds that single mothers (the group allegedly most responsive to tax incentives) who work in one year, but not another year, earn on average $18,000, less than half the minimum income level required to have tax liability.
[4] Similarly, there is virtually no evidence that poor working families are discouraged from striving for more middle-class incomes because of tax rate increases.

why lower-income families who do not have tax liability are appropriately prioritized in the proposed legislation. For one, the **status-quo Child Tax Credit structure primarily benefits middle and high-income families who owe federal taxes**. Under current law, the CTC provides a $2,000 per child benefit to families with incomes up to $400,000. However, only families who otherwise have tax liability benefit from the full $2,000 credit.[5] Low-income families are left out, either receiving no credit at all or less than $2,000 per child until they earn at least $24,800. The proposed legislation partially remedies this perverse structure. It increases the benefits for low-income families who currently receive a partial credit, while still not giving the full $2,000 per child credit to the vast majority of families currently left out.

Second, the legislation's framework leaves only a modest budget for CTC improvements.[6] **Given the limited budget to work with, policymakers should ensure the CTC provisions go to the lower-income families most in need of assistance—those left behind by the current credit's design.** The legislation does prioritize families who currently do not receive the full credit, but does not come close to giving the full $2,000 per child credit to all low-income families. With a larger budget, policymakers could ensure the full credit reaches all low-income families while also increasing benefits to middle-income families with federal tax liability, similar to the American Rescue Plan's CTC expansion.

Third, **a narrow focus on the distribution of CTC benefits misses that the corporate tax cuts included in the proposed legislation offer significant benefits to high and middle-income households.** The figure below plots the share of the total benefits each income group receives from different parts of the deal when fully implemented in 2025. The pink bars show that the CTC provisions give slightly more benefits to lower income groups, with the 0–40th percentile receiving about 63 percent of the total. The orange bars show the distribution of corporate tax benefits, which have the opposite pattern, giving a far larger share of benefits to higher-income groups.[7] Finally, the blue bars show the combined benefit, including both the CTC and corporate provisions.[8] When the legislation is considered as a whole, lower-income groups do not see a disproportionate share of benefits—the lowest income quintile gets about the same amount of benefit as the 20th–80th percentile. To the extent that the overall legislation is unbalanced, it is because it

[5] Families can receive the full $2,000 per child CTC at slightly lower income levels than when they have overall federal income tax liability because the CTC offsets tax liability without accounting for the EITC.

[6] The legislation balances money spent on the CTC provisions with money spent on business tax cuts. All the provisions are paid for by ending a tax break for businesses impacted by the pandemic that has been rife with fraud, which limits the total amount of spending. This leaves only $33 billion to be spent on the CTC split over three years.

[7] While recent economic research questions whether business tax cuts actually benefit non-wealthy workers, the Tax Policy Center's modeling distributes some of the benefits of the corporate tax cuts to workers. Their modeling also distributes the benefits of corporate tax cuts to middle-income families who own stock via the assumption that the value of those stocks increase.

[8] The combined share of benefits is not a simple average of the corporate and CTC provisions because the corporate provisions are more valuable. The deal only balances the total amount of money spent on the business tax cuts with the CTC if the corporate provisions are not made permanent; post-expiration, these provisions will raise money later in the ten year budget window due to timing effects. More details on the calculation are given in the appendix.

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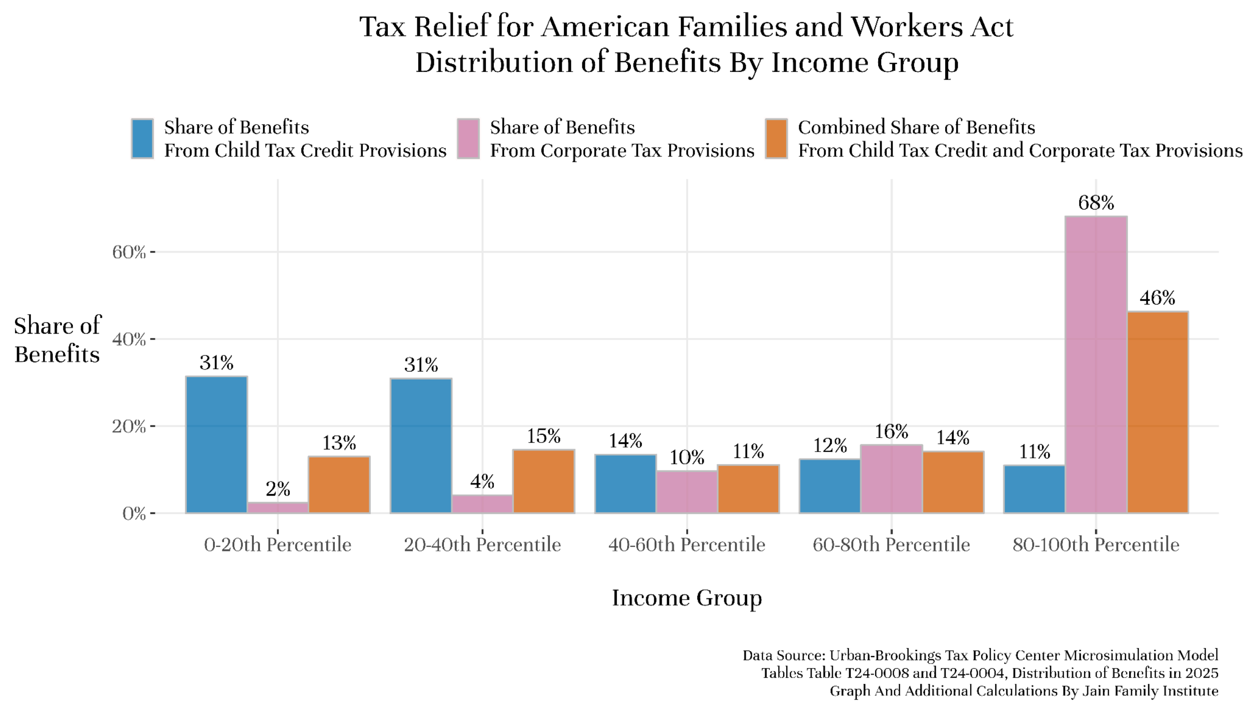
gives a disproportionate share of benefits to the wealthiest Americans, with the richest 20 percent of Americans receiving almost half of the overall benefit.



