Who Gets the Child Tax Credit?

By Leonard E. Burman and Laura Wheaton

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In 1997 Congress created a $500 per child tax credit (CTC). It has since been increased to $1,000 and made available to some lower-income families with children, even if they had no tax liability. Burman and Wheaton find that many low-income families (as well as some with high incomes) receive less than $1,000 per child in tax benefits. Moreover, because of differences in income, family composition, and employment status, nearly half of all black and 46 percent of Hispanic children receive no or reduced benefits from the CTC because their incomes are too low, according to the authors. By comparison, only 18 percent of white children are in that category.

1. Introduction

The largest federal cash assistance program for children is run through the income tax system. The child tax credit (CTC) provides over $46 billion in subsidies to families with children every year (Joint Committee on Taxation, 2005). This is equal to the entire federal budget for children and family services programs (excluding health care) administered by the Department of Health and Human Services (the largest of which is Temporary Assistance for Needy Families, at $18 billion per year). The earned income tax credit (EITC), the largest cash assistance program for low-income families, which is also run through the tax system, totals $39 billion per year.

Originally enacted as part of the Taxpayer Relief Act of 1997, the CTC provided a $500 tax credit for dependent children under the age of 17. Eligibility phased out at high income levels. The credit was also of little or no value to low-income households because few had any income tax liability. (A small refundable tax credit was available to some families with three or more children.) As a result, the CTC was effectively a middle-class entitlement program.

The Economic Growth and Taxpayer Relief and Reconciliation Act of 2001 (EGTRRA) and the Jobs and Growth Taxpayer Relief and Reconciliation Act of 2003 doubled the credit to $1,000 and significantly expanded the credit's refundability. Families with earnings over $10,000 could receive a credit in excess of their tax liability. The refundable portion of the credit increased with earnings. Like many other federal income tax provisions, the $10,000 refundability threshold was indexed for inflation and has now reached $11,000. The expanded refundable tax credit made the CTC more valuable to many lower-income families, though many with very low incomes were still left out.

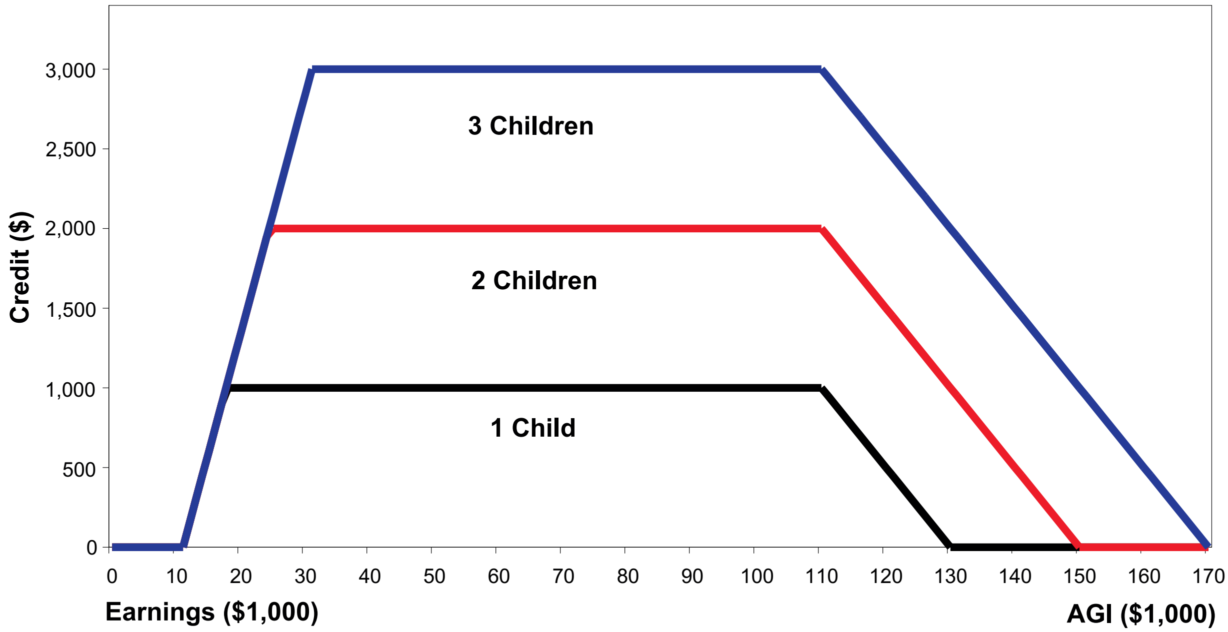
Designed to phase in with earnings, this credit provided a work incentive and offset some of the disincentives created by the phase-out of the earned income tax credit and the income tax itself, both of which affect moderately low-income families. Phasing in the credit with earnings also reduced the likelihood that households would file tax returns solely to claim the CTC. (Almost all households with earnings above $10,000 would file anyway to claim a refund of withheld income taxes and, when eligible, the EITC.) Limiting the credit's availability (at both low- and high-income levels) also reduced the cost to the Treasury.

