



An Expanded Child Tax Credit Would Lift Millions of Children Out of Poverty

By Galen Hendricks and Lorena Roque February 23, 2021

Currently, nearly 11 million—or 1 in 7—U.S. children live in poverty.¹ By that measure, the United States compares dismally with other wealthy countries. Children under age 5 experience higher poverty rates than older children.² Living in poverty during these critical years for brain development has been shown to have significant negative effects on the long-term well-being of children.³ Moreover, children of color are disproportionately represented among children in poverty, reinforcing systemic inequalities, including racial wealth gaps. The harmful effects of child poverty exact enormous costs on America's society and overall economy.

The COVID-19 pandemic has only exacerbated these issues. Millions of parents and caretakers have lost their jobs. Worsening the situation, as schools have closed and switched to remote learning, many parents have been forced to leave their primary occupations to provide child care. As a result, over the course of the pandemic, the share of children living with unemployed parents has reached historic highs.⁴ At the pandemic's peak in April 2020, more than 21 percent of children had at least one parent who was unemployed. This is likely to have a disastrous impact on child poverty in the United States. Indeed, early studies have already indicated that the child poverty rate has substantially increased since the onset of the pandemic.⁵

Thankfully, Congress now has the opportunity to take a historic step forward in reducing child poverty by increasing the child tax credit (CTC) and making it available in full to the families that need it most. As part of his American Rescue Plan,⁶ President Joe Biden has urged Congress to dramatically expand the child tax credit for 2021, including making it fully refundable—meaning that low-income households would receive the full, larger benefit. The proposed changes to the CTC are based on the American Family Act (AFA), legislation sponsored by Reps. Rosa DeLauro (D-CT) and Suzan DelBene (D-WA) and Sens. Michael Bennet (D-CO) and Sherrod Brown (D-OH), that gained the support of nearly all Democratic members of Congress in past sessions.⁷ The AFA built upon a proposal put forward in 2015 by the Center for American Progress.⁸ And now the AFA's

changes have been incorporated into the American Rescue Plan currently moving through Congress—specifically, the tax components of the fiscal year 2021 budget reconciliation bill.⁹ The legislation does the following:

- Takes the transformative step of making the credit fully refundable
- Increases the basic amount of the CTC from \$2,000 to \$3,000 per child and provides an additional \$600 for children under age 6, with those additional amounts phasing down above incomes of \$112,500 for single parents and \$150,000 for couples
- Includes 17-year-olds in the CTC for the first time
- Directs the IRS to make advance payments of the CTC in monthly installments beginning this July, so that struggling families do not have to wait until next year's tax filing season to benefit
- Extends the CTC to Puerto Rico and other U.S. territories¹⁰

Monthly delivery of the CTC was a key element of the American Family Act, aimed at helping parents manage the continuous costs of child rearing even if they have fluctuating incomes.¹¹

These CTC expansions would reduce child poverty in the United States by 45 percent, according to Columbia University's Center on Poverty and Social Policy—lifting nearly 5 million children out of poverty.¹² President Biden's full COVID-19 American Rescue Plan, the other key elements of which are also incorporated into the FY 2021 budget reconciliation bill, would cut child poverty in half, according to the Columbia University researchers.¹³

This issue brief looks at the short- and long-term benefits of enacting these proposals for families and examines their effects on the economic recovery.

The child tax credit has always left the lowest-income families behind

The CTC was created by the Taxpayer Relief Act of 1997 to help families manage the additional costs of raising children.¹⁴ In its original form, the tax credit provided \$400 per child to families and was nonrefundable—meaning that it could only reduce a family's income tax liability and could not be paid as a refund if the family had no tax liability. As a result, the lowest-income families with children, who generally do not owe federal income taxes (though they bear many other kinds of taxes), were unable to access the tax credit. Since its enactment, the CTC has gone through several rounds of changes, increasing the maximum total benefit and allowing low-income families to receive a partial tax credit by making a portion refundable so long as their earnings exceed a specific threshold.¹⁵ But the CTC's biggest flaw is that it is still only partially available, or not available at all, to the lowest-income families, who would benefit most from the additional cash transfers.

Why refundability matters

Many tax credits are **nonrefundable**, meaning that they can only reduce a taxpayer's income tax liability. **Refundable** credits can be paid as refunds to the extent that the credit exceeds the taxpayer's tax liability. In fact, most low-income families with children do not have any federal income tax liability, though they pay and bear the burden of payroll; sales; and other federal, state, and local taxes.

In its current form, the child tax credit is partially refundable. Although the current CTC is \$2,000 per child, only up to \$1,400 per child can be paid as a refund. Furthermore, the amount of the tax credit depends on one's earnings. The credit "phases in" at 0.15 cents for every \$1 earned above \$2,500.