Finally, rhetoric about families with no tax liability significantly misrepresents this group. **While most low-income families do not owe federal taxes, they do pay substantial state-level taxes.**[9] According to the Institute for Taxation and Economic Policy (ITEP), the lowest 20 percent of households pay on average 11.4 percent of their income to state and local taxes. Moreover, the state tax system is on average quite regressive, with lower-income groups paying a higher share of their income to taxes relative to high-income groups. Again drawing on ITEP data, the middle 20 percent of households pay 10.5 percent of their income to state and local taxes, and the top 1 percent pay just 7.2 percent. A progressive federal income tax helps compensate for this dynamic.

It is also important to understand that most people who do not owe federal taxes will owe in the future. **Research using administrative IRS records found that, while in any given year almost half of tax units will not owe taxes, over a five-year period, only 5 percent constantly received a refund and had no tax liability.** Many Americans' incomes are quite volatile, and the tax system mostly avoids taxing people further into poverty when their income drops. The corporate tax code works in a similar way, where companies owe no taxes when they book losses. Benefits for families without tax liability can appear narrowly targeted in any given year, but they benefit a wide range of families over time as some families move up the income ladder while others fall into poverty.

[9] A substantial number of families without tax liability fail to file returns despite being eligible for a refund. My calculations for what income levels families have net tax liability also do not consider the impact of federal excise taxes, namely the gas tax.

Conclusion

The “Tax Relief for American Families and Workers Act” provides a meaningful boost to the child tax credit for low-income working families. While the bill received resounding bipartisan support in the House, some critics have objected to the fact that most of the benefits will accrue as a tax refund to families who do not owe federal income taxes, and it now appears stalled in the Senate.

This report breaks down the tax liability objection to the CTC expansion. I calculate that a family with children would not owe federal income taxes until they earn at least $43,000—in most cases, far higher amounts. It is not possible to provide more income support to low-income families while only delivering benefits to families with tax liability. This point may not be well understood by critics. For instance, Senator Crapo has suggested that the CTC provisions be changed to benefit the working poor. I calculate 98 percent of families with children under the poverty line do not have tax liability—a desire to help the working poor is incompatible with a desire to direct benefits to families who owe federal income taxes.

Complaints about benefits going to families without tax liability also miss important context. The policies that ensure low-income families do not owe taxes—the standard deduction, the Earned Income Tax Credit, and the Child Tax Credit—all have a long history of bipartisan support and expansion. The current legislation focuses on low-income families without tax liability because they currently do not receive the full $2,000 Child Tax Credit that middle and high-income families receive, and the CTC changes operate under a tight budget constraint. Finally, middle and high-income families who receive less from the legislation’s Child Tax Credit expansion benefit more from the legislation’s business taxation provisions. In a combined analysis, the bill would give more benefits to those with income levels between the 20th and 80th percentile than the 0–20th percentile, according to the Tax Policy Center’s modeling.

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Appendix

Modeling Tax Liability in the Population

I calculated tax liability with the Tax-Calculator's open-source microsimulation model, updating tax brackets, the standard deduction, the EITC, and the CTC to 2023 status-quo law. To calculate tax liability in the general population, I used the 2023 CPS-ASEC data. To form filing units in the CPS-ASEC, I used the same methodology as Jones and Ziliak, which, as they've shown, comes closer to matching administratively measured EITC distributions relative to the standard Census tax model's filing units in the CPS. I use the supplemental poverty measure to measure poverty, which accounts for taxes, transfers, and cost of living.

Distribution of Benefits Calculations

To calculate the distribution of benefits by income quintile, I used the Urban Brookings Tax Policy Model tables T24-0008 and T24-0004. These tables break down the benefits of the overall legislation and the Child Tax Credit provisions, respectively.[10] To calculate the impact of the corporate provisions specifically, I subtract the benefits of the CTC provisions from the benefits of the overall legislation—the remaining value represents the corporate provisions.[11] Specifically, I multiply the average federal tax change with the number of tax units to get the aggregate benefit for each income quintile for both the CTC provisions and the overall legislation. I then sum the total benefit across all income groups and divide the benefit for each income group by the total aggregate benefit to get the share of the total benefits that accrue to each income group. This approach can vary slightly (no more than one percentage point) from the published TPC values for "Share of Total Federal Tax Change," due to TPC's rounding of published average tax changes to the nearest $10. I use the share of benefits directly from the tables for the distribution of CTC benefits and the distribution of benefits from the overall legislation, and use my calculation only for inputting the distribution of benefits of the corporate provisions.

[10] The TPC modeling does not include the effect of the CTC earnings lookback. However, this is a relatively small (5 percent) of the total expenditure of the different CTC provisions in 2025, according to the JCT calculations.
[11] The TPC modeling of the overall legislation includes not just the corporate and CTC provisions, but also some provisions for disaster relief and the LIHTC. However, these provisions represent a very small share of overall expenditures of the overall package.

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