Viewed as a work incentive, the CTC phase-in rules are logical (although there is a question as to why lower-income households should be subject to work incentives delivered by two separate programs — the EITC and the CTC). For the majority of recipients, however, the CTC is tantamount to a cash allowance. Viewed simply as a child subsidy, it is hard to understand why the families who most need help are excluded.[1]

[1]Some argue that the EITC is an adequate subsidy for very low-income household with children. The EITC reaches its maximum level of $4,400 for families with two or more children earning $11,000 to $14,370 in 2005 (after which point it starts to phase out). But, unlike the CTC, the EITC reaches a maximum at two children. Also, the EITC has remained unchanged while the CTC was enacted and expanded. It is unclear why Congress would have thought that middle- and upper-income taxpayers were more in need of assistance than low-income families (whose incomes have lagged behind families with higher incomes for several decades). The original credit had three objectives: ''The Congress believed 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.'' (Joint Committee on Taxation, 1997, p. 7.) While low-income families do not pay federal individual income taxes, they do face daunting challenges in meeting the financial

(Footnote continued on next page.)

Figure 1
Phase-in and Phase-out of CTC for Married Filing Joint Returns, by Number of Children, 2005



Note: Refundable credit phases in with earnings at 15% rate; full credit phases out with AGI at 5% rate. The credit actually phases out in $50 increments so the actual phase out is in steps.

Indeed, Congress seemed to adopt this paradigm in the aftermath of Hurricane Katrina. Absent legislation, low-income families with children who lost their jobs because of the hurricane's devastation faced the prospect of losing refundable child tax credits (and, in some cases, a portion of their EITC) because their incomes dropped. To address that problem, The Katrina Emergency Tax Relief Act of 2005 allows families affected by Katrina to use last year's income to compute their CTC and EITC if doing so yields a larger tax benefit.

Arguably, many other families lose income when bad luck strikes, whether as a divorce, a layoff, or a death. But those events do not precipitate Congressional response, so many families who most need the help get little or no benefit from the CTC.

This paper examines the distribution of the CTC in 2005 by income and disparities along lines of race or ethnicity. As expected, most CTC benefits go to families with incomes between $20,000 and $200,000. In addition, because of systematic differences in income, family composition, and employment status, Black and Hispanic children receive much less benefit from the CTC than do White children.[2] Fewer than half of Black children and about half of Hispanic children are eligible for the full $1,000 credit in 2005, compared with 62 percent of White children. Most telling, Black and Hispanic children are more than 10 times as likely to lose credits because their income is too low than because it is too high. White children are more likely to see their credit reduced because their incomes are too high. The average tax credit applicable to White children is $157 more than for Blacks and $83 more than for Hispanics.

