

## Child Tax Credit Fact Sheet

A recent report from the Treasury Inspector General for Tax Administration (TIGTA) finds that over 600,000 taxpayers who appeared eligible for the additional child tax credit did not claim the credit. In response to this study, the Treasury Department will be taking steps to ensure that taxpayers receive the child tax credits to which they are entitled.

The Administration strongly supports the child tax credit. The President's tax relief bill contained a proposal to expand the child tax credit. That proposal was included in The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and signed into law. Informing and educating taxpayers about the expanded child tax credit is a critical component of implementing the EGTRRA tax reductions.

The IRS will be launching an aggressive program to contact all 600,000 families identified by the TIGTA report as potentially eligible for the credit. In November, the IRS will begin sending out a packet to taxpayers that will include a letter and provide them with the needed tax forms and instructions on how to claim the credit if they are eligible.

Many taxpayers have already claimed the additional child tax credit this year. Through August 2002, 8.5 million taxpayers claimed \$4.9 billion in refundable additional child credits. (Before EGTRRA was enacted there was a child tax credit in place. 25.7 million taxpayers claimed \$21.7 billion of nonrefundable child credits through this period, resulting in a total of \$26.6 billion of child credits claimed so far.)

### Background

**Study Results:** The TIGTA study identifies 600,000 taxpayers who appear eligible for the child tax credit based on the information reported on the tax return. However, it is unlikely that all of these taxpayers were, in fact, eligible for the child tax credit. Eligibility for the child tax credit depends on some criteria that would not be known from the tax return (e.g., the relationship of the child dependent to the taxpayer and the citizenship and residency of the child). Some of the 600,000 taxpayers may not have claimed the child tax credit because they had determined that they were not eligible for the credit.

The IRS notifies taxpayers who appear to be eligible for the EITC but do not claim the credit of their potential eligibility for the credit. According to a recent IRS study, 194 thousand taxpayers with children received a notice in 1999 stating that they appeared to be eligible for the EITC based on the information provided on their 1998 tax return. Of these, only about a third responded, requesting the EITC. It is not known why the response rate was so low, but it is possible that many taxpayers did not initially claim the EITC because they knew they were ineligible.<sup>1</sup>

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<sup>1</sup> Prior to the early nineties, the IRS actually calculated the EITC for such taxpayers automatically, but legislative changes in 1990 made it more difficult for the IRS to ascertain eligibility without more information from the taxpayer. The legal precedent for this notification program was report language in the 1978 tax act, which made the EITC permanent.

TIGTA's findings may be partly caused by a first year effect. Many taxpayers may not have claimed the additional child tax credit because they had become eligible as a result of EGTTTRA, and they were unaware of its existence. Utilization of the additional child tax credit should increase, as taxpayers become more aware of this new tax benefit.

Simplification: Another source of concern may be the complexity of the additional child tax credit, which may have discouraged some taxpayers from applying for the credit. The additional child tax credit is difficult to compute and unduly complicated.

First, the eligibility criteria for the additional child tax credit differ from those used for the similar EITC. (Approximately 80 percent of taxpayers who are eligible for the additional child tax credit can also claim the EITC.) Although both credits are based on earned income and the number of children in the family, they use different definitions of earned income and qualifying children. For example, to claim the child tax credit, a taxpayer must demonstrate that he or she provides most of the support of the child. To claim the EITC, the taxpayer must demonstrate that he or she resides with the child for a specified period of time. Having different definitions for as simple a concept as one's child may confuse taxpayers. Another source of confusion is the definition of earned income. When computing the additional child tax credit, taxpayers may count earned income only to the extent that it is included in taxable income; however, when computing the EITC, other types of income that are not included in computing taxable income are counted.

Second, most taxpayers with three or more children are given two different formulas to compute the additional child tax credit. As a result, over one million taxpayers with three or more children compute the additional child tax credit amount twice. First, they compute the credit as a fraction of earned income in excess of \$10,350. Then, they compute the credit using a formula that subtracts the EITC from their social security taxes. Finally, they compare the two amounts and claim only the larger of the two. For most taxpayers, the second computation is unnecessary because their credit is larger under the first method.

In April, the Administration proposed a uniform definition of child, which should help reduce taxpayer confusion when claiming child-related tax benefits such as the additional child tax credit. Under the proposal, the taxpayer could claim the same child for both the EITC and the additional child tax credit.

We are working on other proposals to simplify family-related tax benefits, including the additional child tax credit.

Outreach: During FY 2002, the IRS "marketed" the expanded child tax credit as a benefit to working families, and worked with national and local organizations on outreach and education efforts, including newsletters, flyers, stuffers (both in English and Spanish), and posting information on bulletin boards, web sites, and tax preparation sites. During FY 2002, the IRS produced over 1.5 million publications and stuffers on the expanded child tax credit for distribution to the target audience.

Examples include:

- In March, Chicago Public Schools mailed 500,000 child tax credit stuffers to parents of students in their schools.
- In Columbus, Ohio, IRS staff worked with the Children's Defense Fund, local officials, and business leaders on a joint EITC/CTC Campaign, which distributed 274,000 stuffers in water bills and an additional 1,000 stuffers through a local temporary employment agency. The Campaign also arranged for 10 billboards throughout the city and produced and distributed locally designed EITC/CTC flyers.
- In January, a Community Based Partnership was formed in Dayton, Ohio, to promote awareness of the EITC and child tax credit. A press conference was held at City Hall to announce the formation of the partnership. The coalition produced a customized flyer that referred parents to a Helplink hotline and told them what to bring to a free tax preparation VITA site.
- The IRS worked with the Juvenile Welfare Board in Pinellas County, Florida, to promote the EITC and child tax credit. As part of this effort, over 5,000 letters were sent to businesses, day care centers, houses of worship, and low-income organizations. Take-home flyers were given to every parent with a child in a day care center with information about the EITC and child tax credit.