CHILD AND FAMILY TAX POLICY

IMPROVING LIVES

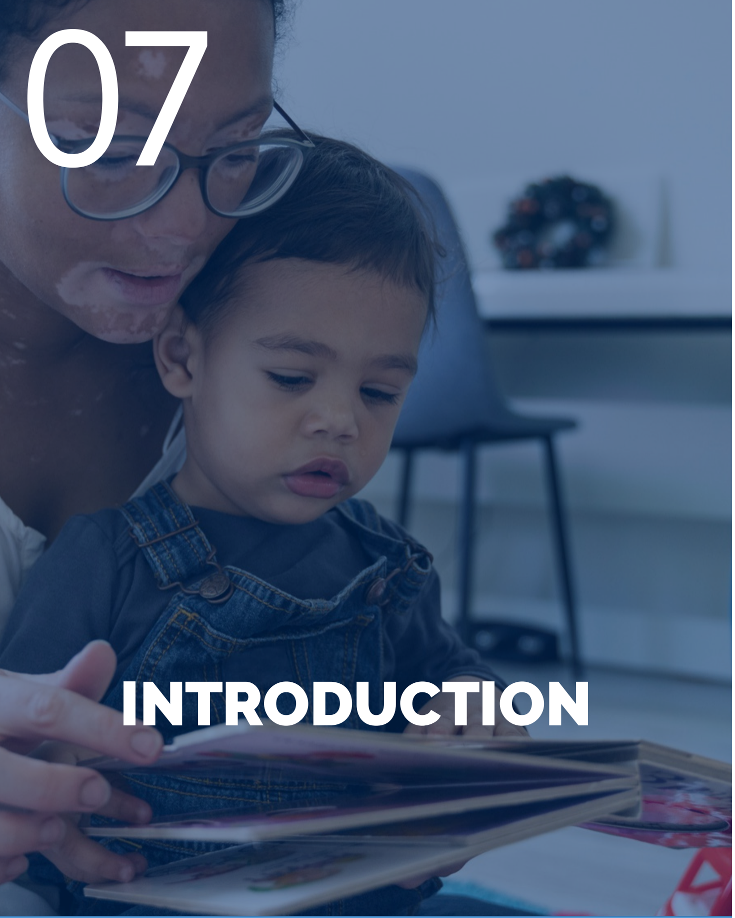
APRIL 2025

About First Focus on Children

First Focus on Children is a bipartisan advocacy organization dedicated to making children and families the priority in federal policy and budget decisions. We engage a broad coalition of advocates, partners, and members of Congress to increase investments in our nation's children and ensure that federal spending reflects the fact that every issue is a kids' issue. Our goal is to ensure policymakers put all of our nation's children first - regardless of race, ethnicity, religion, gender and sexual orientation - so they can thrive now and in the years to come.

For more information about First Focus on Children, or to make a donation, please visit www.firstfocus.org or call 202.657.0670.

Questions, comments, or suggestions about *Child and Family Tax Policy* can be emailed to Michelle Dallafior at michelled@firstfocus.org.



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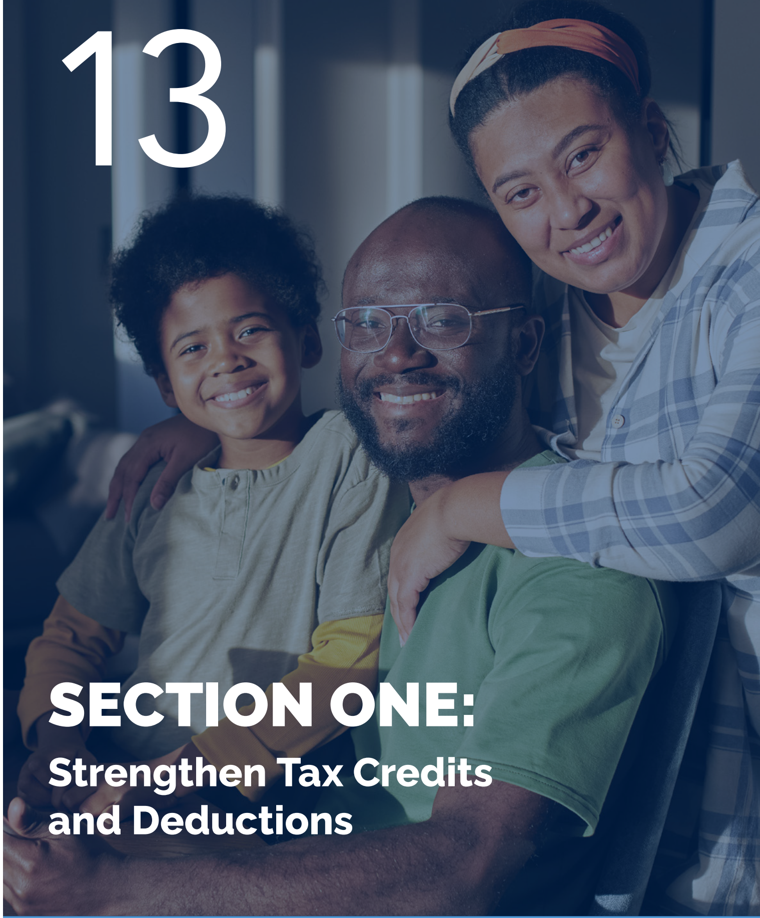

