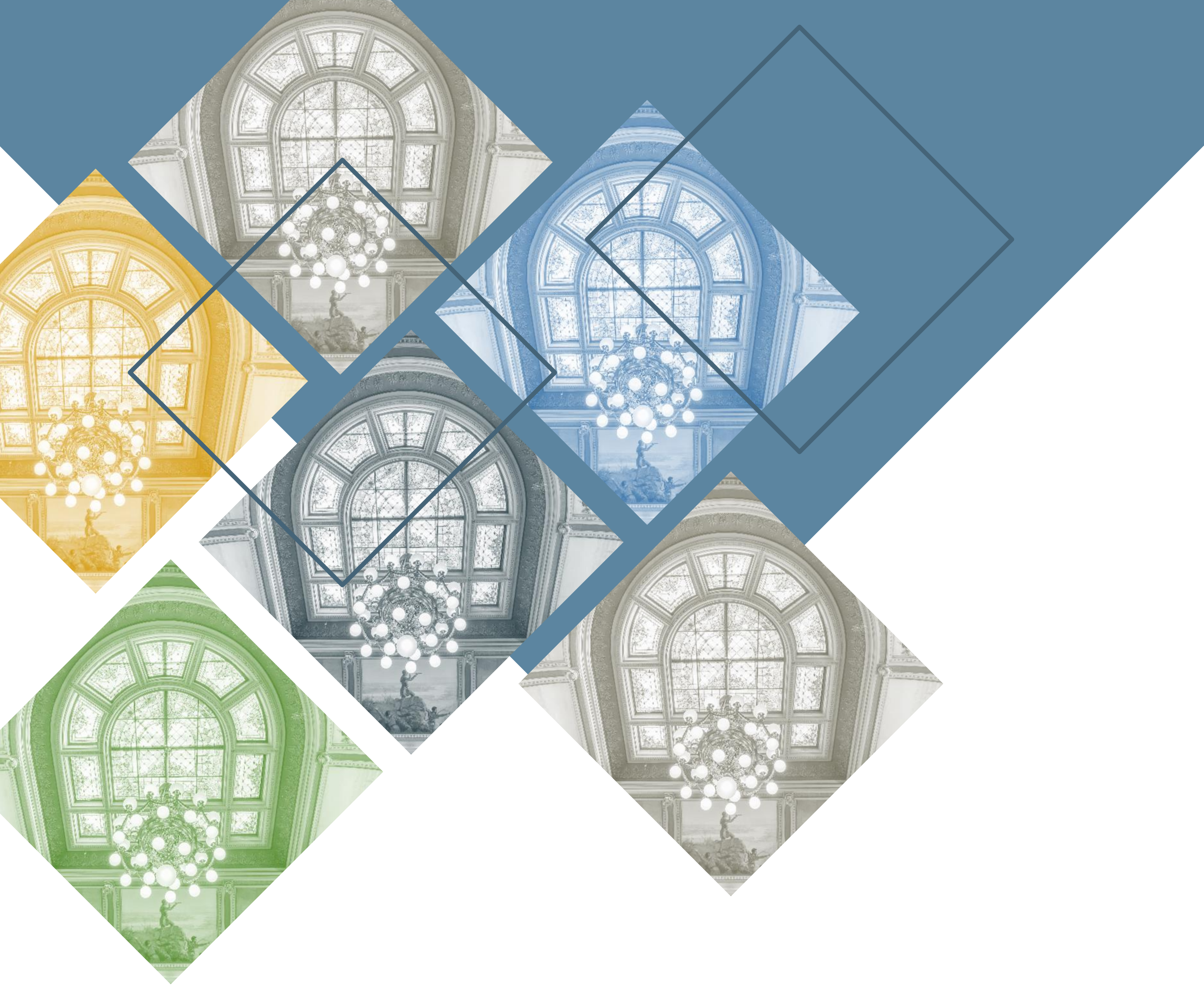

Federal Tax Credits for Individuals and Families

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Erin Sullivan, Legislative Research Analyst

MONTANA STATE LEGISLATURE

Federal Tax Credits for Individuals and Families

People face a benefits cliff when they receive public benefits from the government, earn a raise, and then discover they make too much money to receive the benefits. Sometimes tax credits can help individuals and families when benefits decline as earnings rise. Several tax credits are available to reduce the total income tax owed on both a federal and state level. Each tax credit has different criteria for qualification.

To illustrate the different types of federal tax credits available, let's look at a hypothetical situation. Cassie is a single mom who works in a small office while raising her three-year old son. Her employer does not offer health insurance or child care benefits. At $11 per hour for her full-time job, Cassie earns $22,880 per year. Cassie is currently enrolled in Medicaid Expansion and the Best Beginnings Child Care Assistance program, where she pays $189 per month for full time child care, based on the sliding scale structure.

