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INSIGHT

The Child Tax Credit Under the House Ways and Means Committee "Build Back Better" Reconciliation Language: Specified Child and Presumptive Eligibility

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In September 2021, the House Ways and Means Committee approved reconciliation language that would, among other changes, effectively extend the expanded child credit in effect in 2021 through the end of 2025. Should these changes become law, eligible taxpayers would receive a monthly per-child benefit of up to $300 for young children and up to $250 for older children through the end of 2025. For 2023-2025, the proposal modifies eligibility rules and administration of the credit. (After 2025, there would be no advance payment of the credit under the proposal.)

This Insight first provides an overview of how the 2021 child credit is being issued, followed by an overview of how the child credit could be administered under the House proposal. It concludes with some policy considerations with the House approach. Companion Insights summarize the proposed changes and how the benefit would be calculated under the House proposal.

The 2021 Child Credit and Monthly Payments

While most tax benefits are received once a year as a lump sum after an income tax return is filed, up to half of the 2021 child credit is being issued in six monthly payments between July and December of 2021 as a result of changes made by the American Rescue Plan Act (ARPA; P.L. 117-2).

Monthly advance payments of the 2021 child credit are based on *an estimate* of the credit taxpayers are eligible to claim on their 2021 income tax return. In order to estimate a taxpayer's 2021 child credit, the IRS is generally using 2020 tax data on taxpayers' income, number and age of qualifying children, and marital status.

Because the IRS is using older data to issue these monthly payments, this information may not reflect current circumstances in 2021. Income can change, children can move, and couples may divorce or marry from year to year. In some cases, these changes may result in taxpayers receiving more (or less) in advance payments than they are actually eligible for when they file their 2021 return. In cases where a

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taxpayer receives less, they will generally be able to receive additional amounts as part of their tax refund. In cases where they receive more, they would have *excess payments* of the credit and could need to repay that excess amount.

Safe Harbor

Under ARPA, low- and moderate-income taxpayers who receive excess advance payments of the credit due to *changes in the number of qualifying children between 2021 and 2020* may be protected from paying back some or all of these excess payments due to a safe harbor. (For more details on the safe harbor, see Example 2.) The House reconciliation language would extend a modified version of this safe harbor through 2022.

The Proposed 2023-2025 Credit and Monthly Payments

The reconciliation language temporarily suspends the current credit and replaces it with a new monthly benefit for 2023-2025. The proposal is broadly intended to allow the credit to be more "portable" if children move between taxpayers during the year, and limit repayment obligations in certain cases.

Monthly Payments

As with the 2021 child credit, monthly advances of 2023-2025 credit would be made using older data on taxpayers' annual income, number and age of "specified children," and marital status. If a taxpayer was presumed to be eligible for a specified child—that is, they had "established a period of presumptive eligibility" for the specified child—the taxpayer would generally receive monthly advance payments of the credit for that child (unless they elected not to).

And like the 2021 credit, there may be concerns that a taxpayer may receive an advance payment based on older data that do not reflect their current circumstances. To limit repayment obligations in such cases, the proposal also includes a provision that if the advance payments for a specified child were issued during a period of presumptive eligibility, the taxpayer would in most cases be deemed eligible and hence guaranteed the benefit. (The proposal also includes an "income lookback" provision that will largely eliminate repayment due to annual changes in income.)

Specified Child

Under current law, a taxpayer can claim the child credit for a "qualifying child" who meets several requirements, including being related to the taxpayer, generally as the child's parent, grandparent, aunt/uncle, sibling (the relationship test), and living with the taxpayer for more than half the year (the residency test).

The House reconciliation proposal replaces the definition of a qualified child (determined on an annual basis) under current law with a "specified child" requirement for 2023-2025 (largely determined on a monthly basis). The definition of specified child would differ from the definition of qualifying child in two main ways. First, it would replace the *annual* residency test with a *monthly* residency test. In other words, a child would need to live with the taxpayer for more than *half the month* to be eligible to be claimed by the taxpayer for that month. Second, the proposal would replace the relationship test with a "care test." A taxpayer would be determined to provide uncompensated care for the child in a given month based on a variety of factors including supervising the child's daily activities, providing the child with a secure environment, taking the child to the doctor, involvement in and financial support of the child's education, and any other factor deemed appropriate by the Treasury Secretary. In cases where a child would be the specified child of more than one taxpayer, tiebreaker rules would apply. Broadly, these rules would prioritize the claims of parents over nonparents and relatives over nonrelatives.

