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INSIGHT

The Impact of a "Fully Refundable" Child Tax Credit

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Congress is currently considering an extension of temporary changes to the child tax credit that were enacted for 2021 under the American Rescue Plan Act (ARPA; P.L. 117-2). ARPA made three changes to the child credit that affect the credit amount taxpayers will receive (1) extending the eligibility age of qualifying children to include 17-year-olds; (2) increasing the maximum amount of the credit, with a larger maximum credit for young children; and (3) eliminating the prior-law formula for the refundable portion of the credit. This third change is sometimes referred to as making the credit "fully refundable." (The law also temporarily changed how the credit is being delivered for 2021.)

The Biden Administration has proposed making full refundability permanent, while temporarily extending other provisions of the ARPA expansion for four more years, through the end of 2025. A similar proposal is included in proposed legislation released on September 10 by Chairman Neal of the Ways and Means Committee.

This Insight provides an overview of what full refundability means in the context of the 2021 child credit and summarizes recent research examining the impact of full refundability.

What is full refundability?

In the context of the ARPA-expanded child credit, full refundability means the credit is the same amount per child for low- and moderate-income taxpayers, irrespective of their income. (Higher-income taxpayers are subject to a phaseout of the credit.) Specifically, by making the child credit fully refundable for 2021, ARPA temporarily eliminated the prior-law formula used to phase in the credit for lower-income taxpayers. Under the prior-law formula, a taxpayer with more than $2,500 of earned income was eligible to receive a partial benefit from the credit. Their benefit amount was equal to 15% of earned income above $2,500, subject to a limit of $1,400 per qualifying child. These aspects of the formula are illustrated in points ❶-❸ in several figures below.

Full refundability of the ARPA-expanded child credit is illustrated as a horizontal pink line at the maximum credit amount of $3,600 per young child in the figure below. A taxpayer with one young child would be eligible for the same credit amount ($3,600) regardless of whether they have no income, $10,000 of income, or $100,000 of income. If instead all the ARPA changes had been adopted *except* full

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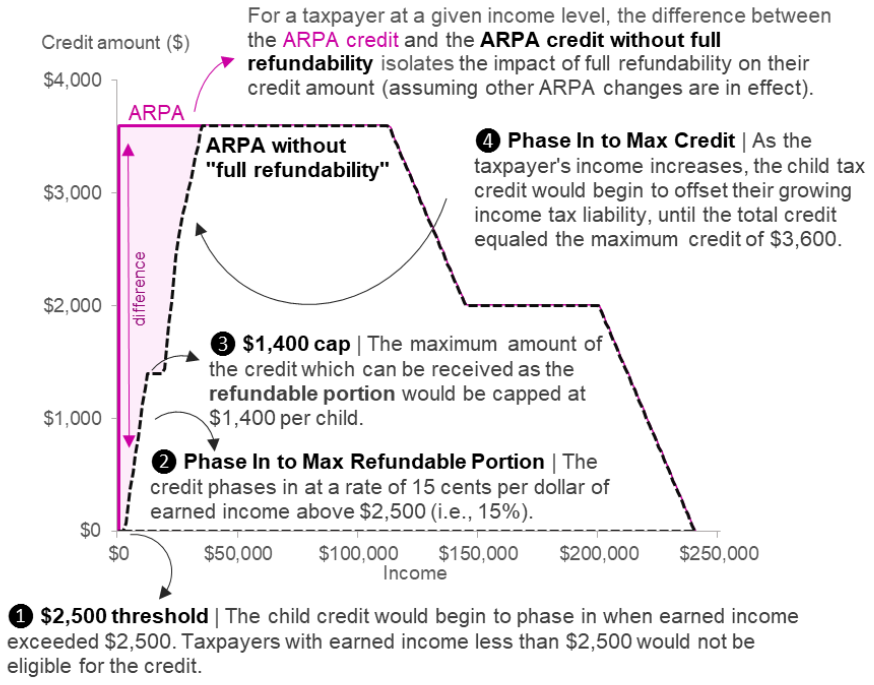
refundability, the credit amount would have phased in with earned income for low- and moderate-income taxpayers, as illustrated by the upward-sloping gray dotted line. The lowest-income taxpayers—those with $0 of earned income—are eligible for the largest increase in the child credit as a result of full refundability (i.e., the vertical distance between the flat pink line and the upward-sloping dotted gray line is the largest). As a taxpayer's earned income increases, the additional benefit from full refundability declines.