When Cassie filed[1] her federal taxes in 2021 for tax year 2020, her situation qualified her for three federal tax credits:

- Earned Income Tax Credit
- Child Tax Credit
- Child and Dependent Care Credit

Let's look at each of these in more detail and see how Cassie qualifies:

Earned Income Tax Credit

The Earned Income Tax Credit (EITC) is a work credit that varies based on income, filing status, and number of dependents. The EITC is a **refundable tax credit**, meaning it pays a refund even if the taxpayer does not end up owing income tax for the year.

In 2020, the amount of the credit varied from $538, for income qualifying filers with no children, to $6,600, for income qualifying filers with 3 or more children. For tax year 2021, the ETIC range is $1,502 - $6,728.

[1] For illustration purposes, we are assuming that Cassie is filing as Head of Household, claiming her son as one dependent, and that no other person is claiming her son as a dependent.

Earned Income Tax Credit for Tax Years 2020 and 2021

Number of Children:	Single[2] workers with income less than:		Married workers* with income less than:		EITC up to:	
	2020	2021	2020	2021	2020	2021
3 or more children	$50,954	$51,464	$56,844	$57,414	$6,660	$6,728
2 children	$47,440	$47,915	$53,330	$53,865	$5,920	$5,980
1 child	$41,756	$42,158	$47,646	$48,108	$3,584	$3,618
No children	$15,820	$21,430	$21,720	$27,380	$538	$1,502

** filing as Married Filing Jointly*

In order to qualify for the EITC the taxpayer must work during the tax year and earn income. The earned income does not have to be from full-time work, and can come from wages, salary, tips, self-employment income, military pay, employer-based disability, and union-strike benefits. Some investment income is allowed in the income calculation; however, the taxpayer is disqualified from the EITC if investment income, including interest, and capital gain distributions, exceeds the limit ($3,650 in 2020; $10,000 in 2021).

Other criteria for claiming the EITC are:

- Valid taxpayer identification numbers for each taxpayer and children claimed for the credit
- Must be between the ages of 25 and 64 if not claiming children
- If claiming children, they must:
  - Be related to and live with the taxpayer(s) in the U.S. for more than half the year
  - Be under 19, under 24 if a full-time student, or any age if totally and permanently disabled

With Cassie filing Head of Household, claiming one child, and earning under $41,756, she qualifies for the EITC.

Child Tax Credit

The Child Tax Credit (CTC) is for qualifying dependent children that meet all the following conditions for the tax year in which the credit is claimed:

- The child is the taxpayer's son, daughter, stepchild, eligible foster child, brother, sister, stepbrother, stepsister, half-brother, half-sister, or a descendant of any of them (for example, grandchild, niece, or nephew)
- Under 17 at the end of the tax year
- Did not provide over half of his or her own support
- Lived with the taxpayer for more than half of the tax year (some exceptions apply)
- Does not file a joint return for the tax year, or files it only to claim a refund of withheld income tax or estimated tax paid

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[2] This category typically only applies to taxpayers filing as Single, Head of Household, or Widowed. However, for 2021, taxpayers who file Married Filing Separately may qualify for the EITC if they also meet other eligibility requirements under the special rule in the American Rescue Plan Act (ARPA) of 2021.

- Was a US citizen, US national, or US resident alien

The CTC is a partially refundable credit for taxpayers earning a minimum of $2,500, with refunds based on the taxpayer's adjusted gross income (AGI). The credit phases out the higher the AGI. For all years except 2021, the CTC is $2,000 per qualifying child, unless the taxpayer has no tax liability, in which case the credit can be up to $1,400 and is referred to as the Additional Child Tax Credit (ACTC).

Child Tax Credit for Tax Years 2020 and 2021

Tax Filing Status	Maximum AGI for Additional CTC *for 2021 only*	Maximum AGI for the Full CTC (Phase-Out Threshold)	AGI Where CTC Disappears
Single	$75,000	$200,000	$240,000
Married Filing Jointly	$150,000	$400,000	$440,000
Head of Household	$112,500	$200,000	$240,000
Married Filing Separately	$75,000	$200,000	$240,000

Temporary Changes to the Child Tax Credit

The American Rescue Plan increased the CTC for 2021 for certain taxpayers and provides a credit of up to $3,600 per child under age 6 and $3,000 per child from ages 6 to 17. The temporary changes also waived the minimum earning requirement and lowered the AGI cap for the additional payment. Certain families can receive monthly pre-payments of the CTC, known as Advance Child Tax Credit Payments, starting in July 2021. The increase in the CTC and advance payments are in effect only for tax year 2021; the parameters set by prior law will be in effect again for tax year 2022, although Congress is considering making the increased payments permanent.