The most recent expansion of the credit was part of the 2017 Tax Cuts and Jobs Act, which doubled the maximum CTC from \$1,000 to \$2,000.¹⁶ The 2017 act allowed many more higher-income taxpayers to claim the credit by raising the phase-out threshold—the amount of annual income above which the amount of the credit begins to decline—from \$75,000 per year for single filers (\$110,000 for married filers) to \$200,000 per year for single filers (\$400,000 for married filers). The law also increased the amount of the credit that is refundable, but the changes were modest and provided little or no benefit to a large share of low-income households. The law increased the maximum amount of the CTC that can be refundable from \$1,000 to \$1,400 and slightly lowered the threshold for the earnings phase-in from \$3,000 to \$2,500. These changes amounted to very little for those at the very bottom of the income spectrum, who either saw no benefit at all or received an increase of just \$75 per year.¹⁷ (see Figure 1)

Because the law failed to make the credit fully refundable, under its current iteration there are still around 27 million children under age 17 whose households don't earn enough to receive the full credit.¹⁸ As a result, just 15 percent of the total benefits of the CTC were claimed by families making less than \$30,000 in 2020.¹⁹ This structure results in disparities in who benefits from the credit: While three-quarters of white and Asian children are eligible to receive the entire CTC, only about half of Black and Hispanic children are able to receive the full benefit.²⁰

FIGURE 1
The 2017 Tax Cuts and Jobs Act (TCJA) left behind the lowest-income families

Increase in child tax credit under the TCJA compared with prior tax law, by select household



Source: Authors' calculations using Tax Cuts and Jobs Act, Public Law 115-97, 115th Cong., 1st sess. (December 22, 2017), available at <https://www.congress.gov/115/plaws/publ97/PLAW-115publ97.pdf>.

Direct cash payments to low-income families significantly improve future outcomes

The economic devastation wrought by the COVID-19 pandemic made the CTC even more essential to low-income Americans. Direct cash payments to families, which were included in the Coronavirus Aid, Relief, and Economic Security (CARES) Act in the form of one-time \$1,200 payments, and the ongoing unemployment insurance increase have shed light on the cracks in social safety net programs during times of economic hardship. Despite millions of job losses, the poverty rate actually fell during summer 2020 because of CARES Act provisions, demonstrating the potency of direct payments and the importance of existing social welfare programs in reducing poverty.²¹ The CTC substantially reduces child poverty by supplementing the low earnings of families receiving the tax credit, who are more likely to have low-wage jobs, fewer benefits, and fewer work protections. However, the CTC could lift more children out of poverty if it were detached from the employment of the adults in their lives.²²

Boosting a poor child's family income early in their life has long-term beneficial effects on education, health, and even employment. A \$3,000 increase in annual family income for children under age 5 translates into an estimated 19 percent earnings increase in adulthood.²³ Providing families with additional income supports during a child's early development has also been shown to have substantial benefits for future health and educational attainment.²⁴ An analysis of Canada's robust child allowance, for example, found substantial positive effects on test scores, as well as maternal, physical, and mental health, following the benefit's expansion.²⁵

Beyond improving children's lives, reducing child poverty would have enormously positive macroeconomic impacts as well. The National Academies of Sciences, Engineering, and Medicine has estimated that child poverty exacts a cost of \$800 billion to \$1.1 trillion in lost economic output annually, suggesting that reducing child poverty is among the smartest investments we can make as a society.²⁶

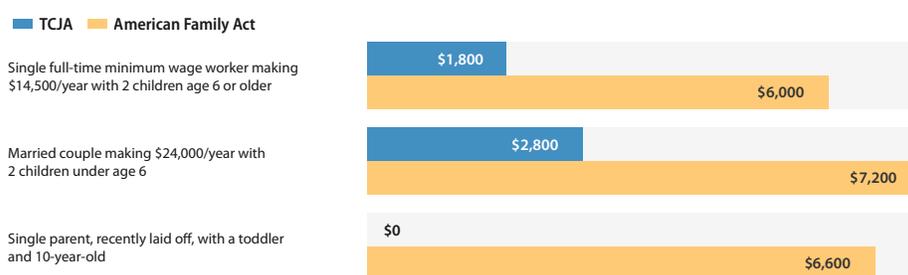
The Biden administration's CTC proposal would lift millions of children out of poverty

The changes to the child tax credit in the American Rescue Plan fix the flaws in the existing CTC and would make a tremendous difference for tens of millions of children. As described above, the bill makes the CTC fully refundable so that it can reach low-income families and allow them to receive the full benefit, increases the maximum amount from \$2,000 to \$3,000, creates a \$600 young-child supplement, makes 17-year-olds eligible, provides for monthly advanced payments, and extends the CTC to Puerto Rico and U.S. territories.