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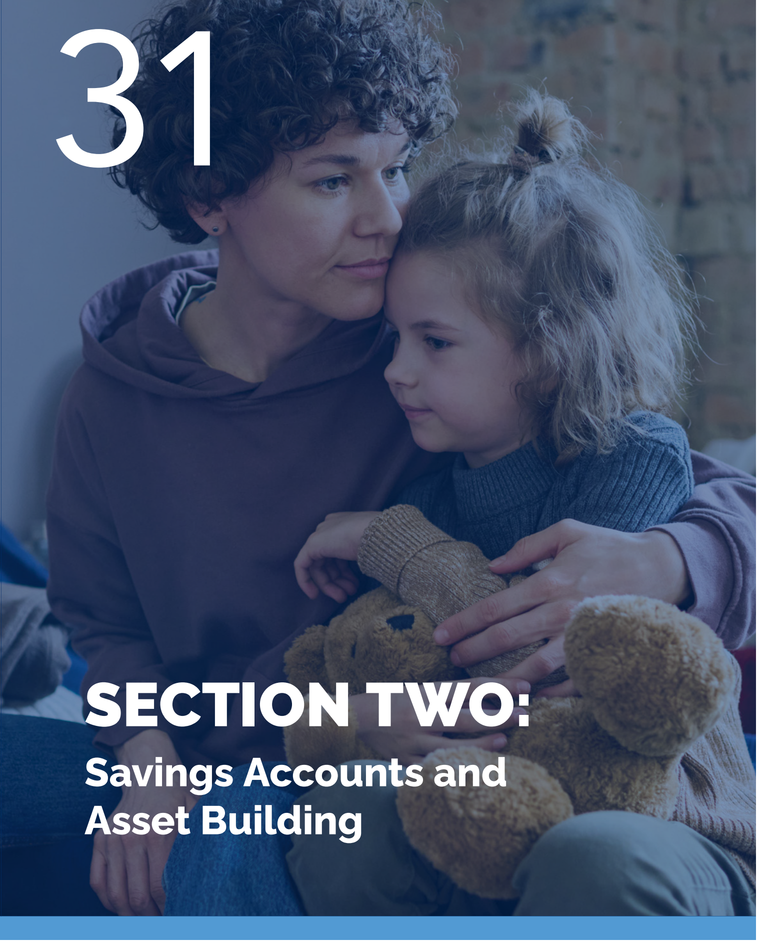
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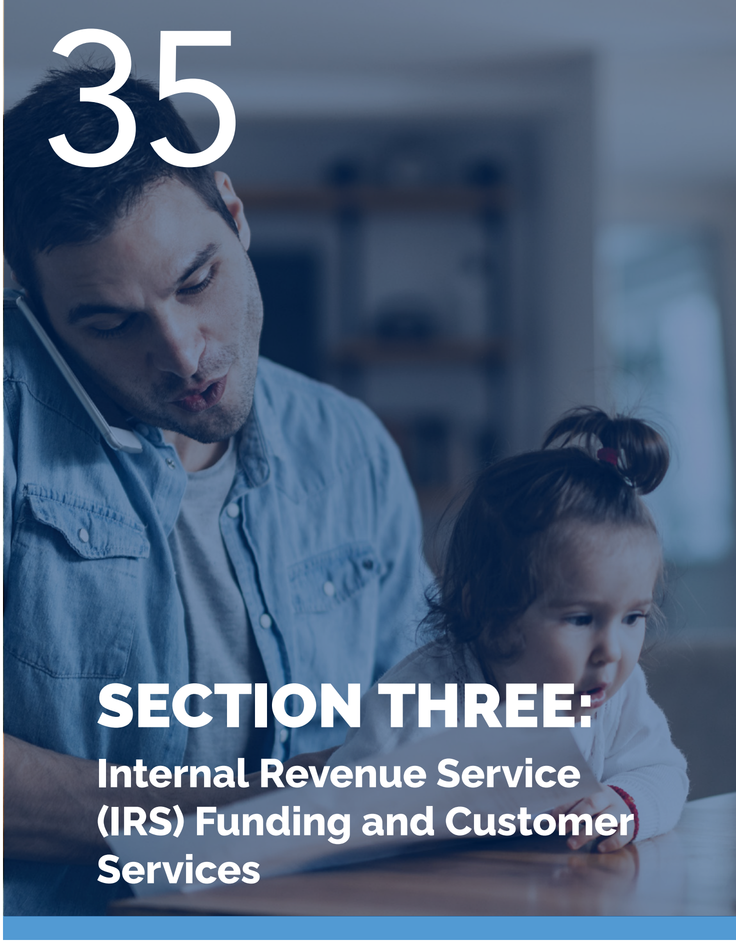
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Notes

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INTRODUCTION

The Need To Reform the Tax Code

All children deserve to live happy, fulfilling lives. This means that all children should have their immediate health and safety needs met, and no child should be denied the chance for a bright future based on their family's hardship.

Our country is failing our children in this regard. Child poverty is on the rise in the United States[1] as households with children struggle with the high cost of food, rent, and other household expenses. The tax code offers one of the strongest tools for improving the lives of children by providing credits, deductions, and asset-building tools that reduce child poverty and promote family economic mobility.

According to First Focus on Children's annual budget analysis, the Child Tax Credit, the Earned Income Tax Credit (EITC), and the Child and Dependent Care Tax Credit (CDCTC) are among the top 20 programs contributing to children's spending in the federal budget. In FY 2022, when tax filers had access to the EITC and a fully refundable CTC and CDCTC, mandatory spending for the three credits accounted for nearly 28% of the share of federal investments in children.

In 2023, the refundable portion of the Child Tax Credit kept 1.34 million children out of poverty. This impact is significant but would have been even greater if the improvements made to the CTC in 2021 under the American Rescue Plan Act (ARPA) were still in place. Columbia University's Center on Poverty and Social Policy found that if the ARPA improvements had continued in 2023, an additional 3.6 million children would have been spared poverty.[2]

Currently, one-quarter of children in the United States live in families that don't earn enough to qualify for the full $2,000 Child Tax Credit. Significant percentages of these children live in large families or rural communities. Children of color are also disproportionately left out,[3] as are babies, whose mothers are more likely to be in and out of the workforce because of complications in pregnancy, labor and delivery, postpartum health issues, lack of paid family medical leave, and other reasons.[4] Other examples of children left behind are those whose parents have passed away or who are victims of natural disasters.[5]

The majority of adults caring for children work outside the home but many still struggle to make ends meet because wages for low-wage workers have not kept up with inflation. Parents and caregivers need reliable income to provide nutritious food, health care, diapers, school supplies, and other resources that improve their children's development and achievement.