The tax code is, of course, officially neutral with respect to race and ethnicity. But these estimates show that design features of programs such as the CTC may make them more or less useful to economically disadvantaged minorities.

2. Description of Child Tax Credit

Tax filers are allowed to claim a child tax credit (CTC) for each qualifying child in a household. The maximum

responsibilities of raising children and presumably benefit as much as others from family value promotion. (In addition, low-income families are burdened by other taxes, including federal payroll and excise taxes and state and local income, sales, and property taxes.)

[2]In this analysis, we will often measure tax benefits on a per child basis, rather than per family or tax unit. For shorthand purposes, we refer to children getting credits although, technically, their parents or guardians claim the credit on their tax returns.

Table 1
Distribution of Benefits from Child Tax Credit (CTC), by Cash Income Class, 2005[1]

Cash Income Class (thousands of dollars)[2]	Tax Units[3]		Percent of Tax Units with CTC	CTC as Percent of After-Tax Income[4]	Share of Child Tax Credits	Average Federal Tax Benefit of CTC ($)	
	Number (thousands)	Percent of Total				All Returns	Returns with CTC
Less than 10	19,560	13.5	0.2	*	0.1	1	991
10-20	25,611	17.7	14.4	0.6	4.5	80	554
20-30	19,953	13.8	26.2	1.5	14.4	330	1,258
30-40	15,289	10.6	27.7	1.5	14.6	437	1,577
40-50	11,738	8.1	27.4	1.2	11.7	457	1,666
50-75	20,700	14.3	31.8	1.1	24.6	543	1,711
75-100	11,936	8.3	35.0	0.9	15.8	605	1,729
100-200	14,432	10.0	29.9	0.4	14.2	450	1,508
200-500	3,797	2.6	1.9	*	0.2	24	1,260
500-1,000	642	0.4	0.7	0.0	*	11	1,724
More than 1,000	335	0.2	0.4	0.0	0.0	5	1,234
All	**144,573**	**100.0**	**21.9**	**0.7**	**100.0**	**317**	**1,451**

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0305-3A).

* Less than 0.05 percent.

[1]Calendar year.

[2]Tax units with negative cash income are excluded from the lowest income class but are included in the totals. For a description of cash income, see http://www.taxpolicycenter.org/TaxModel/income.cfm.

[3]Includes both filing and non-filing units. Tax units that are dependents of other taxpayers are excluded from the analysis.

[4]After-tax income is cash income less: individual income tax net of refundable credits; corporate income tax; payroll taxes (Social Security and Medicare); and estate tax.

child tax credit is equal to $1,000 per child. A qualifying child is a dependent under age 17 at the end of the tax year, a citizen or resident alien, and meets certain relationship tests.[3]

The CTC is partially refundable for tax filers with earnings (wages, salaries, and income from self-employment) over $11,000 per year. The refundable credit is available even if the household has no tax liability after nonrefundable credits. Low-income households may claim a refundable CTC of up to 15 percent of earnings in excess of $11,000 in 2005. Thus, a household with earnings of $12,000 may claim a refund of up to $150 (15 percent of $1,000) if they have at least one qualifying child. Households with earnings below $11,000 generally receive no CTC.

The credit starts to phase out at an adjusted gross income (AGI) of $110,000 for married filing jointly, $75,000 for single, head of household, or qualifying widow(er), and $55,000 for married filing separate returns. The phase-out rate is 5 percent, so a married taxpayer filing jointly with $120,000 of AGI would lose $500 of tax credits. The threshold for the refundable credit is indexed for inflation — it increases every year — whereas the phaseout threshold is unindexed. In consequence, the CTC applies to an ever smaller share of the population over time.

