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INSIGHT

The Child Tax Credit: Temporary Expansion for 2021 Under the American Rescue Plan Act of 2021 (ARPA; P.L. 117-2)

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In recent years, there has been increased interest in providing direct benefits to families with children to reduce child poverty in the United States, sometimes in the form of tax benefits. The National Academy of Sciences (NAS) included a "child allowance" as part of a package of policies to reduce child poverty over 10 years. (Senator Romney has also proposed a child allowance.) Some research has suggested that increasing the amount of the child tax credit that low-income families receive would substantially reduce child poverty, boost future earnings, and potentially improve future health and education outcomes.

In the 116th Congress, there were several legislative proposals to expand the child tax credit, especially for lower-income families that tend to receive little or no benefit from the current credit. In the 117th Congress, a temporary one-year expansion of the child credit (for 2021) was included in the American Rescue Plan Act of 2021 (ARPA; P.L. 117-2). The Biden Administration has proposed making the full refundability provision included in the ARPA expansion of the child credit permanent, while extending other ARPA provisions through the end of 2025.

This Insight provides a summary of the child tax credit prior to ARPA and an overview of the temporary child credit expansion under ARPA for 2021.

How would the child credit have been calculated in 2021 before ARPA?

For 2021, prior to ARPA, the child tax credit would allow eligible taxpayers to reduce their federal income tax liability by up to $2,000 per qualifying child. A qualifying child was generally any dependent child under 17 years old. The credit was reduced in value, or phased out, by $50 for every $1,000 of income over $200,000 ($400,000 for married couples who file joint tax returns).

If a taxpayer's income tax liability was *less* than the maximum value of the child tax credit, the taxpayer may have been eligible to receive all or part of the difference as a refundable credit. The refundable portion of the child tax credit—the amount which was greater than income taxes owed—is referred to as the additional child tax credit (ACTC) and was calculated using what is sometimes referred to as "the earned income formula." Under the earned income formula, the ACTC gradually increased, or phased in, as earned income rose above $2,500. The maximum amount of the ACTC was $1,400 per qualifying child. CRS estimates that about one in every five taxpayers (19%) with a credit-eligible child had low incomes that resulted in them receiving less than the maximum credit.

After 2021, the ARPA expansion described in this Insight is scheduled to expire, and the credit would thus revert to the "prior law" parameters described above until the end of 2025.

How does the child credit change in 2021 under the American Rescue Plan Act?

The American Rescue Plan Act of 2021 (ARPA; P.L. 117-2) makes several temporary changes (for 2021 only) that expand the child tax credit, primarily for low-income taxpayers. These changes include