The high cost of raising young children makes it more likely that families with babies will slide into poverty. The cost of full-time, center-based care for infants — which exceeds the price of in-state college tuition in most states[6] — means that families can spend more than 10% of their income on child care alone.[7] The high cost of raising kids continues through childhood: On average it costs more than $300,000 to raise one child from birth to age 18 (not including college).[8]

Enhancing tax credits such as the Child Tax Credit, Earned Income Tax Credit, and Child and Dependent Care Tax Credit not only helps individual children and their families, but also benefits our country as a whole.

For example, improving the Child Tax Credit can strengthen local economies — the Niskanen Center found that extending the expanded Child Tax Credit for just one year would support the equivalent of 500,000 private-sector jobs.[9]

The United States tax code is the government's primary means of raising revenue to support a wide range of government functions, including the operation of numerous programs and services that benefit children and families throughout the country and abroad. Historically, the individual income tax has generated the most revenue. According to the Congressional Research Service, in FY 2021 the individual income tax contributed $2.0 trillion, or 50.5% of the federal government's revenue. The corporate income tax contributed notably less, generating $212 billion in FY 2021, or 9.2% of total revenue.[10]

Investing in children is one of the most cost-effective and impactful ways to shore up the nation's future. Research shows that investments in children yield immense returns,[11] not just for their lives but for the nation as a whole. Yet, our 2024 Children's Budget[12] finds that the share of U.S. federal spending on children fell to 8.87% in FY 2024, representing the third straight year of decline. Both mandatory and discretionary spending for children fell in FY 2024 as a share of the federal budget. Adjusted for inflation, U.S. investment in children declined nearly 6% from FY 2023.[13] Our Babies in the Budget 2024 analysis shows that the federal share of spending on infants and toddlers is an alarmingly low 1.52%.[14] This disinvestment in children isn't just about numbers — it has real-world consequences for millions of young people. As federal support dwindles, children face increased risk to their health, well-being and future. Early in the 119th Congress, harmful cuts and policy changes have already been proposed to reduce our deficit and support tax reforms skewed toward the ultra-wealthy.[15]

Reforms to build a fairer tax code, including an approach that includes revenue raisers, can help to address our nation's racial, gender, and economic inequities, which disproportionately affect children. Reforming our tax code would also offset the cost of extending individual tax concessions to low-income households. A May 2023 report by the Congressional Budget Office[16] estimates that extending provisions of the 2017 tax law (2024-2033) would add nearly $3.5 trillion to the national debt over 10 years. This number includes $550 billion from extending business provisions and $2.9 trillion from extending the individual and estate tax provisions. In a report released in January 2025, the Treasury Department's Office of Tax Analysis found that extending the expiring individual and estate tax provisions of the 2017 law would cost $4.2 trillion between 2026 and 2035 and the largest tax cuts would go to the highest-income families.[17]

This is money that research shows would be better spent on children. Instead of tax breaks for the nation's wealthiest people and corporations, Congress should approach tax reform in a manner that generates revenue to improve investments in our children and strengthen our economy.

The Opportunity

Reforming tax policies to better support families and children is critical to building a more equitable society. Through reforms outlined below, these tax credits, deductions, savings accounts and other opportunities in the tax code would provide financial stability for families and lift millions of children out of poverty.

First Focus on Children supports comprehensive tax reform. The policy recommendations below are divided into three sections: **(1) Strengthen Tax Credits and Deductions**, **(2) Savings Accounts and Asset Building**, and **(3) Internal Revenue Service (IRS) Funding and Customer Services**.

These recommended tax strategies should not replace existing programs that provide direct assistance to support children's health and well-being, and we would be remiss if we didn't acknowledge that tax deductions and savings accounts typically favor high-income families, while refundable tax credits and investments in direct-support programs better meet the needs of low-income families. We also acknowledge the provisions included in this paper are not an exhaustive list of the parts of the tax code that benefit children and their families. This paper mostly focuses on tax policies that go directly to households with children, which have the largest impact on improving the lives of lower-income children.

Reforms to the tax code are a powerful way to develop a comprehensive policy approach to provide the best outcomes for children and families, especially those who face the biggest barriers to economic mobility. As Congress heads toward intense debates around extending provisions of the 2017 tax law, lawmakers must prioritize reforms that help struggling families meet basic living expenses, reduce child poverty, and promote economic mobility. The Child Tax Credit and Earned Income Tax Credit have been shown to deliver a tremendous return on investment, helping improve near- and long-term outcomes for children and making our country stronger.

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SECTION 1

Strengthen Tax Credits and Deductions

Child Tax Credit (CTC)

Background

The Child Tax Credit (CTC) is a partially refundable tax credit available to households with dependent children, designed to reduce the tax burden and financial stress associated with raising children. The Child Tax Credit was first proposed by the bipartisan National Commission on Children in 1991.[18] It was initially included as part of then-Speaker of the House Newt Gingrich's Contract with America and was first enacted and signed into law by President Clinton through the Taxpayer Relief Act of 1997. Since then, the CTC has been amended several times.[19] In 2009, the American Recovery and Reinvestment Act (ARRA) and related legislation expanded the CTC to as much as $1,000 per child to counteract falling incomes during the Great Recession. A bipartisan agreement struck in December 2015 made this expansion permanent. The agreement also dropped the earned income phase-in amount from $8,500 in 2008 to $3,000; any household with earnings above this threshold qualified for a partial credit. In 2017, under the Tax Cuts and Jobs Act, Congress again lowered the earnings threshold, from $3,000 to $2,500, increased the refundable portion of the tax credit from $1,000 to $1,400 (annually adjusted for inflation), and raised the income thresholds from $110,000 to $400,000 for a joint return and from $75,000 to $200,000 for a single filer or head of household. Unfortunately, the law also limited access to immigrant households by making eligibility contingent upon children having a Social Security number.