The maximum credit and the size of the phase-in and phase-out ranges depend on the number of qualifying children in a tax unit. For example, for a married couple with one child, a $1,000 CTC phases in between earnings of $11,000 and $17,667 and phases out between AGI of $110,000 and $130,000. (See Figure 1.) For a family with three children, the maximum refundable credit of $3,000 phases in between $11,000 and $31,000 of earnings and phases out between $110,000 and $170,000 of AGI.[4]

The $1,000 credit and the new refundability rules are temporary provisions — like the rest of EGTRRA. If

[3]Qualifying relatives include: a son, daughter, adopted child, stepchild, or a descendant of any of them (for example, a grandchild); a brother, sister, stepbrother, stepsister, or a descendant of any of them (for example, a niece or nephew); or a foster child.

[4]A household could benefit from the maximum credit at earnings below these maximums to the extent that it had tax liability (before refundable credits). For example, a married couple with three children who claimed the standard deduction would start owing income tax (before credits) at an income of $26,000 in 2005. If no other nonrefundable tax credits are claimed and wages are the only source of income, the full $3,000 credit would be available at an income of $29,000. The first $300 of the $3,000 tax credit would eliminate income tax liability and the remaining $2,700 would be paid as a tax refund. (Taxable income is $3,000 — or $29,000 minus standard deduction and personal exemptions of $26,000, which implies tax before credits of $300 at the 10 percent tax rate. The family qualifies for a refundable child credit of $2,700 — 15 percent of $18,000.)

Table 2
Distribution of Qualifying Children, by Phase-in/ Phase-out Status

		Number of Children (Millions)	Percent
Phase-In Region	No Credit	9.5	13.9
	Partial Credit	10.0	14.7
	Full Credit	38.8	56.9
Phase-Out Region	Partial Credit	4.9	7.1
	No Credit	5.0	7.3
All		**68.2**	**100.0**

Source: Transfer Income Model, based on CPS data for 2002 evaluated under 2005 law.

EGTRRA is not extended, the CTC will return to $500 per child after 2010 and the new refundability rules will expire.[5]

3. Distribution of Benefits

The CTC is a middle-class tax benefit. Many low-income people receive no benefit because they have no income tax liability and their earnings are too low to qualify for the refundable credit. High-income people do not qualify because their incomes exceed the phase-out range. Moderately low-income and high-income families can receive a partial credit, but the largest credits go to middle-income taxpayers.

According to Tax Policy Center (TPC) projections, about 95 percent of the benefits will go to the 65 percent of tax units with incomes between $20,000 and $200,000 in 2005.[6] (Table 1.) On average, the credit reduces their tax liability (or increases their refund) by between $330 and $605. The largest beneficiaries are those with incomes between $75,000 and $100,000, for whom the CTC's average value is $605. More than one-third of households in that income range claim an average tax credit of $1,729. In contrast, only about 14 percent of households with incomes between $10,000 and $20,000 qualify for any credit. In that income range, the credit is worth only $80 on average ($554 for those who actually claim the credit). Only a tiny fraction of households with income below $10,000 qualify for any credit, and these are households with earnings over $11,000, but offsetting losses that reduce their overall income below $10,000. On average, the CTC is worth only $1 in the lowest income category (but $991 for those few who are able to claim the credit).[7]

Similarly, both the likelihood of claiming the credit and the amount of the credit decline at high income levels. About 30 percent of households with incomes between $100,000 and $200,000 claim the CTC, yielding an average tax savings of $450. Very few taxpayers with incomes over $200,000 qualify, and the average tax savings at those income levels is $24 or less. (The households with high income who do qualify might have very large families — and thus a very large phase-out range, tax-exempt income, or ''above-the-line deductions'' that reduce their AGI below the end of the phase-out range, despite relatively high income.)

Overall, we estimate the CTC will be worth an average of $317 per tax unit in 2005 — or $1,451 per return for the 22 percent of tax units that claim the credit.

Table 2 shows estimates of the number of potentially eligible children (generally, dependents under age 17) who are covered and not covered by the child tax credit. The estimates are generated by the Transfer Income Model (TRIM3), which is based on the March 2003 Current Population Survey (CPS).[8] Using TRIM3, we simulated 2005 tax law as if it had been in effect in 2002.[9] Everyone who appears eligible for the CTC is assumed to take advantage of the credit.