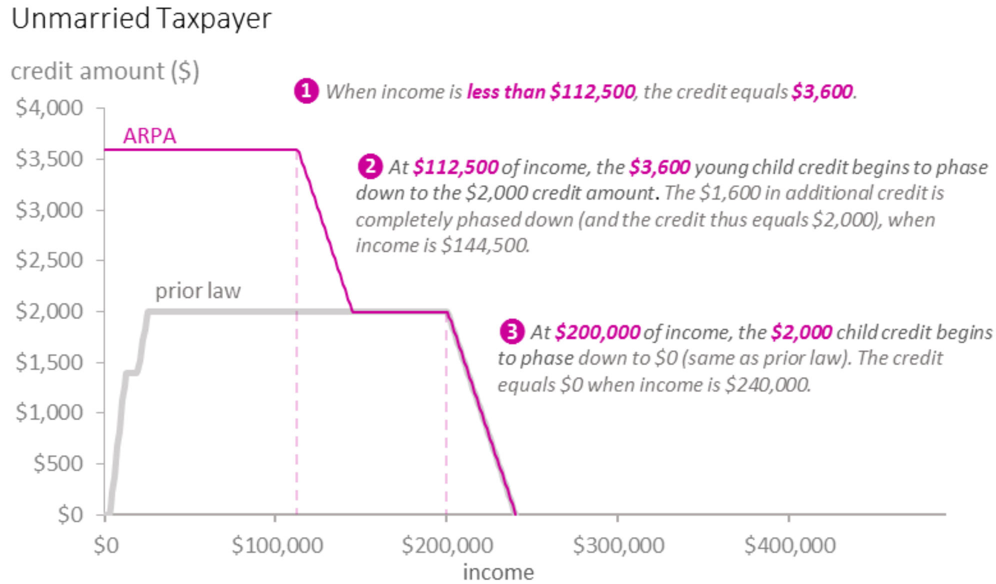
- **Expanding eligibility to 17 year olds:** The law increases the maximum age for an eligible child from 16 to 17.
- **Making the credit fully refundable:** The law eliminates the ACTC phase-in based on earned income and eliminates the ACTC cap of $1,400 per child. Hence, the child credit is "fully refundable" and the full value is available to otherwise eligible taxpayers with no earned income.
- **Increasing the credit for low- and moderate-income taxpayers, with larger increases for younger children:** The law increases the maximum amount of the credit from $2,000 per child to $3,600 per child for a young child (0-5 years old) and $3,000 per child for an older child (6-17 years old), as illustrated in the figures below. Generally, this increase in the maximum child credit of $1,600 per young child and $1,000 per older child gradually phases out at a rate of 5% as income exceeds specified thresholds until the credit amount equals the current-law maximum of $2,000 per child. These thresholds are $75,000 for single filers, $112,500 for head of household filers, and $150,000 for married joint filers. (The actual income level at which the credit phases down to $2,000 per child depends on the number and age of qualifying children.) For many families, the credit then plateaus at its prior-law level of $2,000 per child and phases out when income exceeds the current-law threshold of $200,000 ($400,000 for married joint filers). For larger families, the credit may never plateau at the $2,000 per child level, but simply continue to gradually phase out.

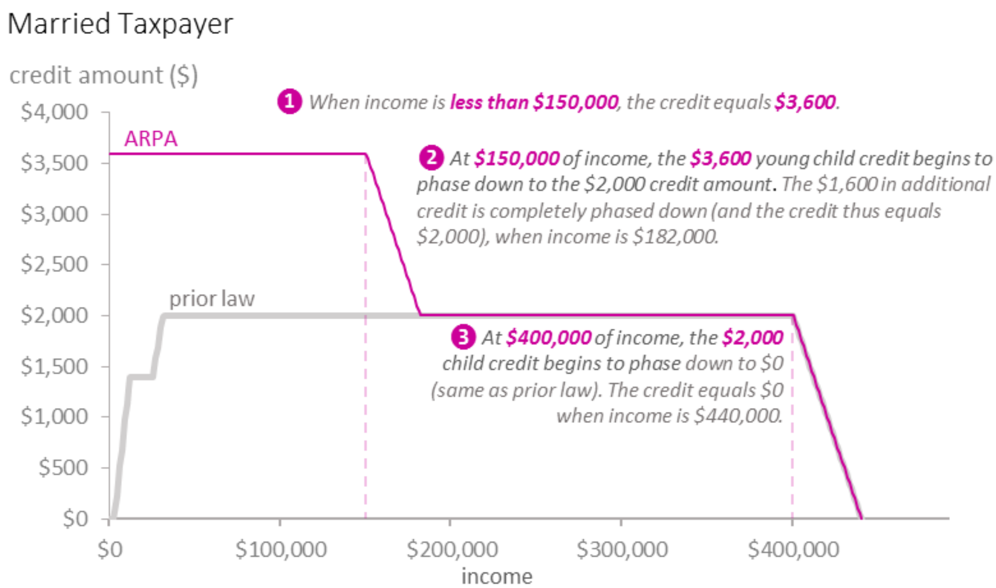
These changes will increase the amount of the credit for low- and moderate-income taxpayers, while higher-income families will generally receive the same benefit as under prior law (unless they have an eligible 17-year-old), as illustrated in the figures below.