The American Rescue Plan Act (ARPA) in 2021 expanded the Child Tax Credit by temporarily increasing the benefit to as much as $3,600 a year per young child and $3,000 a year for children 6 and older, including 17-year-olds, providing advance monthly payments starting in July 2021, and making the credit fully refundable. The ARPA also permanently changed the CTC to allow families in Puerto Rico to qualify for the credit with one qualifying child instead of limiting the credit to households with three or more children. Experts estimate that in 2021 the CTC delivered $70 billion in refundable tax credits to nearly 38 million families and nearly 62 million children. Families received payments totaling more than $93 billion in 2021.[20]

Following the expiration of the ARPA expansions at the end of 2021, the Child Tax Credit reverted to the version passed under the Tax Cuts and Jobs Act. Presently, the Child Tax Credit allows taxpayers to reduce their federal income tax owed by up to $2,000 per qualifying child under the age of 17. If the credit exceeds the amount of taxes owed by a household, the family may be eligible to receive a full or partial refund for the difference up to the maximum amount of the refundable portion of the CTC — $1,500 in 2022. The refundable portion of the CTC — also known as the Additional Child Tax Credit (ACTC) — is calculated as 15% of earnings over a "refundability threshold" of $2,500. Under current law, children must have a Social Security number to qualify for the credit. The CTC is available to households who have work income below certain thresholds ($200,000 for single parents and $400,000 for joint filers) at which point it starts phasing out by $50 for every additional $1,000 of adjusted gross income.

Strengthening the Child Tax Credit

The 2021 improvements to the Child Tax Credit contributed significantly to the largest decrease in the child poverty rate on record (from 9.7% in 2020 to 5.2% in 2021[21]), dramatically reduced food insufficiency,[22] and eased material hardship for tens of millions of households. Families receiving the monthly CTC payments overwhelmingly spent them on basic necessities including food, utilities, housing, education resources, diapers, and paying down debt.[23] It helped families, especially single mothers, increase their labor force participation by allowing them to afford child care, transportation, and other necessities that make it possible for them get to work.[24]

Research from the University of Washington finds that the collective impact of tax credits for families led to a reduction in child maltreatment reports by stabilizing families.[25] These results suggest that child neglect reports decrease when parents have more economic resources. Researchers believe the reduced number of reports could generate many other positive outcomes for children and their families.

The expiration of this unprecedented investment disrupted every aspect of children's lives. Child poverty increased by 163 % in 2023[26] compared to 2021, resulting in an additional 6.2 million children experiencing poverty. Food insufficiency rates among households with children increased 25%.[27] One-quarter of children are no longer eligible to receive the full or sometimes even partial Child Tax Credit because their families earn too little, disproportionately denying access to the credit for Black and Hispanic children, children in single-parent families, rural families, children in larger families, and families with young children, all of whom experienced large declines in child poverty in 2021 as a result of the CTC's expansion.[28]

By failing to include families with little or no income, the current version of the Child Tax Credit punishes children who live in families that face barriers to financial security or experience a disruption in income through no fault of their own. For instance, this provision harms children of parents with disabilities or siblings of children with disabilities, whose parents can only work part-time or who quit to care for their kids. Or children being cared for by grandparents on fixed incomes while parents are undergoing medical care

or substance use treatment. Or children who lost a parent serving in the military or as a police officer or firefighter, who now live in households with reduced income. Or children in households that lose their home, job, or both due to a natural disaster.[29]

Babies are punished because new mothers are more likely to be in and out of the workforce because of complications in pregnancy, labor and delivery, postpartum health issues, lack of paid family medical leave, and other reasons.[30] Families with young children face high costs — infant child care, diapers, formula, and doctor's visits — at a time when incomes are often lowest.

Children in immigrant families continue to experience higher rates of poverty than their nonimmigrant peers because they often remain ineligible for assistance. An estimated 1 million immigrant children with Individual Taxpayer Identification Numbers (ITINs) remain excluded from receiving the Child Tax Credit, unfairly denying them critical support. Families in Puerto Rico did not have access to the advanced monthly payments in 2021, and under current law families with children in Puerto Rico accrue the refundable portion of the Child Tax Credit at a slower rate than families in the states.

To better support families, we must create a permanent, monthly child benefit. A 2019 National Academy of Sciences study determined that cash transfers to households contribute to children's long-term success, leading to better health outcomes, higher educational attainment, and increased earnings as adults. Furthermore, the Academy identifies an improved Child Tax Credit as the most powerful tool we have to combat child poverty and narrow the racial poverty gap.[31]

Regular cash support also provides

financial stability that helps families meet unanticipated expenses and weather economic downturns during an emergency such as the COVID-19 crisis. Regular delivery of assistance also offers a mechanism to adjust benefit levels as needed — for example, to increase payments during an economic crisis. Payments distributed periodically, instead of yearly, allow families to keep up with regular bills, such as rent, utilities, and other expenses.

We strongly recommend that Congress create a permanent, federal, monthly child allowance based on the "best interests of children." The program should be administered by an agency equipped to meet the needs of all children and help families with the greatest barriers to economic stability. Designing the program around the "best interests of children" preempts debate about the "deservedness" of the adults in the children's lives, a conversation that leads to policies that often wind up punishing children.

Important principles for reforming the CTC include:

- **Making the credit fully refundable and increasing the amount (to at least $4,000 per child per year)**
- **Creating a more generous credit for young children (at least $4,600 per child per year for children under 6)**
- **Including all children, regardless of immigration status**
- **Designating 17-year-olds as "qualifying children"**
- **Establishing equity for children in U.S. territories**
- **Establishing a baby bonus that makes the CTC equitable regardless of the child's month of birth**
- **Designing a program that is accessible to all children, especially those in complex living arrangements, involved with foster care or other public systems, unbanked and/or not connected to the tax code so the benefit follows the child**
- **Providing advance payments on a monthly basis — the same schedule as household bills**
- **Guaranteeing that the cash benefit is not counted as taxable income and isn't considered income when determining household eligibility for other benefits and assistance**
- **Offering a simple registration process with an online filing tool in multiple languages and assurance the program complements, not replaces, other supports for families**
- **Protecting families from surprise tax bills through a safe harbor provision and protecting the credit from garnishment**

State legislatures and governors around the country are enacting or expanding state Child Tax Credits, which will offer more information on the benefits and outcomes of similar programs administered by the states.[32]

Congress should look to the American Family Act led by Reps. Rosa DeLauro (D-CT), Suzan DelBene (D-WA) and Ritchie Torres (D-NY) in the 119th Congress and companion legislation sponsored by Sens. Michael Bennet (D-CO), Cory Booker (D-NJ), Raphael Warnock (D-GA), Catherine Cortez Masto (D-NV), Ron Wyden (D-OR) and Dick Durbin (D-IL) as a model. The ARPA temporarily authorized many of the bill's provisions with overwhelming success.

