

## **EMPIRICAL ANALYSIS OF EXTENDING THE REFUNDABLE CHILD TAX CREDIT TO RESIDENTS OF PUERTO RICO WITH FEWER THAN THREE CHILDREN**

**Proposed Changes** – The proposal would make residents of Puerto Rico eligible for the refundable additional child tax credit (ACTC) regardless of family size. Under current law, only households with three or more children are eligible for the child tax credit. The proposal is effective for tax years beginning after December 31, 2014.

This proposal would allow a Puerto Rican tax return filer to receive a comparable amount to that received by an equivalent tax return filer in the United States. An “equivalent tax return filer” in the states is a filer with the same earned income and family structure as the tax return filer in Puerto Rico. However, qualifying earned income for the Puerto Rican tax return means any taxable income reported for tax purposes in Puerto Rico, regardless of whether these amounts were subject to Federal income or payroll tax liability.<sup>1</sup>

Credits payable to Puerto Rico residents would offset any Federal income or payroll tax liability (if any) of the equivalent filer in the states. As a result, tax return filers in Puerto Rico and the equivalent filers in the states would have the same net income after Federal income taxes, payroll taxes, and the additional child tax credit.<sup>2</sup>

The following revenue analysis includes only households with fewer than three children, as households in Puerto Rico with three or more children are currently eligible for the child tax credit.

**Current Law** – Taxpayers with one or more qualifying children may claim a \$1,000 tax credit per child. The qualifying child must meet the citizen requirements and may not have reached 17 years of age during the tax year. The child tax credit begins to phase out when the taxpayers’ modified AGI reaches \$110,000 for taxpayers that are married filing jointly and \$75,000 for taxpayers filing as single or head of household. For married taxpayers filing separately, the phase out begins at \$55,000 of AGI.

A portion of the child tax credit is refundable for all taxpayers, regardless of the taxpayer’s regular tax or alternative minimum tax liability. The refundable credit is limited to the lesser of either (1) the unclaimed portion of the nonrefundable credit or (2) to the extent that the taxpayer’s earned income exceeds a specific threshold (times 15 percent). For tax year 2014, the earned income threshold amount is \$3,000. This analysis assumes that individuals would use the method that would maximize the credit amount.

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<sup>1</sup> Since Puerto Rico residents are not liable for individual Federal income tax on Puerto Rico source income, the analysis assumes that the Puerto Rico residents would calculate the refundable portion of the child tax credit using their Puerto Rico sourced-income.

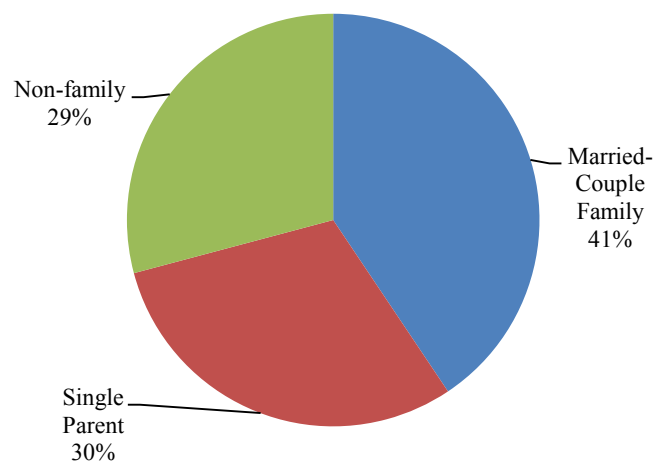
<sup>2</sup> Under current law, Puerto Rico residents with three or more children may claim the ACTC. The payroll tax method used to compute the ACTC credit amount limits the refundable portion of the ACTC. However, recent legislation (introduced by Puerto Rico’s Resident Commissioner, Pedro Pierluisi, H.R. 2454) includes a provision to allow Puerto Rico residents with fewer than two children to claim the ACTC, using the earned income test. For purposes of claiming the credit, any income recognized for tax purposes in Puerto Rico would qualify for the ACTC, even if the income were not subject to Federal income and payroll taxes.