The Joint Committee on Taxation estimates this temporary one-year expansion of the child credit would cost $110 billion, mostly in FY2021 and FY2022 (these estimates also include the relatively smaller cost of permanently extending the credit to residents of U.S. territories).

Child Credit Amount for One Young Child (0-5 Years Old) for 2021

Prior Law and the American Rescue Plan Act of 2021 (ARPA; P.L. 117-2)



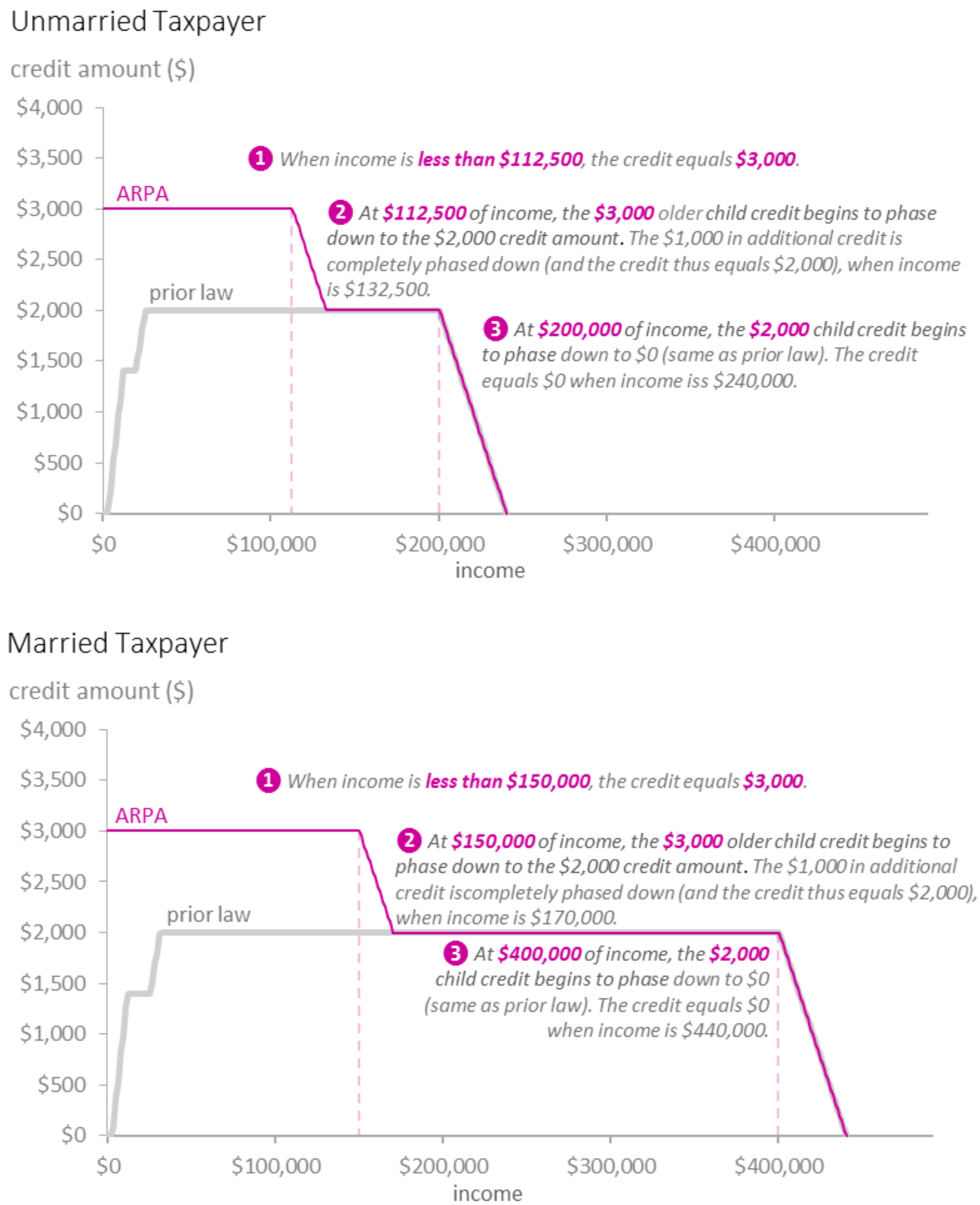


Source: CRS calculations based on IRC §24 and P.L. 117-2.

