WHY A TAX CREDIT SHOULD BE REFUNDABLE

1. **If the credit is not refundable, a substantial proportion of American families — and of American workers — will receive no benefit from it. In particular, large numbers of minority families would be left out.**

   - *A non-refundable children's credit would leave out approximately one-fourth of all American children, one-half of all black children and slightly less than half of all Hispanic children (45%).* Nearly one-fifth of all children living in working families would not benefit from a nonrefundable credit.

   - The federal income tax threshold in 1992 for a two-parent family with two children is $15,250. If the credit is not refundable, families below that level will receive no relief. For a family with three children, there would be no benefit until its income passed $17,550.

   - Yet millions of working families have incomes below these levels. Full-time year-round work at the minimum wage pays only $8,600 per year. Even a low-wage family with a full-time worker and a half-time worker would receive no help from a non-refundable credit.

   - In addition, families with incomes up to several thousand dollars above these levels would get only a partial benefit because the non-refundable credit would exceed the income tax they owe.

2. **These are the very families that have been hit hardest by both wage trends and government policies over recent years.**

   - CBO data indicate that from 1977 to 1992, the bottom fifth of U.S. families will experience an average loss in after-tax income of 10.1 percent. No other income group has fared so badly over this period. (The bottom quintile includes families of four with incomes up to $18,925, precisely the group that would be largely shut out if a credit is non-refundable.)

   - Other data tell an even more sobering story. Between 1972 and 1990, the disposable income of a mother with two children who works and earns wages equal to 75 percent of the poverty line — about what full-time minimum-wage work pays — fell more than $3,100, after adjustment for inflation.

Even when the new Earned Income Credit expansions are fully phased in, the disposable income of this family will still be more than $2,000 below its 1972 level. Cuts aimed at working poor families in other programs such as AFDC have more than outweighed the EIC increases.

- An array of studies also demonstrates that wages have eroded faster for low-wage workers than for any other group in the workforce. This is a key reason for growing income inequality.

- If growing income disparities between the wealthy and other Americans are an important reason to raise taxes on the wealthy and cut them on the middle class, the case is even stronger for providing relief to poor and near-poor families as well.

3. **When state and local tax policy decisions are included, the tilt against low income families is even greater.**

   - Federal cuts in grants to state and local governments — and the current recession — have led most states to raise taxes substantially in recent years. The tax increases states passed this year were particularly large, representing the second largest aggregate state tax increase in the past 20 years.

   - Most state tax systems are highly regressive. Poor and near-poor families are contributing a larger share of their income to these state and local tax increases than are families at higher income levels.

4. **A refundable credit is not a welfare program and won't be seen as one.**

   - The public sees programs as welfare when only low-income families can receive them. Experience has shown that more universal programs that cover the middle class — and also include the poor — are not seen as welfare and do not arouse middle-class resentment.

   - Most of the benefits from a refundable credit would go to middle-class families, not to poor ones.

5. **The money can be found to make a credit refundable.**

   - If the credit is a children's credit, this can be done by initially limiting the credit to children under a certain age, such as 12. The age limit can then be phased up as the revenues raised to pay for the credit increase over time. And if the Pease and personal exemption phase-out provisions of last year's budget package are extended beyond their scheduled expiration after 1996, a large amount of additional revenue will become available at that time; it could be used to extend the credit to children through age 18.

- The cost of the credit can also be modestly reduced if the credit is phased out at a high income level (say above $100,000 or $150,000).

6. **Most of our competitors in the Western industrialized world have a refundable children's credit or its equivalent.** This is one reason most of these countries have child poverty rates far lower than we do, a point those worried about the competitiveness of our future workforce should be concerned about.

   Moreover, if a *non*-refundable credit is created now, it is unlikely it will be made refundable at any future time, since doing so would require raising other taxes solely to benefit low-income families.

7. **If a universal non-refundable credit is established, all children except the poorest one-fourth of them will benefit.** Children of millionaires will receive a benefit; only low-income children will be shut out. Similarly, if a universal, non-refundable wage-based credit is created, millionaires will benefit, but working poor families will not.

WHO WOULD BE HELPED BY MAKING THE CHILDREN'S CREDIT REFUNDABLE?

Most beneficiaries would be working families

A large majority of the families that would be helped by making a children's credit refundable are working families. This is because families that are poor would only be helped if the credit was refundable, and most poor families with children are working families.

- *Nearly two of every three* poor families with children — 63.4 percent — have at least one worker, according to 1990 Census data.

- Furthermore, the 63.4 percent figure is a conservative estimate. Of the families that would be helped if the credit is made refundable, the percentage that are working families is somewhat higher than this. Many of the families that would benefit from refundability are families that have incomes modestly above the poverty line. The overwhelming bulk of those families are working families.

Many beneficiaries would be near-poor

Millions of near-poor working families would benefit far more from a refundable credit than a nonrefundable credit.

- Some near-poor families would *only* benefit from the credit if it is made refundable. These are families that have adjusted gross incomes — the income measure used for tax purposes — below the income tax threshold. (Some income that may lift a family out of poverty is not counted in a family's adjusted gross income.)

- More important, millions of near-poor families would benefit much more from a refundable credit than a nonrefundable credit. For example, under a $300-per-child credit that is not refundable, a family of four with two children and income of $16,000 in 1992 would receive a credit of only $120 (because its income tax liability is $120). If the credit were refundable, the family would receive the full $600 credit, with $480 of it in the form of a tax refund.

- Families of four with incomes between $15,200 (the income tax threshold) and $19,200 (the income level at which the value of a refundable credit and a nonrefundable credit would be identical) would receive more from a refundable credit. This affects millions of working families, especially in low-wage areas.

The merits of helping these working poor and near-poor families are clear. These are families that are "playing by the rules" but often have trouble making ends meet because they earn low wages. They are excluded from assistance under many other government programs.

Most beneficiaries would be white

More than three of every five families with children in poverty — 62.6 percent — are white. Since near-poor families are more likely to be white than poor families are, this is a conservative estimate of the percentage of families helped by refundability that are white. It is likely that about two of every three families that would benefit from refundability are white.

Most beneficiaries would not be on welfare

Most of those who would benefit from refundability are families that are *not* on welfare. This is true for several reasons. First, many are near-poor families who do not receive AFDC. Second, the majority of poor families affected are working families that do not qualify for AFDC benefits. (It should be noted that the maximum AFDC benefit for a family of three in the typical state is $367 a month, or $4,404 a year. This is about one-third of the federal income tax threshold for a family of three. Most families helped by a refundable credit are working families that fall in the margin between the maximum AFDC benefit level and the income tax threshold.)

Moreover, those AFDC families who would benefit from a refundable credit *would receive much less assistance than non-AFDC families*. Under Senator Bradley's refundable credit proposal, AFDC benefits would be reduced 50 cents for each dollar a family received from the credit. For an AFDC family, the benefit from the credit would be $150 per child, not $300.

In addition, making the credit refundable would encourage work among AFDC families — because it would reduce their welfare benefits and replace them with a tax credit that does not decline if a family goes to work.

Large numbers of families will be affected by the decision over whether to make the credit refundable. More than six million families will be excluded if the credit is not made refundable, while two million more will receive a smaller benefit

In 1990, there were 5.7 million poor families with children, virtually none of whom would benefit from a nonrefundable credit. Since some near-poor families do not owe federal income tax, it is likely that more than six million families would be left out entirely if a children's credit is nonrefundable. About two million additional near-poor families would receive a smaller benefit from a nonrefundable credit than from a refundable credit.