Researchers at Columbia University have determined that investment in a child allowance program would pay massive dividends – an estimated 8:1 return on investment.[33] Improving the Child Tax Credit also strengthens local economies. The Niskanen Center think tank found that extending the improved CTC for even just one year would support the equivalent of 500,000 private-sector jobs.[34] Finally, the improved CTC brings our child poverty rate closer to that of other wealthy countries, increasing our competitiveness around the world.[35]

Child and Dependent Care Tax Credit (CDCTC)

Background

The Child and Dependent Care Tax Credit (CDCTC) is a nonrefundable tax credit that allows some families to reduce the amount of federal income taxes owed by subtracting a portion of their yearly child care or dependent adult care expenses from their year-end federal tax bill. The credit helps families partially offset costs of child and dependent care expenses incurred while they work, go to school or actively look for work.[36] Because the CDCTC is nonrefundable, it means that, if a taxpayer owes no federal income tax at the end of the year, the CDCTC has no benefit for him or her.

A taxpayer can claim a credit of up to $3,000 for one qualifying child or dependent under the age of 13 and $6,000 for two or more qualifying children or dependents. The size of the Child and Dependent Care Tax Credit depends on several factors, including the total amount of money a family spent on qualifying expenses for child or dependent care throughout the year, the number of qualifying children and/or dependents, and the amount of the household's annual earned income. Based on Average Gross Income (AGI), a family can receive between 20% and 35% of claimed expenses as a credit, with lower-income families receiving a higher percentage of expenses. For taxpayers with an AGI under $15,000, the credit rate is 35% and the rate declines by one percentage point for each $2,000 earned above $15,000 until the rate reaches its statutory minimum of 20% for taxpayers with an AGI above $43,000. The credit rate for the AGI brackets is not adjusted for inflation.[37]

The American Rescue Plan Act temporarily expanded the CDCTC by making the credit fully refundable, increasing the cap on expenses from $3,000 to $8,000 for one qualifying individual and from $6,000 to $16,000 for two or more qualifying dependents.[38] Furthermore, the credit rate increased for many low- and moderate-income earners to 50% for those earning under $125,000 and it declined for those taxpayers earning above $125,000 until the rate equaled 0% at $438,000 of AGI.[39]

Strengthening the CDCTC

Like all nonrefundable credits, the CDCTC reduces federal income tax liability and benefits middle-income families more than low-income families. Analysts estimate that in 2021, 14% of families with children benefited from the CDCTC; those families saw their taxes reduced by an average of $2,174.[40]

Given the high cost of child care, the benefits of the CDCTC remain inadequate, and, in addition, are provided after a federal tax return is filed, which happens long after the expenses are incurred. Low-and moderate-income families often cannot wait until tax time to be reimbursed for payments they have already made, so subsidies, which are paid on a regular basis to families and/or child care providers as costs are incurred, are therefore more helpful to low-income families.

The Child and Dependent Care Tax Credit Enhancement Act (H.R. 7252/S. 3657), introduced in the 118th Congress by Rep. Danny Davis (D-IL) and Sen. Bob Casey (D-PA), outlines many of these provisions and offers a solid basis for reform. The bill would make the CDCTC fully refundable, an improvement recommended by the National Academy of Sciences 2019 report, "A Roadmap to Reducing Child Poverty." The report notes that a fully refundable CDCTC would concentrate the credit's benefits on families with the lowest income and with children under the age of 5, support parents in the workforce and help reduce child poverty by 9.2% over 10 years.[41]

In addition to making the CDCTC fully refundable, the bill would increase the maximum credit rate to 50%, adjust the phase-out threshold to begin at $125,000 rather than $15,000, greatly increase the amount of child and dependent care expenses that qualify for the credit, and index the credit to inflation. This legislation complements the critically important direct spending on child care through the Child Care Development Block Grant (CCDBG), which provides subsidies to families and providers to help make care more affordable.

To truly reduce the exorbitant cost of child care faced by many U.S. families, as well as increase the supply of quality care, lawmakers must substantially increase subsidies and investments in CCDBG even as they expand and strengthen tax credit opportunities. Ultimately, child care should be treated as the public good that it is, through a universal child care system.

Earned Income Tax Credit (EITC)

Background

The Earned Income Tax Credit (EITC) is a refundable tax credit available to eligible workers earning relatively low wages. Since the credit is refundable, an EITC recipient need not owe taxes to receive the benefit. Many low-income workers, especially those with children, may be eligible to receive the EITC. The EITC, enacted 40 years ago, has evolved from a relatively modest tax benefit to a significant anti-poverty program. Presidents Reagan, Clinton, and Obama all expanded the EITC on a bipartisan basis.

Eligibility for and the amount of the EITC are based on a variety of factors, including residence and taxpayer ID requirements, the presence of qualifying children, age requirements for childless recipients, and the recipient's investment income and earned income. Similar to eligibility for the CTC, tax filers with incomes above certain thresholds based on marital status and the number of qualifying children are ineligible for the credit. For single or head-of-household filers, the maximum qualifying Adjusted Gross Income (AGI) is $43,492 if they have one child, $49,399 if they have two children, and $53,057 if they have three or more children. For married or joint filers, the maximum qualifying AGI is $49,622 if they have one child, $55,529 if they have two, and $59,187 for three or more children.

The amount of the EITC varies based on a recipient's earnings. Specifically, the EITC equals a fixed percentage of earned income until the credit amount reaches its maximum level, remains there for a range of earned income, and is then gradually phased out to zero. The specific values of these EITC parameters (for instance, credit rate, earned income amount) vary depending on several factors, including the number of qualifying children a tax filer has and the filer's marital status. For the 2022 tax year, the maximum EITC for a tax filer without children is $560 per year. The 2022 maximum EITC for a tax filer with one child is $3,733 per year; with two children, $6,164 per year; and with three or more children, $6,935 per year.

