

March 2005



The Child Tax Credit

INTRODUCTION

The Child Tax Credit (CTC) is a federal tax credit available to provide credit to taxpayers with certain earned income. The credit is first applied to reduce or eliminate the worker's tax liability, and in some cases can provide the family a partial refund. The CTC can provide a maximum of \$1,000 credit per child under age 17.

Tax credits are a successful anti-poverty tool. The tax return received from the child tax credit is not counted as income for most other public benefit programs, so it does not reduce the total benefits a family receives.

ADMINISTRATION

The Internal Revenue Service (IRS) has responsibility for administering the child tax credit and credit issuance is determined through the tax forms a person fills out each year. The IRS oversees the information required to be submitted and the forms necessary. The credit and requirements change each year.

Taxpayers can claim this credit by filling out IRS form 1040 or 1040A. Families claiming the refundable Additional Child Tax Credit must also fill out IRS form 8812. Some people may be eligible to receive a refund even if no taxes are owed. These forms are available online from the IRS website at <http://www.irs.gov/formspubs/index.html>.

BENEFITS

The tax credit will first eliminate any tax liability. Once the tax liability is eliminated, the IRS will determine if the taxpayer is eligible for the Additional CTC in the form of a partial refund. This enables some low-income working parents to benefit even if they do not have a high tax liability. The CTC begins to phase out when income is above \$110,000 for married couples filing jointly, \$75,000 for single heads of household or widows, and \$55,000 for married couples filing separately.

ELIGIBILITY

Income Eligibility

To qualify for the credit, families must have earned at least \$10,750 in 2004. Each year that figure will rise with inflation, causing families whose incomes fail to keep pace with inflation to lose out on benefits they otherwise would receive.

Non-Financial Eligibility

Families claiming the refundable CTC must have either a Social Security number (SSN) or Individual Taxpayer Identification Number (ITIN).

Qualifying Children

Each child must meet the following qualifications:

- Be under age 17,
- Claimed on the tax return as a dependent,
- A son, daughter, adopted child, grandchild, brother, sister, stepbrother, stepsister or a descendent of any of those if you care for the child as your own or eligible foster child,
- Foster children must have been placed by an authorized agency and must have lived with the worker for the entire year
- U. S. citizen or resident,
- Have a Social Security number or an ITIN.

**Note* – these criteria differs from those for the the Earned Income Tax Credit qualifying child.

Additional Child Tax Credit

The Additional Child Tax Credit is the refundable portion of the credit. The additional credit includes all taxpayers who have earned income, regardless of the number of qualifying children. For taxpayers whose entire tax liability is not eliminated by the CTC, or for those who owe no income taxes, an additional CTC will be given in the form of a partial refund. The refund will be awarded as either: (1) 15 percent of the income earned over \$10,750, or (2) the remainder of the CTC after any tax liability is eliminated, whichever amount is less.

Note - There is an alternate formula for families with 3 or more children that can provide a larger refundable credit than the calculations illustrated below.

Determining the Child Tax Credit

Two examples:

- **A single parent with one child earned \$12,000 and does not owe any federal income taxes for 2004.** Since no taxes are owed and none of the credit will be used to eliminate tax liability, the entire \$1,000 amount is subject to the refund rules. This allows the family to

receive 15% of the amount of their earnings greater than \$10,750 (but not to exceed \$1,000 per child).

$$\begin{array}{r} \$12,000 \text{ earnings} \\ - \underline{\$10,750} \\ = \$1,250 \\ \times \quad 15\% \\ = \quad \mathbf{\$188.00} \text{ -- refunded CTC amount} \end{array}$$

Note that in this example, the remaining CTC would have been the full \$1,000, which is greater than the \$188 obtained using the 15% rule. Therefore, the family receives this lesser amount.

- **A married couple raising two children earned \$22,000 in 2003 and owes \$215 in taxes.** First, they use their CTC (a maximum of \$2,000 for their two children) to eliminate the \$215 tax bill.

$$\begin{array}{r} \$2,000 \text{ maximum CTC} \\ - \underline{\$215} \text{ taxes owed} \\ = \$1,785 \text{ -- remaining CTC amount} \end{array}$$

With no more tax liability, the family is now eligible for the refundable portion of the CTC, which is 15% of the income earned beyond \$10,750.

$$\begin{array}{r} \$22,000 \text{ earnings} \\ - \underline{\$10,750} \\ \quad \$11,250 \\ \times \quad 15\% \\ \quad \mathbf{\$ 1,688} \text{ -- refunded CTC amount} \end{array}$$

Again, the remaining CTC amount (\$1,785) exceeds the amount obtained from the 15% rule (\$1,688) so the lesser amount will be awarded.

FILING

The credits are claimed on the forms 1040 or 1040A, but cannot be claimed on form 1040EZ. The CTC Worksheet is provided in the instruction booklet for these two forms. If a person does not owe any income tax, they cannot directly claim the CTC, but should file for the Additional CTC using Form 8812. The Additional CTC amounts to 15% of the taxpayer's taxable earned income in excess of \$10,750. Those earning below \$10,750 do not qualify for this tax credit. Form 8812 also provides additional instructions for families with more than three qualifying children.

