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SHOULD THE SENATE RAISE THE INCOME LIMIT FOR THE CHILD TAX CREDIT?

by David Kamin and Robert Greenstein

Legislation that the House of Representatives passed in May would extend the child tax credit to several million higher-income households. Under current law, married families with incomes up to $110,000 receive the full tax credit of $1,000 per child, and married families with two children that have incomes between $110,000 and $149,000 receive a partial tax credit (i.e., a credit of less than $1,000 per child).[1] The House bill would expand the tax credit for families in the $110,000 to $300,000 range. (Married families would receive a full credit until their income surpassed $250,000 and a partial credit until income reached $269,000 for families with one child, $289,000 for families with two children and $309,000 for families with three children.)

Given the bleak deficit picture and the growing emphasis in the Senate on efforts to restore fiscal discipline, expanding the child credit to higher-income families that do not need government subsidies to be able to afford to raise their children does not represent sound policy. The Senate did approve a smaller, but still substantial, expansion of the child tax credit to higher-income families last year, as part of a compromise to obtain near-unanimous support for legislation to accelerate to 2003 an expansion in the child tax credit for working-poor families otherwise scheduled to take effect in 2005. The Senate proposal was not enacted last year, and given further deterioration in the fiscal outlook since last year, such a “deal” would be ill-advised today.

- **Expansion of child credit to higher-income families is costly.** Allowing married couples with incomes up to $250,000 to receive the full child tax credit, as the House bill would do, would reduce revenues by $69 billion through 2014, according to estimates from the Urban Institute-Brookings Tax Policy Center. The price tag rises to $87 billion when the increased interest payments on the debt are included.

  Even a more modest expansion for higher-income households would be costly. If the income level up to which the full child tax credit of $1,000 per child is paid were raised (for married couples) to $150,000 — the level the Senate approved

[1] The point at which the child tax credit is fully eliminated depends on the number of children in a family. In addition, some families with very low incomes receive a partial tax credit or none at all because the credit is only partially “refundable.”

last year[2] — the Treasury would lose $36 billion in revenue through 2014 according to Tax Policy Center estimates (assuming the $150,000 level took effect in 2004 and the child tax credit provisions ultimately were made permanent). The total cost would be $45 billion when the added interest payments on the debt were taken into account.[3]

- **Budget outlook has deteriorated.** Since the Senate last considered the child tax credit in June 2003, the gravity of the nation's fiscal situation has become more apparent. *Since CBO issued its March 2003 budget forecast, CBO's projection of cumulative deficits for the ten-year period from 2004-2013 has increased by $3.4 trillion,* adding to the already large fiscal deterioration that has occurred. This further decline in the fiscal outlook is principally explained by four factors: enactment of the 2003 tax cut; enactment of the prescription drug bill; increased costs for the war in Iraq; and further downward economic and technical adjustments.

  In June 2003, when the Senate last considered child tax credit issues, it was already evident that the fiscal situation was worsening. The 2003 tax cut had just been enacted, and the war in Iraq was underway. But the full fiscal implications of these policies, as well as the budgetary dimensions of the yet-to-be enacted drug benefit, were not yet clear. CBO's projections confirm that in combination, these various policies have resulted in a dramatic expansion of expected deficits. Given this situation, Congress should make every effort to refrain from "digging the hole deeper."

- **Child Tax Credit measure could undercut pay-as-you-go rules.** This year, the Senate has made some strides toward restoring fiscal discipline. In its budget resolution, the Senate approved a "pay-as-you-go" rule that would require all tax cuts and entitlement expansions to be paid for, although there are indications that the Senate might agree to exempt the extension of the "middle class" tax cuts. Raising the income limits for the child tax credit would represent a *new* tax cut for higher-income households, not an extension of an existing "middle class" tax cut. If not paid for, such a new tax cut would undermine the pay-as-you-go principle.

- **Low-income families would receive little benefit and could well be made worse off over time.** As with last year's Senate bill, the expansion of the child

[2] Under last year's Senate bill, married filers would receive the full credit until their incomes surpassed $150,000, and a partial credit until income reached $169,000 for families with one child, $189,000 for families with two children and $209,000 for families with three children.

[3] Under last year's Senate bill, the level up to which the maximum child credit is provided would rise from $110,000 (for married couples) to $115,000 in 2008 and 2009 and $150,000 in 2010. (The income threshold would then have reverted to $110,000 after 2010.) By contrast, under the new House bill, the increase in this threshold (to $250,000) would take effect in 2004 and be permanent. While delaying the year in which such an increase would take effect does reduce costs over the next few years, such a delay has no significant effect on long-term costs, and, from a fiscal standpoint, it is the long-term costs that are of most serious concern. Similarly, an early expiration, as was included in last year's Senate bill, artificially reduces the official cost estimate, but it is unlikely to change the long-term cost of the policy. Such temporary tax cuts are likely to be made permanent.

tax credit for high-income households would likely be coupled with an acceleration of the increase scheduled for 2005 in the component of the child tax credit targeted on low-income working households. That would constitute a worse deal than the compromise in last year's Senate bill. The increase in the low-income component of the child tax credit will take full effect in 2005 anyway. Under last year's Senate bill, this increase would have been accelerated by two years (for both 2003 and 2004). This year, by contrast, any legislation could accelerate the increase by only one year.

According to Tax Policy Center estimates, the acceleration in benefits for low-income families would provide $1.8 billion in tax benefits in tax year 2004 to low-income working families. This $1.8 billion, one-time acceleration could come in exchange for what would eventually become a permanent tax cut for high-income households that would cost $40 to $70 billion over the next ten years and additional amounts in years after that. (It also should be noted that if the Senate were to raise the income level up to which filers may claim the full tax credit to $150,000, rather than to $250,000 as in the House bill, the $150,000 level would likely end up well above $150,000 when the legislation emerged from conference.)

Given that the nation faces long-term deficits that are unsustainable, and that sooner or later steps will have to be taken to offset the costs of the recent tax cuts (as well as the costs of recent program expansions), the potential is high for such a deal on the child tax credit to injure low-income working families and their children over time. These families would receive no added tax benefits after 2004. Yet important programs that assist many of these families eventually could be cut as part of a series of budget reductions instituted to offset the ongoing costs of the tax cuts, including the costs of extending the child tax credit to families at quite substantial income levels.