**Estimated Benefits of Extending the ACTC** – In fiscal year 2013, residents of Puerto Rico received approximately \$228 million in tax refunds attributable to the individual income tax system (distributed to approximately 142, 525 returns). It is likely that the vast majority of these credits result from filing of the Form 1040SS, which allows residents to claim refund amounts from the ACTC.<sup>3</sup>

<b>Table 1 – Amount of Refunds Issued for Individual Income Tax Return Filers Residing in Puerto Rico, Fiscal Years 2011 through 2013</b>			
Source: Internal Revenue Service, Statistics of Income, IRS Data Book			
<b>Fiscal Year</b>	<b>Total Returns Filed</b>	<b>Number of Refunds Issued</b>	<b>Refund Amount (in millions)</b>
<b>2011</b>	n/a	n/a	\$344,470
<b>2012</b>	285,377	159,159	\$261,905
<b>2013</b>	275,111	142,525	\$228,144
For fiscal year 2011, the IRS does not report separately returns for residents of Puerto Rico.			

Table 1 displays the refund amounts for the last three fiscal years for residents of Puerto Rico.

**Graph 1 Households in Puerto Rico, Distributed by Household Structure, 2012**  
Source: U.S. Census Bureau, American Community Survey



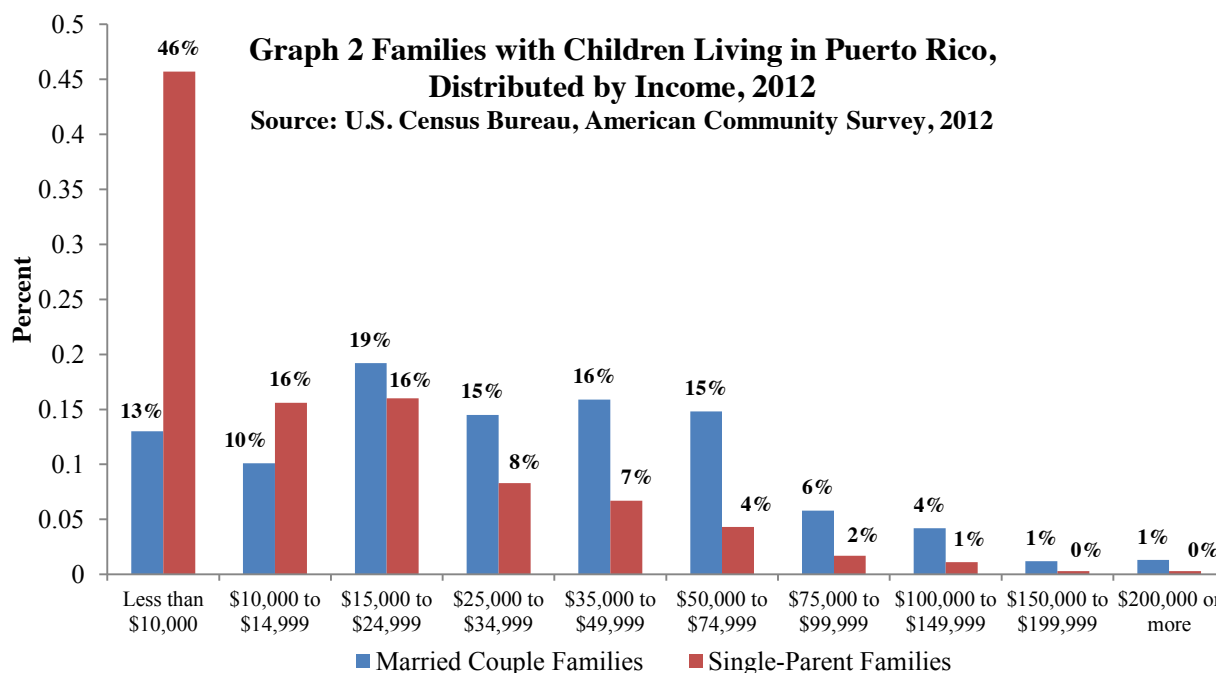
These returns filed include 77,424 returns for individuals that made *estimated* tax payments, suggesting some returns filed had income taxes from U.S. sources.<sup>4</sup> While many of these filers paying estimated taxes may qualify for the ACTC, it is likely that they may have income that is subject to the phase out or that exceeds the income thresholds.