Note: 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 are assumed to file as head of household, married taxpayers are assumed to file joint returns.

Child Credit Amount for One Older Child (6-17 Years Old) for 2021

Prior Law and the American Rescue Plan Act of 2021 (ARPA; P.L. 117-2)



Source: CRS calculations based on IRC §24 and P.L. 117-2.

Note: 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 are assumed to file as head of household, married taxpayers are assumed to file joint returns.

How does ARPA advance the credit?

ARPA directs the Treasury to issue *half of the expected 2021 credit* in periodic payments beginning after July 1, 2021 (these periodic payments will generally be equal in amount). Taxpayers will claim the remaining half of the total 2021 credit when filing their 2021 income tax return in early 2022. The *expected 2021* credit amount is the total amount the taxpayer would be expected to receive in 2021 (and not just the amount of the credit that exceeds income taxes owed).

The amount of the payments advanced in 2021 are estimated based on 2020 income tax data or, if unavailable, 2019 income tax data. Families can update this information on a portal in 2021.

The IRS can adjust income tax withholding to take into account the advanced child credit.

Will taxpayers need to repay the advanced credit?

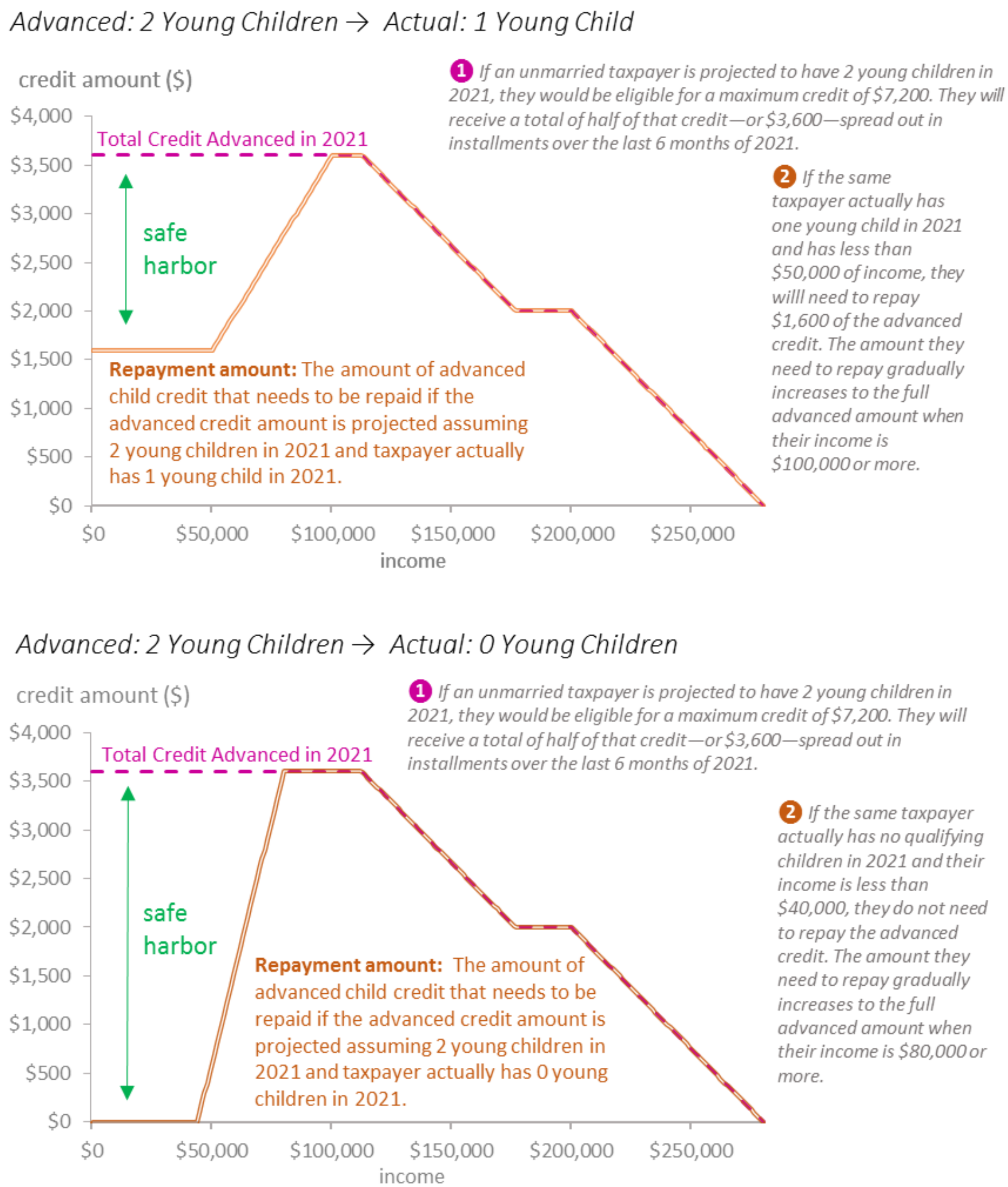
In cases where a taxpayer receives more in advanced payments than they are eligible for—due to changes in income, filing status, or number of children—taxpayers will generally need to repay any excess credit. Repayment may either reduce their 2021 tax refund or result in the taxpayer being required to remit payment to the IRS.