The EITC is provided to individuals and families once a year, in a lump sum payment after they file their federal income tax return. The EITC is a fully refundable credit meaning that individuals with zero tax liability can receive the full amount of the credit as a refund. The EITC has had a significant impact on reducing poverty among recipients with children and is one of the largest and most successful need-tested anti-poverty programs in the United States. In 2023, 23 million tax filers claimed $57 billion in EITC[42] and each filer received an average of $2,743.[43] About 85% of all potential EITC benefits are claimed,[44] but this still leaves 5 million potentially eligible taxpayers who do not receive the credit, resulting in $7 million in unclaimed credits each year.

The EITC received two temporary modifications under the 2009 American Recovery and Reinvestment Act (P.L. 111–5). First, ARRA enacted a temporary larger credit for families with three or more children by creating a new, higher credit rate of 45% (previously, these tax filers were eligible for a credit rate of 40%). Second, ARRA expanded marriage penalty relief by increasing the earnings level at which the credit was phased out for married tax filers in comparison to unmarried tax filers with the same number of children. The Protecting Americans from Tax Hikes (PATH) Act of 2015 (Division Q of P.L. 114–113) made these two modifications permanent.

The pandemic-era American Rescue Plan Act also temporarily enhanced the EITC. The ARPA nearly tripled the amount of the EITC credit for low-income childless workers and broadened eligibility from 25 to 18 years old for former foster youth and youth experiencing homelessness, including full-time students. These improvements had the potential to benefit more than 17 million workers.[45]

Strengthening the EITC

We strongly recommend expanding the EITC to include youth formerly in foster care. The EITC is not currently offered to adults under age 25 unless they are parenting. The current policy assumes that many adults aged 18-24 earn little income but rely on their parents for financial support. While this may be true for some young adults, it is rarely true for youth formerly in foster care or experiencing homelessness on their own. At 21, only 13.2% of youth formerly in foster care report living with a biological or foster parent.[46] Youth formerly in foster care are particularly vulnerable and deserve the benefits associated with poverty programs for adults.

Expanding the EITC would provide a much-needed benefit to approximately 135,000 former foster youth around the country and the millions of young people who experience homelessness on their own, equipping them to become successful adults by reducing poverty and increasing labor market participation with very little additional cost to the taxpayer.

California expanded its state Earned Income Tax Credit in 2017 to include transition-age youth, aged 18-24, without custodial children and in 2020 to include undocumented tax filers. Building on these previous policy changes, California is the first state to establish a Foster Youth Tax Credit, a refundable credit available for current and former foster youth aged 18-25 that started in the 2023 tax season. From 2023-2024, this credit reached more than 5,500 youth and decreased poverty on average by 7% for single filers.[47]

When fully implemented, analysts estimate that this income support program could reach as many as 20,000 current and former foster youth each year, so more outreach work is needed to educate transition-age youth about the benefits and how to receive this credit. Transition-age youth commonly earn incomes below the tax-filing thresholds of the Internal Revenue Service, do not have adequate information about the credits, and lack the assistance of parents or family members in filing their taxes.

American Opportunity Tax Credit (AOTC)

Background

Created in 2009 from the Hope Scholarship Tax Credit, the American Opportunity Tax Credit (AOTC) aims to improve tax-based aid for the high cost of college by providing a credit for a student's first four years of post-secondary education.

For a student to be eligible, they must be pursuing a degree, be enrolled at least part-time for an academic period during the tax year, have not finished their first four years of higher education, have not claimed the AOTC for more than four years and not have a felony drug conviction.

Families or students who earn more than $80,000 but less than $90,000 (over $160,000 but less than $180,000 for a married couple) are eligible for a reduced amount of credit. Filing individuals can receive a maximum of $2,500 annual credit per student.

The AOTC primarily benefits low- and middle-income families: 46.6% of AOTC benefits go to families with incomes between $30,000 and $100,000. The refundability component of the tax credit benefits lower-income earners. In 2015, $17 billion was given through the AOTC.[48]

Strengthening the American Opportunity Tax Credit

Congress made the AOTC permanent in the 2015 bipartisan tax deal. We recommend the following changes to improve access for low-income families and students:

- **Allow credit payments to be made periodically to help families and students prepare for regularly occurring college expenses**
- **Eliminate the four-year cap on the AOTC for students who need more than four years to graduate**
- **Expand outreach and education to increase the take-up rate among low-income students and households of color**
- **Increase the refundability of the credit. Families and students with no tax liability after receiving the credit currently are eligible only for 40% of the remaining credit, up to $1000.**

Establishing a Renters' Tax Credit

Background

Although rent increases have slowed in some regions of the country, rent prices nationally have increased nearly 20% since 2019.[49] Yet despite the great need for rental assistance, only 1-in-4 families who are eligible for rent assistance receive it. Families with children represent a decreasing share of federal housing assistance beneficiaries[50] even though the majority of households on the waitlist (60%) are families with children. Even when families do obtain vouchers, they struggle to find landlords who will accept them. Voucher discrimination against families with children is compounded by racial discrimination.

The federal government distributed $80 billion in housing tax benefits in 2020, 80% of which went to homeowners. The tax code must similarly accommodate renters. Creating a properly designed and implemented national renter tax credit would help meet renters' needs by delivering resources directly to families and young adults and reaching many more people than are currently served by rental assistance.

A renters' tax credit should:

- **Be large enough to relieve the housing cost burden on low-income households**
- **Be made available to children and youth in households with the largest barriers to housing stability**
- **Be delivered monthly, when rent is due**
- **Include a safe harbor provision so the**

lowest-income households are not at risk of owing more at tax time

- **Support families with children by increasing the credit for family size, inflation, and geographic differences in housing costs**
- **Reach homeless households as well as those who lack a formal lease**
- **Be layered on top of already existing subsidies such as the Low-Income Housing Tax Credit (LIHTC), so that it complements rather than replaces assistance a family is already receiving**
- **Be designed without burdensome bureaucratic requirements**

Lawmakers should look to the lessons learned from the Internal Revenue Service's delivery of monthly Child Tax Credit payments in 2021 and build upon that effort.

