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Budget Model

Incentive Effects of the Romney and Biden/Neal Child Tax Credit Proposals

Summary: This post compares effective marginal tax rates (EMTRs) under the Family Security Act proposed by Sen. Romney and the Child Tax Credit (CTC) expansion proposed by Rep. Neal and President Biden. Married families with children and less than $45,000 in income would face EMTRs 4.4 percentage points higher under the Romney proposal and 6 percentage points higher under the Biden/Neal proposal.

Introduction

Several weeks ago, Congressman Richard E. Neal (D-MA), Chairman of the House Ways and Means committee, released legislative proposals for COVID economic relief to be considered under the budget reconciliation process. These proposals are modeled after President Joe Biden's proposed $1.9T stimulus package. One major element of the proposal is an expansion of the Child Tax Credit (CTC), similar to the plan envisioned in Biden's campaign proposal.

The Biden/Neal proposal arrived days after Senator Mitt Romney (R-UT) released a plan (dubbed the Family Security Act) to consolidate several forms of federal child assistance into a single, expanded child benefit.

Each proposal would entail significant changes to the structure of child benefits in the United States. In particular, the proposals would extend the full value of benefits to families with little or no income who, under current law, are partially or fully excluded from the CTC. The proposed changes would therefore affect some adults' work incentives. In this brief, we present estimates of effective marginal tax rates on wage earnings—the tax rate on the next dollar of income from working—by family structure and income group under each proposal.[1]

Current law

Under current law, the CTC provides a credit of up to $2,000 per child aged 16 and younger who are US citizens. The credit is partially refundable, meaning that some families with low incomes are not eligible for the full value of the credit. A family for whom the credit's value is larger than their federal income tax liability is eligible to receive a refund equal to 15 percent of earnings above $2,500, up to a maximum per-child value of $1,400. Currently, the credit begins phasing out for married couples with Adjusted Gross Income (AGI) of more than $400,000 ($200,000 for single parents) at a 5 percent rate. The credit is scheduled to become less generous in 2026 when the expansion enacted in the Tax Cuts and Jobs Act expires.

The Biden/Neal proposal

This proposal would raise the CTC value to $3,000 for children 17 and under with a $600 bonus for children under age 6. The credit would *begin* phasing out at income levels of $112,500/$150,000/$75,000 (head of household/married filing jointly/single), after which the per-child value would plateau at its current-law value of $2,000. The credit value phases out at a rate of 5 cents per additional dollar of AGI. Notably, this phaseout design is consistent with Biden's campaign promise not to raise taxes for families making under $400,000.

Furthermore, under this proposal, families would receive advance payment of the tax credit on a monthly basis. The payments, as designed, would be handled through the Internal Revenue Service and require additional infrastructure to administer. Overpayments would be reconciled when families file 2021 tax returns.

Because this proposal is envisioned as part of a COVID-19 relief plan, the expanded CTC provision is temporary and expires in 2022. PWBM estimates that the proposal would cost $100 billion.

The Romney proposal

Senator Romney's proposal would consolidate several child assistance programs in order to provide a more generous, fully-refundable monthly child allowance delivered monthly through the Social Security Administration.[2] Unlike the Biden/Neal proposal, which is temporary, the Romney proposal calls for permanent reform. The Family Security Act would provide a child allowance of $4,200 annually ($350 per month) for children ages 0-5, and $3,000 annually ($250 per month) per child ages 6 through 17. The credit would phase out at a rate of $50 for every additional $1,000 of income above the phase out threshold ($200,000 single/$400,000 joint). This maintains the same phase out rate and thresholds as apply to the CTC under current law.

In addition, the proposal eliminates several existing forms of child benefits, some through the tax code and others through federal spending programs. On the spending side, the proposal would end Temporary Assistance for Needy Families (TANF), a block grant program that provides time-limited cash assistance to low-income families with children, and calls for additional unspecified restrictions to eligibility requirements for the Supplemental Nutrition Assistance Program (SNAP).