In cases where an incorrect amount of the advanced payment is *due to net changes in the number of qualifying children*, up to $2,000 per child of the advanced payment is protected from repayment (the "safe harbor" amount) for lower-income taxpayers. This safe harbor amount gradually phases down as income increases. *Net changes in number of qualifying children* can occur, for example, when a single parent had two children in 2020 (the year of the information used to estimate the advanced credit), but, because one of their children now lives with the other parent or another relative, only one child in 2021.

Below is an illustrative example of how much would need to be paid back if an unmarried taxpayer receives an advance payment based on a projection that they have two young children in 2021 (and so are estimated to be eligible for a $7,200 credit, of which $3,600 would be advanced), but in actuality, they have one or none.

Repayment of Advanced Child Credit for Children Incorrectly Claimed Under the American Rescue Plan Act of 2021 (ARPA; P.L. 117-2)

Unmarried Taxpayer, 2021



Source: CRS calculations based on IRC §24 and P.L. 117-2.

Notes: Stylized example assuming advanced amount based on projection that taxpayer has two young children in 2021. In actuality, the taxer only has one young child (top panel) or no young children (bottom panel). The taxpayer has no other qualifying children. An ummarried taxpayer with children (top panel) is assumed to file as head of household. An unmarried taxpayer with no children (bottom panel) is assumed to file as single.

A more detailed overview of determining the payback amount can be found in the figure below.

Steps for Reconciling Advanced Payments of the Child Credit with the Actual Credit on 2021 Tax Returns Under the American Rescue Plan Act of 2021 (ARPA; P.L. 117-2) That Occur Due to an Incorrect Number of Qualifying Children