ARPA-Expanded Child Credit by Income for 2021
With and ***Without*** Fully Refundability
Unmarried Taxpayer with One Young Child



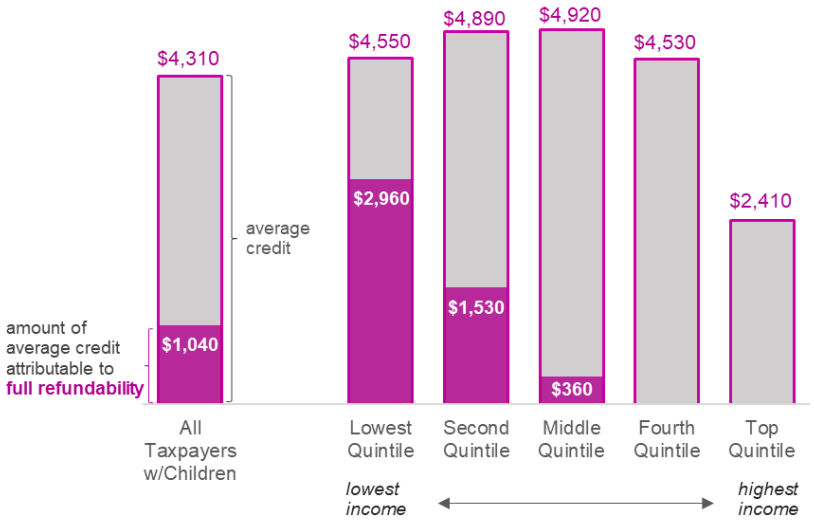
Source: CRS calculations based on Internal Revenue Code §24 and P.L. 117-2.
Notes: A stylized example assuming the taxpayer has one qualifying child and all income is earned income, with no other sources of income and no above-the-line deductions claimed. Unmarried taxpayers with child credit-qualifying children are assumed in this example to file as head of household.
The **refundable portion** of the credit is the amount of the credit that exceeds income tax liability and is often referred as to the additional child tax credit or ACTC. The nonrefundable portion of the credit is the amount of the credit which reduces income tax liability. The sum of the refundable portion (capped at $1,400 per child) and the nonrefundable portion cannot exceed the overall maximum credit of $3,600 per young child.

What is the impact of full refundability of the child tax credit?

The Tax Policy Center (TPC) estimates full refundability of the ARPA-expanded child credit increases the average credit amount by $1,040 (from $3,270 to $4,310) among taxpayers with children, as illustrated in the figure below. According to these estimates, full refundability results in a larger average credit for the bottom 60% of taxpayers, with larger average increases for lower-income taxpayers. The lowest-income taxpayers with children are estimated to receive the largest benefits from full refundability. The lowest-income 20% of taxpayers (i.e., the lowest quintile) receive a credit that is more than twice as large on average because of full refundability (an average credit of $4,550 under ARPA, of which $2,960 is

attributable to full refundability). The remainder of the increase in the average credit is attributable to the larger per-child credit and expanded eligibility to include 17-year-olds.

ARPA-Expanded Child Credit by Income Quintile
Taxpayers with Children



Source: CRS calculations based on estimates from the Tax Policy Center, Tables T21-0227 and Table T21-0229.
Notes: Includes both filing and nonfiling taxpayers (i.e., tax units). The income percentile classes used in this figure are based on the income distribution for the entire population and contain an equal number of people, not tax units. The incomes used are adjusted for family size by dividing by the square root of the number of people in the tax unit. The resulting percentile breaks are (in 2020 dollars): 20%, $18,900; 40%, $37,100; 60%, $64,400; 80%, $108,400; 90%, $157,400; 95%, $221,300; 99%, $514,100; 99.9%, $2,261,800.

