

The Federal Child Tax Credit

What is the federal child tax credit?

Parents may claim a credit against federal income tax for each child under age 17. The credit was enacted in the Tax Relief Act of 1997 (TRA) and first allowed in 1998. It was expanded under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and later laws. It equaled \$400 per child in 1998, increased to \$500 in 1999, \$600 in 2001 and 2002, and \$1,000 for 2003 through 2012. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (TRUIRJCA) extended the \$1,000 per-child amount through 2012. Unless extended by Congress, the credit will decrease to \$500 per child in 2013 and following years.

Are there income limitations?

The credit is reduced by \$50 for every \$1,000 of income over \$110,000 of adjusted gross income for married joint filers and \$75,000 for head of household filers. A married couple filing jointly with two children under age 17 will become ineligible for the credit when their income reaches \$150,000; a single parent claiming the credit for one child will become ineligible when income reaches \$95,000.

Is the credit refundable?

The child credit is partly refundable; the refundable portion is referred to as the “additional child tax credit.” In tax years 2009 through 2012, the additional child tax credit equals the greater of:

- 15 percent of earned income over \$3,000, or,
- for families with three or more children, payroll taxes in excess of the federal earned income tax credit.

For example, a married couple with two children under age 17 and \$30,000 of income is eligible for \$2,000 in child tax credits, \$1,000 for each child. If the couple claims the standard deduction, their federal income tax will equal \$290 in 2012. They use \$290 of their \$2,000 credit to reduce their liability to \$0. They may claim up to 15 percent of their earnings in excess of \$3,000 as a refund. Assuming all \$30,000 of their income is from wages, that means they would be eligible to claim up to \$4,050 of the remaining credit as a refund (15 percent of \$30,000 minus \$3,000 equals \$4,050). The result is that they claim \$290 as an offset to their tax liability and are paid the remaining \$1,710 as a refund.

When first enacted in TRA, the child credit was only refundable for taxpayers with three or more children, and only to the extent that their payroll taxes exceeded the federal earned income tax credit. The implicit rationale was that the refundable portion of the federal earned income tax credit was first used to offset payroll taxes for Social Security and Medicare, and then any payroll taxes left over after the federal earned income tax credit could be offset by the federal child credit. This refund mechanism was limited to families with three or more children because families with fewer children and no federal tax liability would typically have all of their payroll taxes offset by the federal earned income tax credit and none left over

to be offset by the new child credit.

In 2001 the refundable portion was changed to be the greater of:

- a percentage of earned income over a minimum amount for all families regardless of the number of children, or,
- for families with three or more children, payroll taxes in excess of the federal earned income tax credit (the provision that was already in law).

The 2001 law set the minimum amount at \$10,000 and provided for it to increase annually for inflation. The American Recovery and Reinvestment Act of 2009 temporarily reduced the indexed \$10,000 to \$3,000 for tax years 2009 and 2010 only; TRUIRJCA extended the \$3,000 threshold to 2011 and 2012. Unless Congress extends the expanded refundability of the credit, in 2013 only families with three or more children will be able to claim the credit as a refund, and the refund will be limited to payroll taxes in excess of the federal earned income tax credit.

***How much do
Minnesotans claim?***

In tax year 2009, 429,237 federal income tax returns filed by Minnesotans claimed \$577 million in the nonrefundable portion of the federal child credit. The average amount claimed was \$1,344. For the same year, 260,508 returns filed by Minnesotans claimed \$348 million under the refundable additional child credit. Some of these returns also claimed the nonrefundable portion of the credit. The average additional child tax credit was \$1,336.

***What is the effect of
the TRUIRJCA
sunset on the
federal child credit?***

Most provisions extended by TRUIRJCA will expire after tax year 2012. Included among the provisions subject to sunset are:

- the increase in the child tax credit from the \$500 per child amount set in the late 1990s to \$1,000, and
- allowing the credit to be claimed as a refund equal to a percentage of earned income over a threshold.

Unless Congress extends those provisions beyond 2012, in 2013 the per-child credit amount will decrease from \$1,000 to \$500 and the credit will be refundable only for households with three or more children, and only to the extent that their payroll taxes exceed the federal earned income tax credit.

The number of Minnesota households that claim the child tax credit is expected to fall by about 130,000 filers to 430,000 in tax year 2013 as a result of the TRUIRJCA sunset, and the total amount claimed by Minnesota filers is estimated to decrease by about \$560 million to \$350 million. The \$560 million decrease will consist of a reduction of about \$325 million in the nonrefundable portion of the credit and of about \$235 million in the refundable portion.

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