Steps to Reconcile Advanced and Actual Credit	Example 1 Single parent with 2 qualifying young children in 2020 and 1 young child/0 older children in 2021	Example 2 Single parent with 2 qualifying young children in 2020 and 0 qualifying children in 2021
	Maximum projected 2021 credit: $7,200 **Maximum amount of credit advanced in 2021:** $3,600	
Step 1. Determine maximum safe harbor amount. Determine net difference in (a) number of qualifying children used to determine *advanced credit* and (b) number eligible for *actual credit* in 2021. Multiply this amount by $2,000.	The net difference between the (a) number of qualifying children from a 2020 tax return (2 children) used to determine the advanced credit and (b) the number of children claimed on a 2021 tax return (1 child) is **1 child**. $1\ child\ x\ \$2{,}000 = \$2{,}000$	The net difference between the (a) number of qualifying children from a 2020 tax return (2 children) used to determine the advanced credit and (b) the number of children claimed on a 2021 tax return (0 children) is **2 children**. $2\ children\ x\ \$2{,}000 = \$4{,}000$
Step 2: Phaseout maximum safe harbor, if applicable. Depending on **income** and **filing status in 2021**, the maximum safe harbor may be subject to reduction. Safe harbor reduced ratably (i.e., proportionally) between: **$40,000-$80,000** single filers **$50,000-$100,000** head of household filers **$60,000-$120,000** married joint filers	**No phaseout**: If a single parent in 2021 (i.e. head of household filer in 2021) has income under $50,000, their safe harbor is not reduced (i.e., it equals the **maximum safe harbor amount**). **Phaseout:** If a single parent in 2021 has income between $50,000 and $100,000, the maximum safe harbor phases out ratably in relation to income in the phaseout range. For example, if income were **$60,000** in 2021, the maximum safe harbor would be reduced by: $[\frac{\$60{,}000-\$50{,}000}{\$100{,}000-\$50{,}000}]$=**20%** A **$2,000** safe harbor **reduced by 20%** would equal **$1,600.** **No safe harbor:** If a single parent in 2021 has **more than $100,000** in income, their safe harbor amount is **$0**.	**No phaseout**: If a single person in 2021 (i.e. single filer in 2021) has income under $40,000, their safe harbor is not reduced (i.e., it equals the **maximum safe harbor amount**). **Phaseout:** If a single person in 2021 has income between $40,000 and $80,000, the maximum safe harbor phases out ratably in relation to income in the phaseout range. For example, if income were **$60,000** in 2021, the maximum safe harbor would be reduced by: $[\frac{\$60{,}000-\$40{,}000}{\$80{,}000-\$40{,}000}]$=**50%** A **$2,000** safe harbor **reduced by 50%** would equal **$1,000.** **No safe harbor:** If a single person in 2021 has **more than $80,000** in income, their safe harbor amount is **$0**.
Step 3: Calculate the amount that needs to be recaptured (or paid back) on 2021 tax return: Subtract the safe harbor amount (determined after step 2) from the total amount advanced in 2021. If the **safe harbor amount** is greater than or equal to **advanced amount**, none of the advanced amount needs to be paid back.	If income in 2021 for a single parent is: **Under $50,000**: Payback amount is **$1,600.** This amount equals the **$3,600** in total advanced credit they received in 2021 minus the **$2,000** safe harbor. **$50,000+:** Payback amount gradually increases from **$1,600** to the total advanced amount when income is $100,000 or more. *If income was $60,000, the **safe harbor** would be **$1,600**, the single parent would need to pay back **$3,600** - **$1,600** or **$2,000**. (Since this single parent would generally be eligible to receive $3,600 in the young child credit on their 2021 tax return, this recapture would effectively reduce their 2021 child credit by $2,000.)*	If income in 2021 for a single person is: **Under $44,000:** Payback amount is **$0** since the advanced amount of **$3,600** is less than **$4,000** when income is under $40,000. Between $40,000 and $44,000 the safe harbor gradually declines but is still greater than or equal to $3,600. **$44,000+:** Payback amount equals **$3,600** *minus* **safe harbor** until income iss $80,000 or more at which point the total advanced amount needs to be repaid. *If income was $60,000, the **safe harbor** would be **$1,000**, the single person would need to pay back **$3,600** - **$1,000** or **$2,600**.*

Sources: CRS analysis of P.L. 117-2.
Notes: Assumes advanced payment that would be received in 2021 would be based on 2020 income and family structure (number of qualifying children and marital status). Broadly, income is assumed to be the same between 2020 and 2021 to isolate the impact of a changing number of qualifying children.

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