**Demographic Effect** – Currently, only those families with three or more children qualify for the ACTC, therefore the coverage is somewhat uneven (applying only to those families with adequate payroll tax liability, suggesting those many in need would not qualify). Extending the credit to families of all sizes would bring the credit to all families in need.

<sup>3</sup> Form 1040SS provides a simplified method for taxpayers to claim the ACTC, without filing the longer Form 1040. However, Puerto Rico residents with income sources on the U.S. mainland would be subject to U.S. income and payroll taxes.

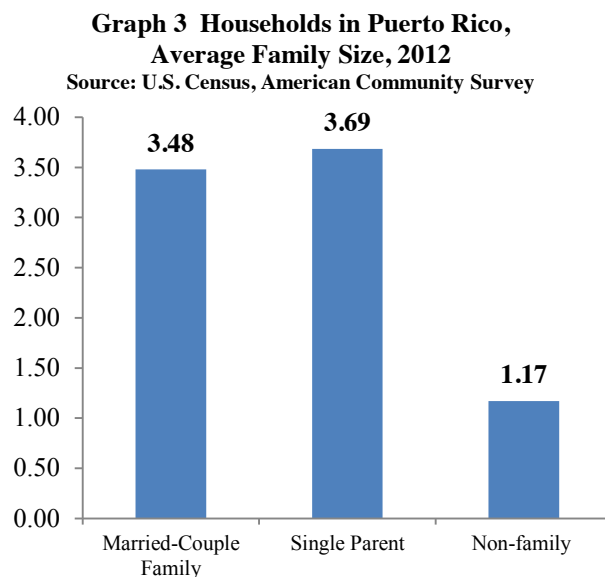
<sup>4</sup> Individuals with income and payroll taxes resulting from employment would not make estimated tax payments. Employers would withhold any potential tax liability through the payroll process. Therefore, it is safe to assume that they are likely higher-income individuals with U.S. sourced income (e.g. either self-employed or have other sources of taxable income).

As Graph 1 indicates, 41 percent of families have two-parent households, but 30 percent have single-parent households.<sup>5</sup> Based on census data, the vast majority of children reside in homes



with one or two parents. However, as Graph 2 indicates, approximately 56 percent of families with children are living in poverty.<sup>6</sup> This is particularly true for single-parent households, which are likely to have more children than married-couple households (refer to Graph 3). Refer to the U.S. Census Bureau, American Community Survey, 2012, which reports that married-couple families average 3.48 people while single-parent households average 3.69 people (with one less adult present).

Average family size is somewhat larger in single-parent households (with one fewer parent in the household, this suggests a greater number of children). The combination of lower incomes and larger family sizes suggests that single-parent households would receive the greatest benefit from extending the CTC. Further, providing the refunds could effectively move some families out of poverty and provide greatly needed resources to the lowest-income families, even if they did not move out of poverty. The following table provides an estimate of the number of families that would qualify for the extended child credit (excluding those that receive



<sup>5</sup> Non-family households include single individuals, or unrelated individuals sharing living quarters.

<sup>6</sup> This statistic is consistent with data from the U.S. Census Bureau, American Community Survey as well as, the *Kids Count Puerto Rico 2012 Databook*, prepared by the National Council of La Raza.

the credit under current law). These estimates suggest that approximately **648,000 additional families** would receive benefits through an extension of the ACTC. This would provide approximately **\$400 million in additional family resources when fully phased-in**.