Dependent Care Assistance Program (DCAP)

Background

The Dependent Care Assistance Program (DCAP) is an employer-sponsored flexible spending account program that allows employees to set aside pre-tax dollars from their paychecks to pay for child and dependent care. Employers can also contribute to an employee's DCAP. The definitions for "qualified dependent care expenses" and "qualified dependent" used for the exclusion are the same as for the CDCTC.

Any individual who has earned income and needs child care to work or be able to look for work is eligible for dependent care tax benefits. For DCAP specifically, only employees with employers who offer a DCAP plan — and are not "highly compensated employees"— can take advantage of the program. The Internal Revenue Service classifies "highly compensated employees" as those who typically earn more than $120,000.

For a DCAP, the employee agrees that a specified pre-tax amount of their earnings be set aside for the employer-sponsored program. The employer DCAP must be a written plan that is generally available to all employees, but it need not be funded by the employer. The tax benefit from the exclusion depends on the marginal tax rate of the working caregiver and the amount that they allocate to the DCAP each year.

Unfortunately, DCAP has not been updated since 1986 and the maximum contribution is not enough to meaningfully address the rising cost of child care. For far too many families the cost of child care is prohibitive. According to the U.S. Department of Labor (DOL), U.S. families spend between 8.9% and 16.0% of their median income on full-day care for just one child and that figure varies widely depending on the age of the child, population size of the county, and

type of care provided.[51] The maximum DCAP family contribution is $5,000 annually, is not indexed for inflation, and does not increase for multiple children.

The ARPA temporarily raised the limit on the contribution to $10,500, but that higher maximum credit expired in 2022. The DCAP, like all tax deductions, overwhelmingly benefits middle- and upper-income families because they have higher marginal tax rates and can afford to set pre-tax money aside. Lower-income families, often living paycheck-to-paycheck, can struggle to set aside income into a tax-deferred account, while families living in poverty typically do not earn enough to even incur net income tax liability, meaning they receive no or less benefit from a tax deduction.[52] Data demonstrates that, currently, low- and moderate-income families receive a small share of the tax benefits of the DCAP. DCAP participation also is limited because only workers with sponsoring employers can participate. According to a 2020 Bureau of Labor Statistics survey, 43% of civilian workers had access to dependent care flexible spending accounts.[53] According to Treasury Department data, in 2020,[54] families earning more than $100,000 in annual income received 88% of the DCAP benefits and families making $30,000 or less received approximately 1% of the benefit from DCAPs. Additionally, employees who contribute the maximum amount allowable to their DCAP cannot also claim the CDCTC. For those who contribute less than the maximum, for every dollar of the employer-sponsored DCAP excluded from the taxpayer's income, they must reduce the maximum amount of qualifying expenses claimed for the CDCTC.

Strengthening DCAP

Direct assistance and refundable tax credits are targeted toward meeting the needs of low- and moderate-income families. Any DCAP expansion should be coupled with proposals that guarantee greater benefits to families in lower income brackets.

There are, however, improvements that can be made to the DCAP to better meet the increasing costs of child care. These changes include allowing families to debit directly from an account at the time monthly bills are due, rather than waiting for reimbursement at a later, annual date. The DCAP exclusions also should be decoupled from the CDCTC to allow taxpayers to claim the maximum allowable CDCTC for out-of-pocket child care expenses regardless of their DCAP contribution, since the average cost of child care is greater than both.[55] In addition, the credit should be indexed to inflation and the exclusion maximum should be increased.

Advanced Premium Tax Credits for the Health Insurance Marketplace

The Health Insurance Marketplace (Marketplace) provides coverage to more than 21 million Americans, including approximately 2 million children. Enactment of enhanced levels of Advanced Premium Tax Credits (APTCs) under the American Rescue Plan Act of 2021 dramatically increased affordability of Marketplace coverage. However, the enhanced APTCs are set to expire at the end of 2025. If allowed to expire, millions of Americans would see their health insurance costs suddenly increase, jeopardizing health care coverage for families and their children across the country. During the 118th Congress, Sen. Jeanne Shaheen (D-NH) and Sen. Tammy Baldwin (D-WI) introduced the Health Care Affordability Act of 2024 (S. 5194), which would make the enhanced APTCs permanent. Rep. Lauren Underwood (D-IL) introduced companion legislation in the House (H.R. 9774).

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SECTION 2

Savings Accounts and Asset Building

Background

Studies have shown that even a small amount of savings can have a positive effect on a child's social-emotional development and improve a family's outlook for a child's future.[56] Indeed, 71% of children from high-savings, low-income families rise out of the lowest income quartile over their lives, compared with just 50% of children from low-income, low-saving families.[57]

Savings not only lift children and families out of poverty but promote economic security, breaking the cycle of generational poverty. Children in low- and moderate-income families with just $500 or less saved for college are three times more likely to enroll in college and four times more likely to graduate than children without any savings.[58]

The tax code is a critical tool to promote asset building and long-term savings. Yet current tax policy assists and incentivizes middle and high-income families to save and build assets without similar provisions for low-income families. Low-income families may be unable to take advantage of tax credits and savings accounts because of their lower tax liability or may be unaware of these opportunities due to a lack of outreach.

Establishing Child Savings Accounts

Helping families save for their children's future through accounts that are augmented by the federal government would give low-income children a strong financial foundation for adulthood. This idea is not a new one, and over the years, states and local jurisdictions have initiated baby bonds programs and children's savings accounts.

A national "baby bonds" program, as proposed in the 118th Congress by Rep. Ayanna Pressley (D-MA) and Sen. Cory Booker (D-NJ) in the American Opportunity Accounts Act (H.R. 1041/S. 441), offers one powerful way for children to build savings and address the racial wealth gap. On average, young white Americans (ages 18-25) hold nearly 16 times the wealth of young Black Americans.[59] This legislation would authorize federally funded and managed savings accounts (American Opportunity Accounts) for children under the age of 18. The government would automatically deposit $1,000 for each child born (annually adjusted for inflation), and funds would grow over time as the account earns interest until age 18. Each year, a child could receive up to an additional $2,000 deposit from the government. Children from lower-resourced households would be eligible for higher amounts. A young person could access the funds at 18 for allowable uses such as educational expenses, purchasing a home, or other targeted wealth-building assets that break down the structural barriers in our society that many Black, Hispanic, and other communities of color face in accumulating wealth and achieving economic mobility.