A significant fraction of dependent children under age 17 do not qualify for the full tax credit, either because their families' earnings are too low or because their incomes (AGI) are too high. Of 68 million children potentially eligible in 2002 for the CTC under current income tax rules, only 39 million (57 percent) would have received the full $1,000 credit, our simulations show. (Table 2.) More than 28 percent were in households with too little earnings to take full advantage of the credit and

[5]A refundable child tax credit for certain families with three or more children predates EGTRRA and will continue past 2010. However, most low-income families receive a larger benefit from the EGTRRA provisions (Burman, et al. 2002).

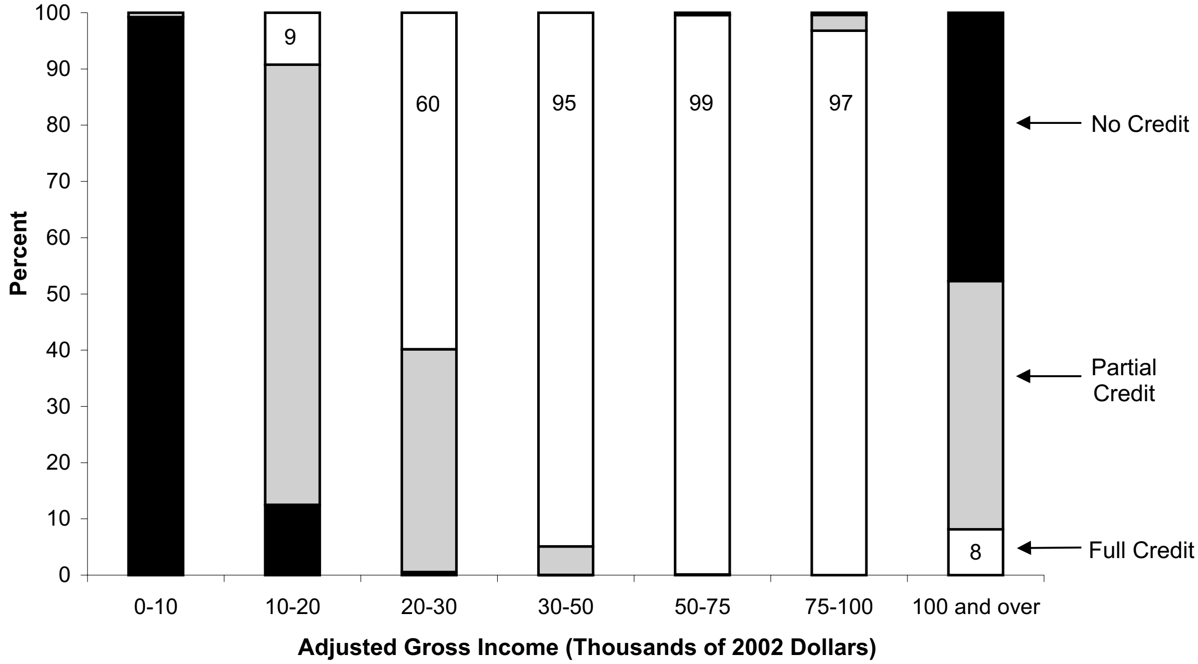
[6]The TPC projections are computed by our microsimulation tax model. The model is based on sample data from individual income tax returns augmented by information about non-filers from the Current Population Survey. See Rohaly, et al. (2005) for a description of the tax model.

[7]Note that many of the low-income families who receive little or no benefit from the CTC are eligible for the EITC, which can be worth up to $4,400 for low-income families with two or more children. See Burman, et al. (2002) for a discussion about how changes to the EITC, the CTC, and other provisions affected lower-income families with children.