On the tax side, the proposal would eliminate both the Head of Household filing status, a preferential filing option that lowers effective tax rates for unmarried adults with children, and the Child and Dependent Care Tax Credit, a nonrefundable credit that covers the cost of a share of qualified childcare expenses.

The plan would also reform the Earned Income Tax Credit (EITC), a refundable wage subsidy credit which, under current law, scales the generosity of benefits by the number of children in a family. Under the proposal, the credit's phase-in rates would be determined solely on whether the tax unit is childless or not with maximum credit values of $1,000 for childless single-filers, $2,000 for childless joint filers and single-filers with any dependents, and $3,000 for joint filers with dependents. The proposal would maintain the value of the current earned income credit for tax units with adult dependents.

Finally, the proposal would eliminate the itemized deduction for state and local taxes (the "SALT deduction"). According to Senator Romney, this provision would offset the net budget cost of the other provisions listed above.

PWBM estimates that the tax provisions of Romney proposal would cost $283 billion over ten years.

Analysis of Incentive Effects

An individual's effective marginal tax rate (EMTR) is the tax rate they face on an additional dollar of income. This rate is determined by the statutory tax rate they face (according to their bracket in the federal income tax system) and by other tax credits and incentive programs, including child benefit programs. Without child tax benefits, the average EMTR faced by households with children would be 3 percentage points higher. The changes to child tax benefits proposed in the Romney and Neal plans would alter the EMTRs families face. These changes may influence household choices about whether to work, and if so, how many hours to work.

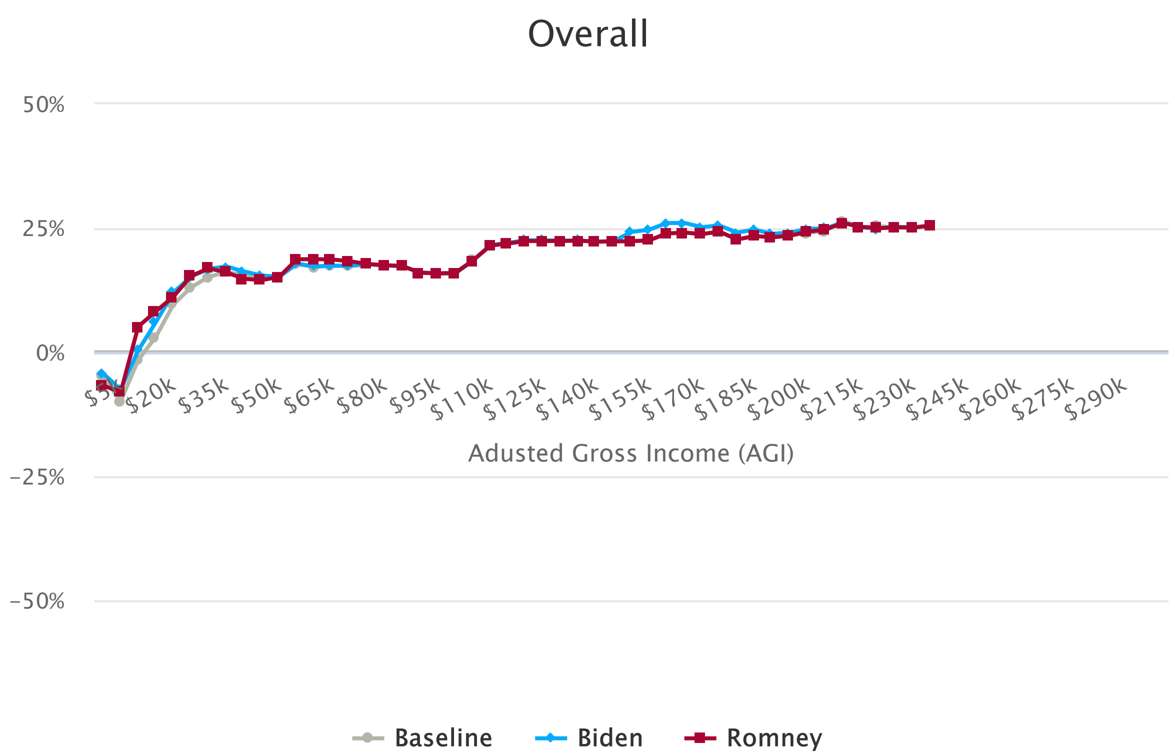
Figure 1 shows PWBM's estimates of overall EMTRs—including the EITC, CTC, and other taxes and transfers in the tax code—under current law, the Biden/Neal CTC proposal, and the provisions of Romney's Family Security Act that affect child benefits.[3] The effective marginal tax rate on labor income is calculated using the PWBM Tax Module for each tax unit. We calculate the average EMTRs within AGI groups of $5,000 increments, as well as by marital status and presence of children.