FIGURE 2

The American Family Act would substantially raise the child tax credit for low-income families

Child tax credit under the American Family Act compared with the current Tax Cuts and Jobs Act (TCJA)



Source: Authors' calculations using the American Family Act of 2019, S. 690 116th Cong., 1st sess. (March 6, 2019), available at <https://www.congress.gov/bill/116th-congress/senate-bill/690>.

Taken together, these changes would massively benefit families and dramatically cut child poverty rates—moving more than 4 million children out of poverty and cutting in half the number of children in deep poverty, according to Columbia University estimates.²⁷

Ensuring that the tax credit is fully refundable, however, is fundamental to achieving these outcomes. Merely increasing the value of the credit without removing its tie to earnings would greatly reduce the effect and continue to leave out millions of children in families that are most in need.

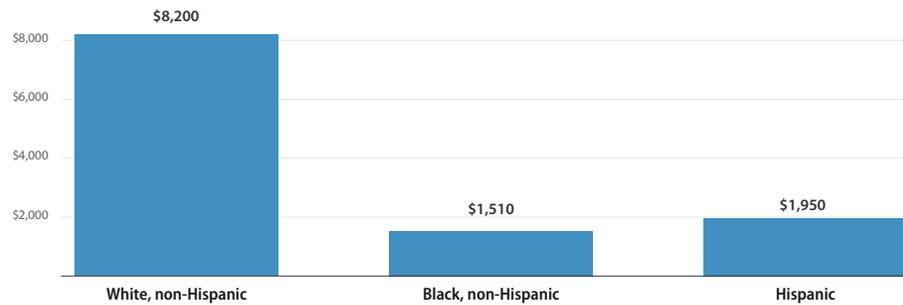
Black and Latino households would substantially benefit under the Biden plan

Expanding access to a direct-payment program such as the CTC would especially benefit Black and Latino households, who, on average, have substantially less in cash reserves than white families.²⁸ In 2019, non-Hispanic white households held an average of \$8,200 in cash reserves, while Hispanic households had an average of just \$2,000 in reserves and Black households held just \$1,500. (see Figure 3) The CTC can boost these households' cash reserves, helping families avoid temporary cash shortfalls and ridding them of reliance on high-fee, short-term credit—such as payday loans.

FIGURE 3

Black and Hispanic families have substantially less cash in reserve compared with white households

Median cash reserves in transaction accounts by race and ethnicity, 2019



Note: Transaction accounts include: checking, savings, money market, and call accounts as well as prepaid cards.

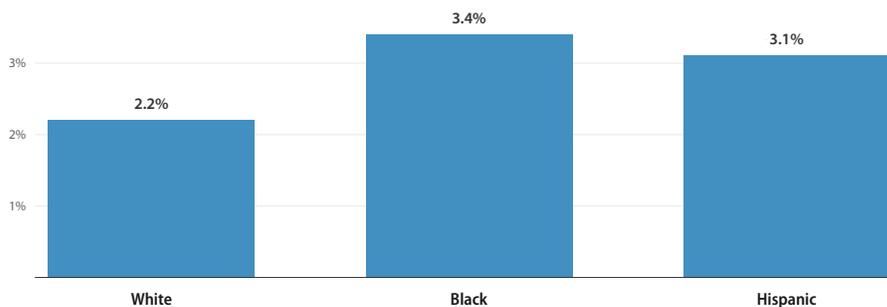
Source: Federal Reserve, "Survey of Consumer Finances, 1989 – 2019: Transaction accounts by race or ethnicity," available at https://www.federalreserve.gov/econres/scf/dataviz/scf/chart/#series:Transaction_Accounts;demographic:race14;population:all;units:median (last accessed February 2021).

Furthermore, data show that increasing the CTC to \$3,000 for each child ages 6 and above and to \$3,600 for each child younger than age 6—as proposed in the pending legislation²⁹—would substantially benefit Black and Latinx families.³⁰ The Center on Budget and Policy Priorities estimates that the proposed expansions would lift a total of 9.9 million children above or closer to the poverty line, including 2.3 million Black children, 4.1 million Latino children, and 441,000 Asian American children.³¹ These reforms would dramatically reduce the childhood poverty rate, cutting childhood poverty by 52 percent for non-Hispanic Black children and 45 percent for Hispanic children, according to recent estimates from Columbia University’s Center on Poverty and Social Policy.³²

FIGURE 4

The American Family Act would substantially benefit Black and Hispanic families

Increase in income due to child tax credit expansion under the American Family Act, by race and ethnicity



Source: Aidan Davis, Jessica Schieder, and Steve Wamhoff, "Child Tax Credit Enhancements Under the American Rescue Plan" (Washington: Institute on Taxation and Economic Policy, 2021), available at <https://itep.org/child-tax-credit-enhancements-under-the-american-rescue-plan/>.