<b>Table 2 – Estimated Child Tax Credit Eligibility of Households (with Children Present) and Estimated Number of Children Affected</b>				
<i>Source: Author's estimates based on U.S. Census, ACS, 2012 and IRS, SOI Data, 2011</i>				
<b>Income</b>	<b>Married-Couple Households</b>	<b>Single-Parent Households</b>	<b>Total Households</b>	<b>Estimated Total Number of Children</b>
Less than \$10,000	66,606	170,209	236,815	318,876
\$10,000 to \$14,999	10,113	27,839	37,952	53,964
\$15,000 to \$24,999	56,950	29,330	86,280	90,443
\$25,000 to \$34,999	46,196	10,351	56,547	51,817
\$35,000 to \$49,999	79,186	23,067	102,253	90,194
\$50,000 to \$74,999	75,956	15,878	91,835	63,224
\$75,000 to \$99,999	29,805	4,721	34,526	22,264
\$100,000 to \$149,999	2,162	–	2,162	1,038
\$150,000 to \$199,999	–	–	–	–
\$200,000 or more	–	–	–	–
<b>Total</b>	<b>366,974</b>	<b>281,394</b>	<b>648,369</b>	<b>691,820</b>

**Income Effect** – Extending the child tax credit to all families in Puerto Rico would increase family income for many families in poverty. Table 3 provides the U.S. poverty guidelines for the contiguous 48 states and the District of Columbia and Puerto Rico. Considering these income thresholds and the current income distribution (refer to Graph 2) over half (approximately 62 percent) of all single-parent households have incomes below the poverty guidelines. Nearly one half (approximately 42 percent) of married-couple households have incomes below the poverty guidelines.

<b>Table 3 – U.S. Poverty Guidelines, 2014</b>	
<i>Source: U.S. Department of Health and Human Services</i>	
<b>Persons in Household</b>	<b>Poverty Guideline</b>
1	\$ 11,670
2	\$ 15,730
3	\$ 19,790
4	\$ 23,850
5	\$ 27,910
6	\$ 31,970
7	\$ 36,030
8	\$ 40,090
<i>For families/households with more than 8 persons, add \$4,060 for each additional person.</i>	

Extending the child tax credit to all families in Puerto Rico would both provide a significant impact on poverty and provide a significant increase to household incomes. Based on this analysis, Table 4 provides the **estimated** increase to household incomes for those families that would become eligible to receive the ACTC as well as the **estimated** children in those households.

Extending the ACTC would provide benefits to approximately 648,000 families, but would *move an estimated 20 percent out of poverty*. Approximately 692,000 children would be affected, and an estimated *131,100 (19 percent) would move out of poverty*.

<b>Table 4 – Estimated Potential Increase in Household Income from Extending the Child Tax Credit to Residents of Puerto Rico</b> <i>Source: Author's estimates based on U.S. Census, ACS, 2012 and IRS, SOI Data, 2011</i>				
Income	Total Households	Increase in Household Income	Moving Out of Poverty	
			Families	Children
Less than \$10,000	236,815	30%	–	–
\$10,000 to \$14,999	37,952	16%	17,100	29,600
\$15,000 to \$24,999	86,280	8%	43,200	45,800
\$25,000 to \$34,999	56,546	5%	31,100	24,700
\$35,000 to \$49,999	102,253	5%	35,800	31,000
\$50,000 to \$74,999	91,835	3%	–	–
\$75,000 to \$99,999	34,526	2%	–	–
\$100,000 to \$149,999	2,162	1%	–	–
\$150,000 to \$199,999	–	–	–	–
\$200,000 or more	–	–	–	–
<b>Total</b>	<b>648,368</b>	<b>–</b>	<b>127,200</b>	<b>131,100</b>
<b>Percent of Newly Eligible Households/Children</b>			<b>20%</b>	<b>19%</b>

