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New tax code's implications for low-income families

The Tax Cuts and Jobs Act (TCJA) signed into law by President Trump in late 2017 went into effect on January 1, 2018.[1] The legislation makes the most extensive changes to America's tax code in 30 years. This *Fast Focus* describes the Act's short- and long-term implications for low-income families with children. It draws from work by scholar Elaine Maag of the Urban Institute-Brookings Institution Tax Policy Center.

Many low-income families will see gains under the TCJA through 2025

On the whole, low-income families fare better over the next seven years under the TCJA than pre-TCJA tax policy. On average, families with children in the bottom fifth of the income distribution[2] will see their taxes drop by an estimated $210 annually from 2018 through 2025, when some provisions are set to expire.

The pre-TCJA tax policy had five major provisions to subsidize families with children. The TCJA makes changes to all but one, as described below.

Child Tax Credit expands

Before the TCJA, the Child Tax Credit (CTC) provided a credit of up to $1,000 per child under age 17. If the CTC exceeded taxes owed, families could receive some or all of the credit as a refund, known as the Additional Child Tax Credit (ACTC). In this brief, we refer to both as the CTC for simplicity. The CTC delivered $56 billion in benefits in 2017.[3] The TCJA makes the following changes:

- The maximum CTC per child under age 17 doubles from $1,000 to $2,000.
- The maximum refundable portion of the new CTC is capped at 15 percent of a family's earned income over $2,500 (the cut-off was at $3,000 pre-TCJA), up to a maximum refund of $1,400.
- Under the TCJA, the CTC provides a new $500 nonrefundable credit for families with certain dependents who would not otherwise qualify for the CTC[5] (such as those with 17- and 18-year-old children living at home; 19- to 24-year-old children in school full time, and elderly dependent parents). The credit, along with the larger CTC for children under 17, offsets all or part of the TCJA's repeal of personal exemptions (see below).

New-CTC scenario: Under the TCJA, a family with one child that earns $10,000 and does not owe any federal income taxes will receive a CTC refund of $1,125 ($10,000 earned income less $2,500 x 15% = $1,125.) Under the old tax code, they would have been eligible for a credit of up to $1,000.[4]

Standard deduction almost doubles

To ensure that all taxpayers have a portion of their income that is not subject to federal income tax, tax filers may either itemize their deductible expenses (such as charitable giving) or deduct a flat amount (the standard deduction). The TCJA makes the following changes:

- The standard deduction increases from pre-TCJA amounts of $6,500 for individuals, $9,550 for heads of household (typically single parents), and $13,000 for married couples, to $12,000, $18,000, and $24,000, respectively, under the TCJA.
- The standard deduction under the TCJA is indexed to increase with inflation using the Chained Consumer Price Index instead of the Consumer Price Index that was used pre-TCJA. This results in lower inflation estimates on which the standard deduction is calculated, which reduces growth of the standard deduction relative to prior law.

New standard deduction scenario: A married couple with one child that files jointly and earned $22,700 would have no taxable income both pre-TCJA and under the TCJA after claiming the $24,000 standard deduction for married couples. Assuming a simple tax scenario, their income tax after credits (including the standard deduction and other credits) would have been -$4,468 under the old law and -$4,861 under the TCJA. This represents a $400 boost in income after tax credits. Put another way, under the TCJA, the family would see a 1.8% increase in take-home income.[6]

Child and Dependent Care Credit is unchanged

The Child and Dependent Care Tax Credit (CDCTC) allows a credit for childcare and care for an elderly relative. The CDCTC is nonrefundable, so very-low-income families with no tax liability don't benefit from it.

Earned Income Tax Credit will grow more slowly over time

The Earned Income Tax Credit (EITC) is a refundable tax credit that boosts earnings of low-wage workers; in 2016, the federal cost was $60 billion. Ninety-seven percent of outlays go to families with at least one child, and the credit helps some 11 million families avoid poverty each year. The TCJA makes the following changes:

- The index used to calculate cost of living increases to the EITC was changed (as it was for the standard deduction, described above), resulting in slower growth of the credit's value to low-income families over time. The EITC is otherwise unchanged.

New-EITC scenario: The curtailed EITC increases for inflation will erode the value of the credit for a married-couple family with two children earning $20,000 per year by an estimated $168 in tax year 2027.[7]

Personal exemptions are eliminated

Pre-TCJA, taxpayers could claim personal exemptions of $4,150 per taxpayer and dependent, thereby reducing their

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taxable income. In 2014, taxpayers claimed $1.1 trillion in personal exemptions.[8] The TCJA makes the following change:

- Personal exemptions are eliminated—but the TCJA's large increase in standard deductions (see above) is intended to compensate for much of the change. For families with children, increases in the CTC also compensate for this change. Notably, the personal exemption was scheduled to be indexed for inflation, while the CTC does not grow with inflation.