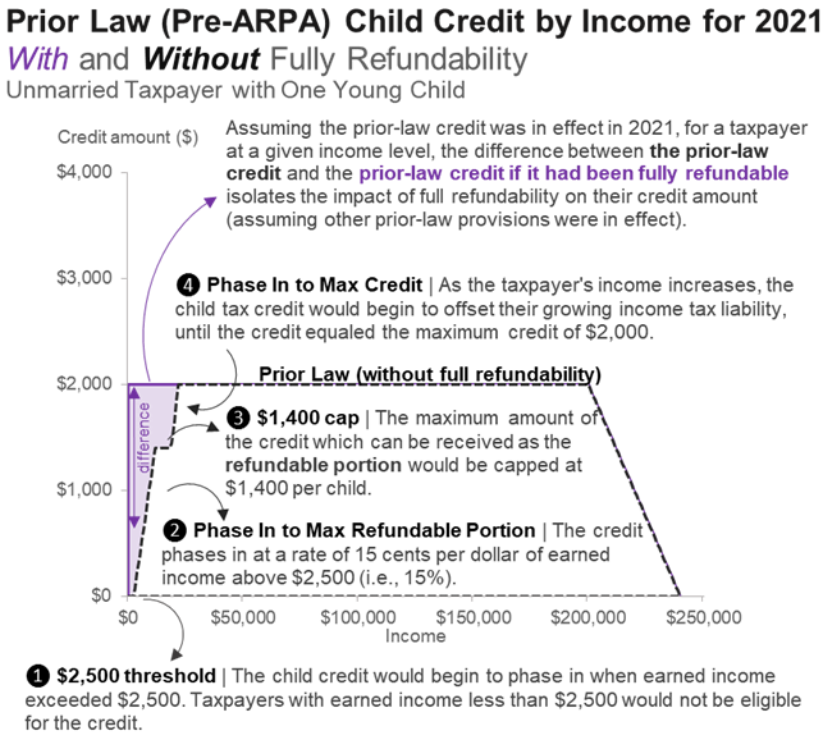
Full refundability results in the largest increase in the credit amount for the poorest taxpayers. It also expands eligibility to the poorest taxpayers—those with less than $2,500 of earned income—who were previously ineligible for the credit. Research suggests that before ARPA about a third of all children lived in households whose low incomes made them ineligible for the maximum child credit amount ($2,000 per child at the time). CRS research suggests that full refundability is a major factor in the poverty reduction impact of the ARPA-expanded child credit, both in terms of the prevalence and depth of child poverty. The Center on Budget and Policy Priorities estimates that the ARPA-expanded child credit *with full refundability* will lift 4.1 million children out of poverty, but *without full refundability* the credit would lift a smaller number of children—0.5 million—out of poverty (a difference of 3.6 million). The Jain Family Institute estimates a similar figure of 3.2 million children who would have remained in poverty if the ARPA-expanded child credit had not been fully refundable.

The budgetary cost of full refundability of the ARPA-expanded child credit is estimated to be about half of the total cost of the ARPA expansion, according to the Tax Policy Center (about $53 billion per year of TPC's estimated $97.0 billion cost of the ARPA-expansion).

The budgetary cost of full refundability depends in part on the overall per-child benefit amount. As Elaine Maag of the Tax Policy Center notes, "If Congress keeps full refundability but reduces credit amounts to pre-ARP[A] levels [$2,000 per child], overall benefits would be lower. But low-income families would still receive substantial benefits if the lower credit amounts were made fully refundable."

TPC estimates that making the pre-ARPA child credit ($2,000 per-child) fully refundable would cost an additional $24 billion per year. While the benefits of this policy change would be concentrated among lower-income taxpayers (as illustrated in the figure below), the antipoverty effects would be smaller due

to the smaller overall credit amount. One estimate from the National Academy of Sciences (NAS) suggests a benefit comparable to a $2,000 fully refundable credit would lift 2.5 million children out of poverty.



Source: CRS calculations based on Internal Revenue Code §24.
Notes: A stylized example of what the credit amount would be for 2021 if ARPA was not in effect (but assuming the changes from P.L. 115-97 were in effect). Example assumes the taxpayer has one qualifying child and all income is earned income, with no other sources of income and no above-the-line deductions claimed. Unmarried taxpayers with child credit-qualifying children are assumed in this example to file as head of household.
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The Biden Administration estimates if the credit were to revert to its prior-law level of $1,000 per child in 2026 (as it is scheduled to under current law) and was also fully refundable (which it is not under current law), the additional annual cost of full refundability would be less than $3 billion a year.

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