[8] Information presented here is derived in part from the Transfer Income Model, Version 3 (TRIM3) and associated databases. TRIM3 requires users to input assumptions and/or interpretations about economic behavior and the rules governing federal programs. Therefore, the conclusions presented here are attributable only to the authors of this report. TRIM3 was developed by the Urban Institute under funding from the Office of the Assistant Secretary for Planning and Evaluation of the Department of Health and Human Services. A description of the TRIM3 model is available online at http://www.trim3.urban.org/t3technical.php.

[9]The March 2003 CPS contains data on household income for 2002.

Figure 2
Percent Distribution of Qualifying Children by CTC Receipt and Family Income



Source: Transfer Income Model, based on CPS for 2002 evaluated under 2005 law.

14 percent had income that was too high. All told, almost 10 million children with very low family incomes received no credit, and another 10 million qualified for a partial credit because of insufficient earnings.[10]

Figure 2 shows the percentage distribution of full, partial, and no credits by AGI based on the TRIM3 model. No children with family incomes below $10,000 qualify for a full credit. Less than 1 percent qualify for a partial credit because family earnings still exceed $11,000, even though losses and deductions reduce AGI below $10,000. Only 9 percent of children in families with income between $10,000 and $20,000 receive a full credit, which is less than the 13 percent of children in this income range that qualify for no credit at all. Eligibility for the full credit jumps at higher income levels: 60 percent of those with incomes between $20,000 and $30,000, and 95 percent or more of those with family incomes between $30,000 and $100,000, receive the full $1,000 per child credit. Few children in families with incomes over $100,000 receive the full credit because their incomes are in or above the AGI phaseout range.

The differences in income eligibility translate into differences in eligibility by race and ethnicity. Hispanic and Black families tend to have lower incomes than otherwise similar White families. There are also systematic differences in terms of family composition and marital status, which can affect tax liability and ability to use tax credits.[11]

Under current tax rules, about 46 percent of Hispanic children would have qualified for less than a full credit because their families' earnings were too low in 2002. (Table 3.) Almost 50 percent of Black children are in that

[10]Note that the incidence of partial credits is not based solely on earnings, but also on family size. The more qualifying children, the larger the maximum credit is and the greater the likelihood that the tax unit will not be able to benefit from the full credit.

[11]For example, Black children are much less likely than Whites to live with married parents, and Hispanic children are somewhat less likely to do so. The differences between Whites and Hispanics largely disappear among low-income families, but the differences remain dramatic between Whites and Blacks. In 2002, only 14 percent of low-income Black children lived with married parents, compared with 50 percent of Hispanics and 52 percent of Whites (Wherry and Finegold, 2004). Blacks and Hispanics were also much more likely to be poor and somewhat less likely to be employed than Whites (Finegold and Wherry, 2004).

Table 3
Variation in Credit Eligibility Among Qualifying Children by Race and Ethnicity

Percent Distribution of Qualifying Children		**Hispanic**	**Black**	**White**	**All**
Phase-In Region	No Credit	19.1	28.1	8.8	13.9
	Partial Credit	26.9	21.4	9.3	14.7
	Full Credit	50.1	45.7	61.9	56.9
Phase-Out Region	Partial Credit	2.3	2.5	9.8	7.1
	No Credit	1.7	2.3	10.1	7.3
All		**100.0**	**100.0**	**100.0**	**100.0**
Average credit ($2005)					
Including zeroes		$638	$564	$721	$679
Excluding zeroes		$805	$810	$891	$862
Percent with less than full credit					
Earnings too low		45.9	49.5	18.2	28.7
Income too high		3.9	4.8	19.9	14.5
Percent of low-income children with no credit but positive earnings		54.0	47.6	54.5	51.9
Number of Children (millions)		12.5	10.2	40.7	68.2
Percent of all		18.3	14.9	59.7	100.0
Number with refundable credit (millions)		7.9	5.5	13.0	28.3
Percent with refundable credit		63.6	53.9	32.0	41.6

Note: Black and White include only non-Hispanics. Other race/ethnicity and those who report multiple races are included in the "All" column.