Child savings accounts also provide an opportunity for children to build savings. In the 118th Congress, Sens. Bob Casey (D-PA), Ron Wyden (D-OR), and Chuck Schumer (D-NY) and Reps. Don Beyer (D-VA), Joyce Beatty (D-OH), and Suzan DelBene (D-WA) introduced the 401Kids Savings Act (S. 3716/H.R. 7162), which would establish a federal Child Savings Account program designed to help children in low-income households build assets that they can access when they turn 18.

Based on contribution limits set by the Treasury Department, the federal government would seed accounts with $500 for U.S. resident children under the age of 18 whose parent or guardian earns less than $100,000 per year. The contribution would phase down by $25 for each $1,000 of modified adjusted gross income over $100,000. The Secretary of the Treasury also would have the power to deposit $500 annually into the savings accounts of children in foster care for whom no deposit was made for the year. An additional matching

amount, not to exceed $250, would be available for households qualifying under the Earned Income Tax Credit program. The contributions would be adjusted for inflation, and the account would be tax-exempt, excluded from a child's gross income, and would not affect eligibility for other means-tested programs.

The accounts would be invested in U.S. Treasury bonds and the funds would be distributed once the child reaches age 26, receives an associate or bachelor's degree, or enlists in active duty military service. Funds also could be rolled over into a retirement account, used to start a business or used as a down payment to buy a home in the name of the account beneficiary.

The legislation directs the Treasury Department to work with the Internal Revenue Service and the Department of Health and Human Services to ensure that accounts are established on behalf of youth in foster care, and that those children are well-informed about the creation of and the rules associated with their savings accounts.

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SECTION 3

Internal Revenue Service (IRS) Funding and Customer Services

Protecting IRS Funding and Establishing a Family, Youth and Worker Benefit Unit

The Internal Revenue Service (IRS) is a crucial component of the U.S. federal government, responsible for collecting taxes and ensuring compliance with tax laws. Over the years, the IRS has faced challenges due to constrained budgets, which have impacted its ability to modernize technology, combat tax evasion, and maintain effective customer service. Increased funding was urgently needed to allow the IRS to address these shortcomings by improving its infrastructure and customer services, reducing the backlog of tax returns, and enhancing enforcement measures to close the tax gap — the difference between taxes owed and taxes collected.

The Inflation Reduction Act of 2022 (IRA), provided a significant funding boost of nearly $80 billion to the IRS over a decade. This additional investment is intended to modernize the agency's operations, strengthen enforcement against high-income tax evaders, and improve taxpayer services to help them meet their obligations, receive quick responses to questions, and have access to in-person assistance. Importantly, the increased funding also is available to leverage outreach channels to ensure taxpayers are aware of all available tax credits such as the CTC, EITC and CDCTC and that uptake of these benefits increases for those who are eligible. Unfortunately, roughly a quarter of the $80 billion already has been rolled back and the remaining funds could be a source for spending offsets in future budget decisions.

In June 2022, the Treasury Department estimated that close to 2.3 million children under age 18 were eligible for the expanded Child Tax Credit but had not been claimed on tax returns.[60] Transition-age youth commonly earn incomes below the tax-filing threshold, and lack adequate information about the tax credits, guidance from parents, and tax support programs to help them navigate the system.[61]

In addition, despite enhanced outreach efforts by the Biden Administration to marginalized communities, families still had insufficient information, misinformation or lacked the resources to meet deadlines and overcome administrative challenges for the expanded CTC and the Individual Taxpayer Identification Number (ITIN) application process. The Process to apply for an ITIN is burdensome, time-consuming, and can contain language barriers, and those using an ITIN to receive the CTC lacked access to online filing tools.[62]

We recommend that the IRS establish a family, youth and worker benefit unit with dedicated staff to identify hard-to-reach families and individuals and enhance outreach to those who face the biggest challenges and the highest barriers to accessing available tax credits. Proponents of the additional IRS resources emphasize that the agency's modernization efforts and enhanced outreach and customer services improve fairness and equity in the tax system. Critics have expressed concern that the increased resources could lead to excessive audits or inefficiencies and unfortunately, Congress has rescinded more than 25% ($21.6 billion) of the agency's IRA funding.[63] Significant funding cuts for the IRS would result in delayed refunds, slower service for taxpayers and businesses and an increase in the deficit.[64] It is important to reject attempts to rescind the IRA funding for the IRS as well as proposals to cut funding in the annual appropriations process.

Expand and Make Permanent the Direct File Program

With the additional resources from the 2022 IRA, the IRS launched more digital tools in the last two years than it had in the 20 years prior. One such tool is the Direct File program, which allows certain taxpayers to file online directly with the IRS, free of charge. According to the IRS,

140,000 filers used the pilot program, claiming more than $90 million in refunds and saving an estimated $5.6 million in tax preparation fees.[65] The Direct File program makes it easier for eligible families to claim the CTC and EITC and 90% of respondents ranked their experience with the program as excellent or above average.[66] During the 2025 tax filing season, half of U.S. states will offer free tax filing through Direct File. Research shows that Direct File could deliver $5-$12 billion in federal refunds annually to low-income families who currently do not file returns. When the program is made fully available in all 50 states and for various tax situations, IRS Direct File could save taxpayers $11 billion annually in cost and time savings. appropriations process.[67]

We strongly urge Congress to protect the much-needed IRS funding for modernization efforts and improved customer services, including building on the successful Direct File program and making it permanent.

Conclusion

A more equitable tax code that works because everyone pays their fair share would support healthy child development and help stabilize families struggling to afford everyday living expenses. The tax reform debate provides a tremendous opportunity for lawmakers to enact changes that would significantly reduce child poverty, address income, racial, and gender inequities, and build financial security for all our nation's children and their families.

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