Obtaining Assistance in Filing

Many workers pay to complete their tax forms each year. This can cost \$120 or more to do. Paid tax preparers may also charge additional fees for filers who want a "rapid refund". However, there are many **free** tax preparation sites with trained volunteers. Several of these sites

have been developed through a program called Volunteer Income Tax Assistance (VITA), under the guidance of the IRS. You can find information about these sites on the Children’s Defense Fund website at <http://www.childrensdefense.org/benefits/> or on the National Community Tax Coalition website at <http://www.tax-coalition.org/litc.htm>.

Bank Accounts and Asset Building

According to the Center for Economic Progress more than 10 million households in the United States do not have bank accounts at traditional financial institutions. These “unbanked” households pay more for check cashing and other routine financial transactions and face difficulty establishing a credit history. With no safe place to store their savings – or earn interest on them – these households also have less ability to accumulate assets. While millions of middle and upper-income Americans are encouraged to build assets through generous tax breaks for homeownership, retirement, education, and business investment, the vast majority of low-income families do not benefit from these policies.

One good way to assist families in swiftly obtaining their tax returns is to ensure they have an open bank account. In considering direct deposit for their tax refund, inform taxpayers that:

- They will receive their refund more quickly.
- The refund will arrive at the earliest possible date – on the day the IRS issues the check.
- They will know the refund is safe – it won’t be lost in the mail, stolen from their mailbox, or misplaced in their home.

Many area banks do provide accounts at low or no cost for low-income families.

Further Information

FDIC Money Smart is a free curriculum that can be obtained on the Federal Deposit Insurance Corporation (FDIC) website. The first module focuses on banking issues and introduces banking services to individuals. The material comes with a power point presentation, teacher curriculum with trainer notes and student workbook. The material can be ordered at: <http://www.fdic.gov/consumers/consumer/moneysmart/>.

The *Corporation for Enterprise Development (CFED)* website contains useful information on Individual Development Accounts (IDAs), Children's Savings Accounts (CSAs) and other asset-building tools. These materials teach how to complement income support policies for the poor with policies that promote asset ownership. More information can be found at: <http://www.cfed.org/>

LOOKING FORWARD

Eligibility Changes

It is important to obtain updated information on the tax laws each tax season. In addition to the income criteria adjusting each tax season, it is always possible that other changes may be

legislated. Information is posted on the IRS website. In addition, the Center on Budget and Policy Priorities (www.cbpp.org) and the Children's Defense Fund (www.childrensdefense.org) provide updated information that can help you navigate the IRS forms and rule changes.

Finally, the IRS *Publication 972* provides good explanations of the CTC. The publication is on the IRS website at <http://www.irs.gov/pub/irs-pdf/p972.pdf>

ADVOCACY

The Act to Leave No Child Behind® is comprehensive piece of legislation for America's children introduced by Senator Christopher Dodd of Connecticut and Representative George Miller of California. The Act incorporates policies and programs proven to improve the lives of children. Many of the provisions in the Act's 12 titles are drawn from legislation previously introduced by Republicans and Democrats in Congress. Representing a renewed commitment to our children, the Act will benefit every child in America. It recognizes that children do not come in pieces, but in families and communities.

The Act's provision for improvements to the Child Tax Credit can be found under Title IV—*"Fair Start - Lifting All Children Out of Poverty - Tax Relief to Assist Low-Income Working Families;"* under subtitle A, "Expanding the Child Tax Credit." We can help millions more families by making the credit fully refundable.

You can advocate for improvements in Child Tax Credit by:

- Writing your Members of Congress and urging them to support important legislation such as the Act to Leave No Child Behind®. You can find sample letters at <http://capwiz.com/cdf/home>
- Keeping up to date on children living in poverty, TANF and tax issues facing children by joining the Children's Defense Fund email group, you can do this by going to <http://capwiz.com/cdf/mlm/>.

MAKE THE MOST OF BENEFITS FOR WHICH PEOPLE ARE ALREADY ELIGIBLE

The CDF Tax and Benefit Outreach Project is a national initiative to ensure children and poor working families receive tax, income, health insurance and other benefits for which they are eligible. The initiative connects low- to moderate-income families with existing federal and state programs, like the Earned Income Tax Credit, the Child Tax Credit, Food Stamps, and public health insurance, to help lift them and their children out of poverty.

Well-off taxpayers can hire an accountant to make sure they obtain every tax benefit the law allows. The more than 20 million American children in families struggling on incomes below \$30,000 a year (12.9 million below the poverty line) lack this help and are unaware of or unable to obtain available tax credits, food stamps, health care, child care and other assistance they urgently need.

OTHER GROUPS ADVOCATING ON TAX CREDITS

- Center on Budget and Policy Priorities – www.cbpp.org
- National Tax Coalition - <http://www.tax-coalition.org>
- Center for Economic Progress - www.centerforprogress.org.
- IRS VITA Sites - www.irs.gov
- Annie E. Casey Foundation - <http://www.aecf.org>

Be sure to check our other informational materials on other available tax credits, children's health insurance and food stamps. If you have any questions please feel free to call the Children's Defense Fund at (202) 662-3542.