Figure 1. Effective Marginal Tax Rates by Proposal and Family Type

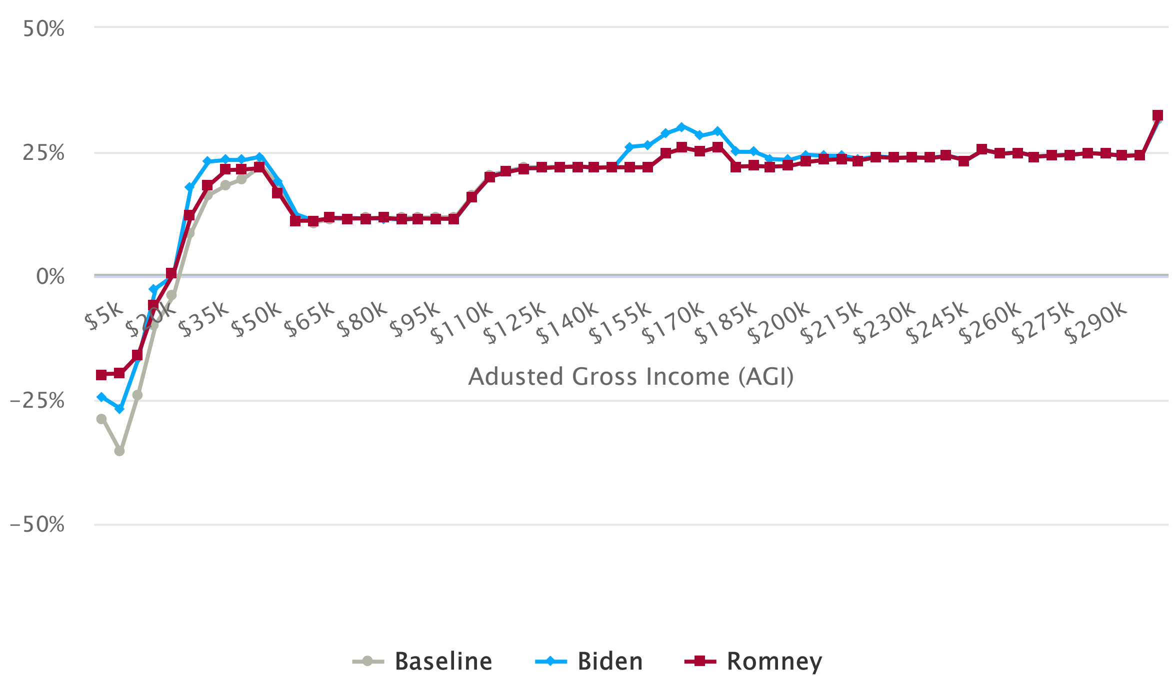
DOWNLOAD DATA

Family Type:

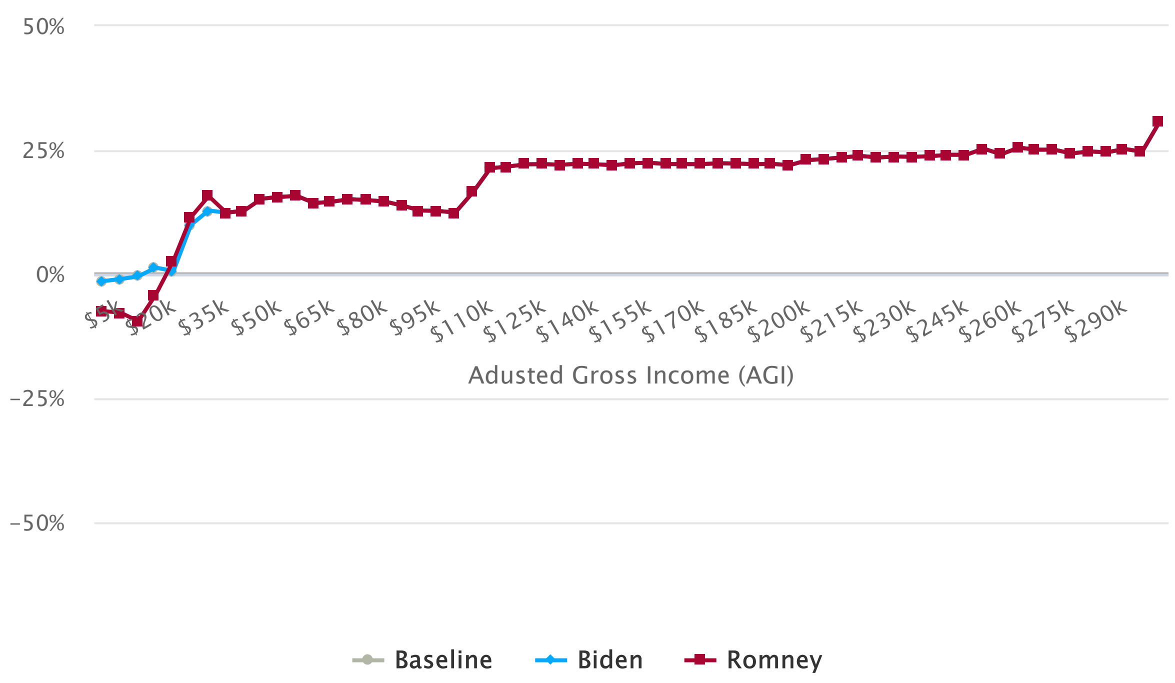
Overall ▼

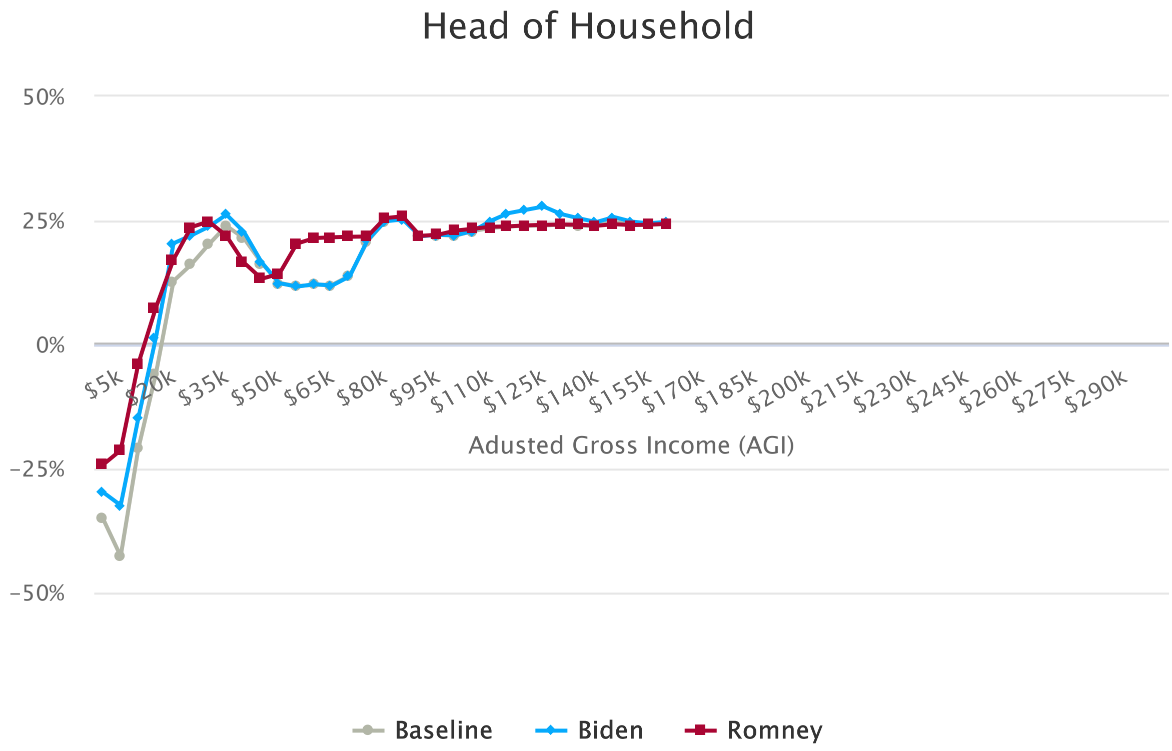


Married, With Children



Married, No Children





Proposed changes to the phase-in and phase-out structures for the CTC and EITC would be the main source of changes to EMTRs and labor incentives. For example, both the Romney and Neal plans would make the child credit (or child allowance) fully refundable, eliminating phase-in of the benefit. For families currently in this phase-in range, under full refundability each additional dollar of earned income would no longer result in an increase in credit value. The EMTR these families face would rise under the proposed plan.

EMTR changes for childless families

Under the Biden/Neal proposal, individuals and families without children do not see any change in their EMTRs from current law.

The Romney proposal increases the EITC benefit for childless families, however, resulting in negative marginal tax rates for low-income childless families. Under the Romney proposal, on average, joint filers without dependents earning under $20,000 in AGI would see a 6.7 percentage point decrease in their EMTR.

EMTR changes for married filers with children

Both proposals would affect the EMTR faced by joint and individual filers with children. As discussed earlier, full refundability of the proposed child credit (and child allowance) raises EMTRs for low-income families with children. Relative to current law, married families with any children and earning less than $45,000 would face EMTRs 4.4 percentage points higher under Romney's FSA and 6 percentage points higher under the Biden-Neal proposal. Although both the Biden/Neal and Romney proposals would raise EMTRs from their lowest point (less than -35 percent under current law), both proposals would maintain the steep increase in marginal tax rates as low-income families phase out of various forms of federal assistance.