TCJA individual tax provisions set to expire after 2025 unless extended by Congress

Many TCJA provisions concerning individual taxes (e.g., increased CTC credit amount, reduced CTC earned income threshold, increased standard deduction) are slated to expire after 2025. The expirations would result in a tax increase for most low-income taxpayers unless the provisions are extended by Congress and signed into law by the president.[9]

The average reduction in taxes for low-income families under the TCJA will be $210 in 2018. In 2027, after the provisions will have expired, families in the bottom fifth of the income distribution will owe an average of $160 more in taxes than they would without the TCJA. The projected increase is mainly a product of the law's slower growth in the EITC.

Benefits of the TCJA vary across household types, sizes, and income levels

While most low-income families will see modest gains under the TCJA, at least in the short-term, some fare better than others. Single parents with young children benefit more from the TCJA than do married couples and families with older children. Under the new law, families with fewer children receive larger tax cuts than those with more children, with some exceptions.

The combined TCJA tax benefit of two children for a single parent provides substantial help to those earning $15,000 or more, but little benefit to very-low-income families (Figure 1). In particular, the pattern of benefits adds up to substantial help to families in the $15,000 to $40,000 range, but little to no benefit to many very-low-income families, who do not owe enough tax to be eligible for the full $2,000 CTC.

Although on average low- and moderate-income families with children will initially see tax relief under the TCJA compared to pre-TCJA, in 2027 after certain provisions will have expired, their taxes will increase (Figure 2).

Conclusion

The TCJA brings extensive changes to the tax code, some of which benefit low-income families with children more than the pre-TCJA tax code. After 2025, some but not all of the TCJA's provisions that directly affect low-income families are set to expire. Without further action, this will result in a tax increase for low-income Americans. Independent analyses of the law's effects on the economy and jobs differ significantly, but the Congressional Budget Office estimates that the tax cuts will result in a revenue loss of $1.7 trillion through 2028.[10] In addition, some politicians are calling for federal spending cuts, which may have implications for low-income families.[11]

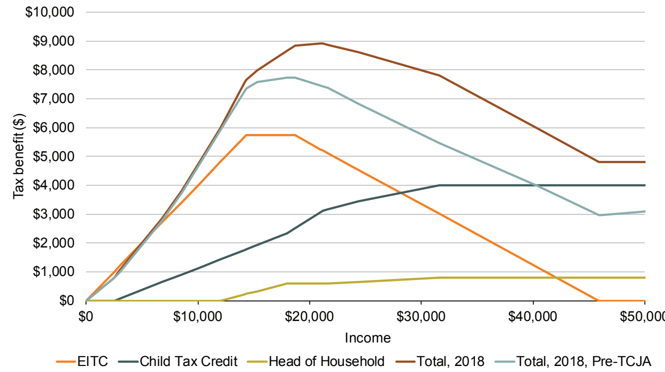

Figure 1. The combined TCJA tax benefit of two children for a single parent provides substantial help to those earning $15,000 or more, but little benefit to very-low-income families.

Source: Courtesy of the Urban-Brookings Tax Policy Center (TPC); calculations by Elaine Maag, TPC senior research associate.

Note: Excludes effects of CDCTC. EITC equals the credit for a single parent with two children. Calculations assume that all income is from earnings and that children are under age 17 and eligible for all benefits.

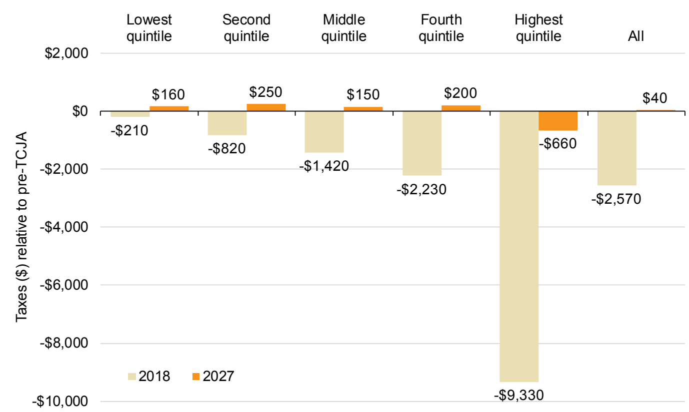

Figure 2. The average tax change for families with children by income quintile under the TCJA (versus pre-TCJA) shows an initial reduction for lowest-income quintile families in 2018, until after 2025 (e.g., shown here in 2027), when their taxes will increase by about $160.

Source: Courtesy Urban-Brookings Tax Policy Center microsimulation model Tables T17-0312 and T17-0316.

Key areas for future research

Maag suggests key areas of research needed in light of the TCJA's changes vis-à-vis low-income families:

- How does the treatment of small and large families vary under the new tax law at various income points?
- What is the long-term impact of switching from an indexed benefit (the dependent exemption) to a tax benefit not traditionally indexed (the Child Tax Credit)?
- How do changes in the tax system complement or offset likely changes in social programs?

For a list of the sources used for this brief and further reading, visit irp.wisc.edu/resource_type/fast-focus/. Edited by Deborah Johnson.

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