Presumptive Eligibility

A period of presumptive eligibility could be established by the Treasury Secretary based on information on a prior-year tax return, information provided on an online portal, or another manner the Treasury Secretary prescribed. Taxpayers would need to certify that they would expect to be able to claim the child as a specified child for at least three months. (Electing not to receive advance payments would not prevent a taxpayer from being considered presumptively eligible for the benefit.)

A period of presumptive eligibility could last up to a year, but would end earlier in cases of fraud/reckless disregard, if another taxpayer made a claim for that child as their specified child (a "disputed claim"), or if the Treasury Secretary had other information that called into question the taxpayer's eligibility to claim that child. Taxpayers would generally be notified when a period of presumptive eligibility had ended.

Policy Considerations

The new eligibility definition and presumptive eligibility are designed to make the credit more flexible to reflect family circumstances. However, they also introduce new complexity into the tax code, creating a novel definition of eligibility that differs from definitions used for other child-related tax benefits like the earned income tax credit (EITC). It is unclear how the IRS will be able to accurately determine when a taxpayer has a specified child given the limited data on where children live for a given month and who cares for them. Presumptive eligibility may lessen these concerns, since a taxpayer who has established a period of presumptive eligibility for a specified child is effectively deemed eligible and hence guaranteed the benefit.

But presumptive eligibility raises its own questions. What will the processes be for establishing presumptive eligibility? How will the IRS determine fraud or reckless disregard by a taxpayer when establishing presumptive eligibility, as opposed to taxpayer confusion and honest mistakes? What will a taxpayer's recourse be if the IRS makes an incorrect determination of a period of presumptive eligibility? And in cases where two taxpayers have a specified child for the same time period, would presumptive eligibility place different and potentially inequitable burdens on them in order to receive the benefit (see the example below)?

Hypothetical Example of Presumptive Eligibility

Assume based on prior information that a parent is deemed presumptively eligible for the 2023 credit. (The parent may have checked a box on their prior-year return indicating they expected to have a specified child for at least three months in 2023.) Absent any different determination by the Treasury Secretary, or competing claim within that year, the parent could be deemed "presumptively eligible" and receive 12 monthly payments in 2023. The taxpayer would generally not need to repay any of these monthly payments when they filed their 2023 return (in early 2024).

Now assume that in February of 2023, the child actually went to live with a grandparent for the rest of the year. The grandparent was unaware of the child benefit and did not file a competing claim with the IRS in 2023. The parent also did not update information with the IRS during 2023 to stop receiving the payments. When the parent files their 2023 income tax return, they may or may not be subject to recapture, depending on whether the IRS determines they received the payments fraudulently/due to reckless disregard.

But the grandparent may also be ineligible to claim the credit on their 2023 return because they did not establish a period of presumptive eligibility with the IRS for 2023. Specifically, proposed Section 24A(c)(7) may result in the grandparent being ineligible.

Proposed Section 24A(c)(7) provides:

Eligibility determined on basis of presumptive eligibility –
(A) In general. – if a period of presumptive eligibility is established under section 7527B(c) for any individual with respect to any taxpayer – (i) such individual shall be treated as the specific child of such taxpayer for any month in such period of presumptive eligibility, <u>*and (ii) such individual shall not be treated as the specified child of any other taxpayer with respect to whom a period of presumptive eligibility has not been established for any such month (emphasis added).*</u>

The reconciliation proposal provides that if a taxpayer is delayed or fails to establish a period of presumptive eligibility, they can elect to receive a retroactive payment (or a credit on their return) that covers 3 months of payments. This "grace period" payment or credit is allowed only once per taxpayer within a 36-month period. If the delay/failure to establish a period of presumptive eligibility is due to a hardship (including domestic violence, serious illness, or natural disaster), the amount of the credit is increased to cover 6 months of payments. Nonetheless, this would reflect less than the 11-month period the grandparent had the specified child in this example.

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