Other dependents

The CTC is only for qualifying children aged 16 and younger. Once the child turns 17, they no longer qualify for the credit. However, parents can claim a Credit for Other Dependents (ODC) for children that do not qualify for the CTC that the parents are still supporting, including children in college, as well as aging parents who live with the taxpayer. The ODC is worth $500 per qualifying individual; however, this is a **nonrefundable credit**, which means the amount of credit is limited to the amount of tax owed. If the tax liability is zero, then no refund applies.

With Cassie filing Head of Household, claiming one child, and earning under $200,000, she qualifies for the CTC.

Child and Dependent Care Credit

The Child and Dependent Care Credit (CDC) is a **nonrefundable credit** of up to $6,000. The credit is calculated as a percentage of the amount of qualifying expenses paid for child care while taxpayers are working or looking for work. The percentage is based on AGI and ranges from 20% to 35%. The maximum credit allowed is $3,000 for one child and $6,000 for two or more children; however, there are limitations to the credit.

For example, if a taxpayer received dependent care benefits through work that was deducted from their income, such as a flexible spending account, those amounts must be subtracted from the total amount claimed.

Dependents must be under the age of 13 in order qualify, and the care provider cannot be a spouse, parent of the dependent, or other child of the taxpayer who is under the age of 19. The age limitation does not apply for dependents that are disabled.

Certain restrictions apply for children of divorced or separated parents or parents living apart and individuals qualifying for part of the year.

Cassie paid $2,268 in child care through the Best Beginnings program in 2020. Depending on her tax liability, she may qualify for a portion of the CDC.

Let's come back to our hypothetical situation. Cassie claimed the Earned Income Tax Credit, Child Tax Credit, and Child and Dependent Care Credit on her federal tax return for tax year 2020. In 2021, Cassie received a promotion and accompanying raise to $16 per hour, which is $33,280 per year, or 191% of the FPL. Because of her promotion, Cassie became ineligible for Medicaid Expansion and had to find alternative health insurance through a health insurance marketplace. Her Best Beginnings co-payment also increased to $607 per month, so her total child-care payments for 2021 will be $7,284.

When Cassie files her 2021 taxes, she can still claim the EITC, CTC, and, depending on her tax liability, the CDC. Since her health insurance changed from Medicaid to a plan on the exchange, there is another credit that Cassie now may qualify for: the Premium Tax Credit.

Premium Tax Credit

The Premium Tax Credit (PTC) is a **refundable credit** for taxpayers who purchase health insurance through a health insurance marketplace. The credit is designed for low to moderate income earners who earn 100-400% FPL for their family size, and the amount of the credit is based on a sliding scale, with greater credit amounts available to lower incomes. There are several additional requirements to qualify for the PTC, including not being eligible for coverage through a government program or employer-sponsored plan, keeping qualified health insurance coverage with paid premiums, and claimants cannot file as 'married filing separately' or be claimed as a dependent by another person.

Since Cassie purchased a health plan on the exchange in 2021, and her employer does not offer healthcare, she may qualify for the PTC.

Montana Tax Credits

Montana has two tax incentives available for individuals and families that are like their federal counterparts:

- **Montana EITC:** Refundable credit; calculated at 3% of the federal EITC determined for the tax year. For example, if a taxpayer received $3,000 in federal EITC, they would receive $90 in Montana EITC.
- **Montana Child & Dependent Care Deduction:** Deduction instead of a credit; based on AGI; maximum of $2,400 for one qualifying individual, $3,600 for two, $4,800 for three or more.

While not addressed on a federal level, another Montana tax credit that may help families where grandparents are raising their grandchildren is the elderly homeowner and renter tax credit. This is a refundable income tax credit of up to $1,000 for property taxes paid by eligible taxpayers in low to moderate income households.

Tax Credits May Help with Benefits Cliffs

Tax credits provide a benefit to low income families by reducing the amount of taxes they owe or providing a refund, which may have a significant impact on the family's financial situation. For example, in 2018, the federal EITC lifted approximately 9.4 million people out of poverty, including 5 million children.[3] Because some of these federal tax credits are refundable, even taxpayers whose income is below the threshold for mandatory filing may qualify for a refund, as long as they file a tax return to claim it. Maine's benefits cliff study, completed in 2018, found that "tax credits, particularly refundable tax credits, work to counter declining benefits as earnings rise. In the absence of a holistic and integrated benefits structure that works across multiple assistance programs, tax credits can be used to create a more intentional and appropriate overall benefits structure."[4]

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