The Biden-Neal proposal would also raise EMTRs for higher-income families with children. Families with AGI between $150,000 and $200,000 would see the tax rate on each additional dollar of income rise by nearly 3 percentage points, on average. This is a result of their falling in the first phase-out range of the proposed CTC.

EMTR changes for head of household filers with children

Head of household filers in the low end of the income distribution would see similar increases to their EMTRs as married filers with children. Under the Romney proposal, those who currently file under head of household status with between $50,000 and $80,000 in AGI would see a 6.4 percentage point increase- in their EMTRs on average due to the proposed elimination of head of household status. Under the Biden-Neal proposal, head of household filers with AGI between $110,000 and $140,000 would see a 2.5 percentage point increase in EMTRs on average, as these families would fall in the first phase-out range of the proposed CTC.

This analysis was conducted by Victoria Osorio and John Ricco. Prepared for the website by Mariko Paulson.

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1. This post compares the portion of each proposal that affects child benefits. Of the Biden-Neal stimulus proposal, we only compare the provision that would expand the Child Tax Credit. Of the Family Security Act, we model the following provisions: proposed Child Allowance and CTC repeal, simplified EITC, Child and Dependent Care Credit (CDCTC) elimination, and elimination of Head of Household status. The FSA also proposes eliminating the SALT deduction, eliminating TANF, and modifications to SNAP eligibility, all of which are excluded from this analysis. ↩

2. Our analysis in this post considers marginal tax rates for those who receive benefits under each proposal, and so we do not consider here how differences in program design may affect participation rates or administration of each proposal. ↩

3. That is, we do not include the effects of eliminating the SALT deduction in these figures. This analysis is focused on provisions affecting child benefits only. ↩