Expanding the CTC could help the United States recover from the recession and bring large returns over the long run

Implementing an expansion of the child tax credit would be a powerful way to immediately help millions of families who are currently struggling due to the COVID-19 pandemic. The CTC expansion for 2021 in President Biden’s rescue bill would cost an estimated \$110 billion in 2021—a small fraction of the eco-

conomic relief distributed so far.³³ By contrast, the 2017 tax cuts, which were heavily weighted toward higher-income Americans, were estimated to cost more than \$300 billion this year.³⁴

Because the rescue bill would begin distributing the expanded CTC this year rather than in one lump sum at tax time next year, these provisions would provide timely and much-needed financial relief to families and help smooth volatile income streams. In 2021, families in the bottom quintile of the income spectrum would see their after-tax incomes rise by 9 percent, on average.³⁵ This, in turn, would help speed the economic recovery, since low-income families are most likely to spend additional cash by purchasing goods and services; those purchases would provide income to other people and businesses, generating additional economic activity. (This is known as the “multiplier effect.”) Research has shown that during recessions, CTC expansion can provide particularly effective stimulus, generating as much as \$1.50 in economic activity for every \$1 spent.³⁶ Moody’s Analytics recently estimated the revenue effects of Biden’s economic relief proposal and found that his plan to increase the CTC had a short-term fiscal multiplier of 1.25—meaning it would raise gross domestic product by \$1.25 for each \$1 spent during the first quarter of 2021.³⁷ Moody’s Analytics estimated that increasing the earned income tax credit and child tax credit were the two tax policies with the biggest multiplier effects.

Though the most urgent priority is to provide cash to families this year, which is why the rescue bill provides for a one-year expansion, later this year Congress should make permanent the changes to the child tax credit—along with the earned income tax credit expansions. This would most likely happen as part of a larger investment package that should also increase taxes on high-income Americans and profitable corporations that have done well during the pandemic. Over the long run, investments to alleviate child poverty by increasing the child tax credit for low- and moderate-income families would produce vastly positive benefits, including increasing family income and dramatically improving economic mobility for children whose families receive the tax credit.

An increasing volume of research has shown that the United States has ample fiscal capacity to make smart and effective investments in human capital, which yield significant long-run returns.³⁸ Substantially increasing the CTC on a permanent basis would help secure economic stability for working families, reduce inequality, and sustainably boost economic growth. It would be one of the most effective investments we can make as a society.

Another critical reform in the American Rescue Plan: Expanding the earned income tax credit

The rescue bill also includes a number of other critical tax reforms, including a complementary policy to expand the earned income tax credit (EITC) for workers who are not raising children in their home.

The EITC currently offers a credit to low- and moderate-income working families. The credit phases out much faster for low-income workers without qualifying children, however, dropping to zero for single filers who make more than \$15,980 per year or married filers who make more than \$21,920 per year. The maximum credit for workers without qualifying children is also much smaller, topping out at \$543, compared with \$3,618 or more for those with at least one qualifying child.³⁹

The EITC is a highly successful anti-poverty program and wage subsidy. In 2018, it benefited more than 22 million working people and lifted about 5.6 million people above the poverty line.⁴⁰ But workers who aren't caring for a child in their homes, including those who help support noncustodial children, have largely been excluded from the credit, and as a result are one of the only groups that is taxed into—or deeper into—poverty by the federal tax code.⁴¹

President Biden's rescue bill would address these issues by nearly tripling the maximum benefit for childless workers—raising the credit to \$1,502—and benefiting single workers with incomes up to \$21,427 per year and couples with incomes up to \$27,367 per year.⁴² The bill would also expand the eligible age range, allowing both older and younger workers to claim the credit. Taken together, these important reforms would expand access for more than 17 million adults who are largely excluded from receiving the credit.⁴³ Young workers and students—particularly young Black, Hispanic, and Asian American/Pacific Islander workers, who are more likely to work in jobs that pay low wages, disproportionately live in poverty, and were severely affected by the coronavirus pandemic—would especially benefit from these proposals.⁴⁴

The IRS estimates that the EITC is currently only claimed by 4 out of 5 eligible workers, so it will be important to pair both the EITC and CTC expansions with strategies at the federal, state, local, and community levels to identify and reduce administrative and systemic barriers to program participation.⁴⁵ In addition, it will be important to ensure that workers who lose earnings due to the pandemic are not further hurt by a reduction in their EITC. Congress addressed this problem for 2020 by allowing workers to choose to calculate their EITC based on their 2019 earnings, but it will need to be addressed again for 2021.⁴⁶

Conclusion

With President Biden including critical expansions to the child tax credit in his proposed rescue package now moving through Congress, the United States has a golden opportunity to dramatically reduce the nation's unacceptably high rates of child poverty. Taken together with strong investments in other assistance programs, policymakers can cut child poverty, help close persistent racial disparities, and set America on a better path toward a rapid and equitable recovery. It's an opportunity that must be seized.

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