Source: Transfer Income Model, based on CPS data for 2002 evaluated under 2005 law.

situation, compared with 18 percent of Whites. In contrast, Whites most often lose the credit because their families' incomes are too high. Almost 20 percent of Whites had incomes in the phase-out range or higher, compared with 4 percent of Hispanics and 5 percent of Blacks.

Overall, only half of Hispanics and 46 percent of Blacks qualified for a full $1,000 credit, compared with 62 percent of Whites. Conversely, 19 percent and 28 percent of Hispanics and Blacks, respectively, received no credit because their incomes were too low, compared with less than 9 percent of Whites. Some ineligible families had no earnings at all, but more than half were working and had earnings. Among children in families with earnings too low to qualify for any credit, 54 percent of Hispanics, 48 percent of Blacks, and 55 percent of Whites had some earnings.

These differences also translated into systematic differences in the average credit per qualifying child. Overall, an Hispanic child qualified for an average credit of $638, a Black child, $564, and a White child, $721. Restricting the sample to children whose families qualified for at least some credit, the averages were $805, $810, and $891, respectively.

Finally, note that these estimates might understate disparities in the actual use of the credit. The simulations assume that everyone who is eligible claims the credit, but there is evidence that low-income Hispanics and Blacks may be less knowledgeable about tax subsidies than otherwise similar Whites. Maag (2005) found, based on the 2002 National Survey of American Families, that only 27 percent of Hispanic parents with incomes below twice the poverty threshold knew about the EITC, compared with 68 percent of Black non-Hispanic parents, and 74 percent of others. These differences are statistically significant. Although these disparities in knowledge might not necessarily translate into less utilization of credits (because, for example, paid preparers or low-income tax clinics provide help), the data raise the possibility that certain minority groups may be less likely to benefit from income-support programs offered through the tax code than otherwise similar White families. In that case, the disparities in credit utilization might be even larger than the disparities in eligibility.

4. Conclusion

As currently formulated, the child tax credit excludes millions of children in low-income working families. Because of differences in income, family composition, and employment status, nearly half of Blacks and 46 percent of Hispanics receive no or reduced benefits from the CTC because their incomes are too low. By comparison, only 18 percent of White children are in that category. Indeed, White children are more likely to see their credits shrink because household income is too high.

These problems could be solved if the CTC were available to all qualifying children regardless of income, but that solution would raise concerns about tax administration (millions of tax returns would be filed solely to claim the CTC) and cost to the Treasury. Some critics would also charge that a credit designed to encourage work was being transformed into a welfare program.

Senators Snowe and Lincoln recently proposed a more modest reform, the Working Family Child Assistance Act of 2005.[12] The legislation would return the threshold for the refundable tax credit to $10,000 and repeal indexing for inflation. As a result, more and more lower-income children would become eligible for partial or full credits over time. Racial disparities would persist with this lower floor on earnings, but they would likely become smaller over time as increases in nominal earnings push more and more low-income families above the threshold for the refundable credit. Since there would still be an earnings requirement, few if any additional tax returns would be filed solely to take advantage of the credit. And the cost to the Treasury would be comparatively modest. The Tax Policy Center estimates that the Snowe-Lincoln legislation would increase outlays by $7 billion through tax year 2010, assuming it takes effect in 2006. By 2010, 2 million additional children would receive at least some credit and an additional 0.8 million would qualify for the full $1,000 tax credit.

The desirability of this or any other policy option depends on how it is financed. Recent practice has been to finance tax cuts with increases in the deficit, which sets up our children for potentially large future taxes or benefit cuts. A better approach, especially if children are to be the focus of public attention, would be to pay for any new tax cuts with offsetting tax increases or spending cuts.

[12]Burman, et al. (2005) examine other options to assist low-income families with children.

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