**Estimated Revenue Effect** – The following sections provide an overview of the steps necessary to estimate the revenue effect of extending the child tax credit to residents of Puerto Rico. Data from the Puerto Rico American Community Survey indicates that overall, 31 percent of households include children under the age of 17. After estimating the additional child tax credit for Puerto Rico residents (consistent with legislation introduced in 2011), this provision provides average benefits (refunds) of \$1,297 per family (based on comparable payments to families in Mississippi, the U.S. state with the highest poverty level). These average refunds rely on data for all taxpayers, regardless of filing status and number of family members. The lowest income families received the greatest benefit from the provision, with average refunds approximately 20 percent more than amounts received by families in higher income classes.<sup>7</sup>

**Behavioral Response** – It is important to consider the behavioral response of offering a program that provides a modest benefit, but also requires significant paperwork and information sharing. Early experience in the United States with credits targeting lower income taxpayers indicates that (1) those eligible for the credit often did not claim the credit and (2) those that claimed the credit often did not claim the full amount to which they were entitled.

<sup>7</sup> Refer to Internal Revenue Service, Statistics of Income, Tax Table 2 – Mississippi Individual Income and Tax Data, by State and Size of Adjusted Gross Income, Tax Year 2011. For purposes of this estimate, the ACTC is equal to 15 percent of a family's earnings in excess of USD 3,000 or USD 1,000 per child, whichever is less. If the value of the family's credit is greater than its actual federal tax liability, the family is eligible to receive the difference as a refund.

Puerto Rico presents unique challenges, because individuals would have to file a simplified Federal income tax return to claim the benefits from the child tax credit.<sup>8</sup> While doing so would provide benefits to the household, the take up rate is likely to be slow and gradual.<sup>9</sup> The estimates in Table 5 assume a gradual (5 percent per year) increase in *the eligible population* claiming the child tax credit. Further, during ten-year budget period (approximately mid-way), there is an additional increase in *the eligible population* to reflect the potential for government programs to educate and inform taxpayers of the availability of the credit.<sup>10</sup>

Table 5 provides the estimated revenue effect of extending the refundable child tax credit to all residents of Puerto Rico regardless of family size. The estimate is consistent with provisions detailed in H.R. 2454 (previously introduced in 2011), with one exception. The estimate assumes that the credit would be available for all eligible families, *without* the phase-in included in the previous legislation.

**Table 5 – Estimated Revenue Effect of Extending the Refundable Child Tax Credit to Families with fewer than Three Children** (Assumes an Estimated Learning Curve)  
(dollar amounts in millions)

	<b>Revenue Effect Fiscal Years 2015 – 2017†</b>	<b>Average Annual Benefits Fiscal Years 2015-2017</b>	<b>Estimated Ten-Year Revenue Effect‡</b> <b>2015 – 2023</b>
<b>Total CTC</b>	<b>-\$820</b>	<b>\$256</b>	<b>-\$2,775</b>
†Provisions for the current CTC expire in tax year 2017; therefore, the estimate provides the potential revenue associated with extending the CTC during this period.			
‡This estimate assumes that the U.S. Congress would extend the current CTC for all taxpayers effective for tax years after 2017. It does not reflect the cost of extending the CTC for all taxpayers residing in the U.S. states. The estimate assumes an effective date of taxable years beginning after December 31, 2014.			

<sup>8</sup> Under current law, families (without U.S. income tax liabilities) claiming the child tax credit for 3 or more children may file the Form 1040SS, which offers a simplified filing experience. However, early experience in the United States with credits targeting lower income taxpayers indicates that (1) those eligible for the credit often did not claim the credit and (2) those that claimed the credit often did not claim the full amount to which they were entitled. However, the estimate assumes that taxpayers would be eligible to file a simplified return that does not entail the extensive reporting requirements facing other taxpayers.

<sup>9</sup> A reasonable estimate of the first-year participation is approximately 25 percent.

<sup>10</sup> This is consistent with actual EIC experience in the United States.