FAMILY TAX CREDITS IN THE AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009

The American Recovery and Reinvestment Act (ARRA) provides substantial new tax benefits for most working families. All of the provisions discussed below are at least partially refundable, so they will help low- and moderate-income workers with little or no federal income tax liability. This makes them more effective as economic recovery measures because lower-income people are more likely to spend additional income to purchase goods and services in their community. And, they will help keep millions of Americans out of poverty as the recession worsens.

The tax provisions discussed below do not affect 2008 tax returns (due April 15, 2009), with the potential exception of the First-Time Home Buyer Credit. The other changes will be seen in increased paychecks in 2009 and 2010 or when 2009 and 2010 tax returns are filed the following year.

Making Work Pay Credit

The new, fully refundable Making Work Pay Credit, in effect for 2009 and 2010, is equal to 6.2 percent of earned income, up to $400 for an individual and $800 for a couple. The credit applies to joint, not individual, earnings. Thus, a married couple could qualify for an $800 Making Work Pay Credit even if only one partner in the couple works.

The credit begins to phase out for those with modified adjusted gross income in excess of $75,000 ($150,000 for married couples filing jointly). Individuals with income above $95,000 and couples with income above $190,000 will not get the credit.

Workers will see larger paychecks beginning April 1, 2009, if not sooner, because the IRS has released new withholding tables. Many workers will receive about $10 extra each week (totaling $400 for the year). Weekly paycheck increases will be smaller in 2010 because the payments will be spread throughout the year. Workers who do not receive the full credit through reduced withholding will receive the outstanding amount when they file their tax returns the next year. They will not receive a separate check from the U.S. Treasury the way they did for the 2008 Economic Stimulus Payments.

Workers who hold multiple jobs, high-income workers for whom the credit phases out, and both single- and dual-income married couples should be alert for the need to adjust their withholding throughout the year so that they do not face penalties for too little prepayment of tax.

Child Tax Credit

The Child Tax Credit (CTC) can be worth up to $1,000 per child for families with qualifying children under the age of 17. But the CTC is only partially refundable. The refundable portion of the CTC is 15 percent of earnings above a threshold, up to the maximum value of the credit. The earnings threshold for the refundable CTC was set at $10,000 in 2001 and set to increase for inflation each year. In 2008, because of inflation, the threshold would have reached $12,050 – but last year, Congress reduced the earnings threshold for 2008 to $8,500.

The ARRA reduces the earnings threshold for the refundable component of the CTC from $12,550 in 2009 and an estimated $12,600 in 2010 to $3,000 for both years.

The reduction in the earnings threshold means that, for example, parents with two children earning $10,000 a year, who are eligible for a refundable CTC of $225 for 2008 (0.15($10,000-$8,500)), would be eligible for a refundable CTC of $1,050 in 2009 and 2010 (0.15($10,000-$3,000)). (If they had only one

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child, they would be eligible for a maximum of $1,000.) Compared with 2008, this change will make 2.9 million more children eligible for the credit and increase the credit for an additional 10 million children.

Tax filers will receive the credit on their tax returns the year after it is earned.

Earned Income Tax Credit

The Earned Income Tax Credit (EITC) provides a wage supplement for low-income workers, especially those with children. The credit equals a fixed percentage of earnings up to a maximum dollar amount and then phases out to zero; both the percentage and the maximum credit depend on the number of children in the family.

Under prior law, families with more than two children received no extra credit. The EITC was 40 percent of qualifying earnings for families with two or more children. For 2009 and 2010, the ARRA increases the credit to 45 percent of qualifying earnings for families with three or more children.

In addition, the marriage penalty has been reduced. When two low-income people marry, their EITC can drop because their higher combined income puts them in the range in which the EITC declines. For 2009 and 2010, the income range over which the EITC phases out for married couples (regardless of the number of children) has been increased to $5,000 more than the threshold for single people.

The EITC is fully refundable. Workers may elect to receive the EITC as a refund on tax returns filed the year after it is earned, or they may elect to receive a portion in their paychecks as it is earned.

American Opportunity Tax Credit

To help pay expenses for higher education, the Act replaces the Hope Scholarship Credit, which is not refundable, with a partially refundable American Opportunity Tax Credit (AOTC). The AOTC is worth up to $2,500 a year, increased from $1,800.

Coverage has been extended from two years to four years of schooling for 2009 and 2010, which will enable some students currently enrolled to complete their education. Students must attend school at least half-time.

The AOTC starts to phase out for tax filers with adjusted gross income in excess of $80,000 ($160,000 for married couples filing jointly). Individuals with income above $90,000 and couples with income above $180,000 will not get the credit.

Unlike the Hope Scholarship Credit, 40 percent of the AOTC (up to $1,000 per year for 2009 and 2010) is refundable and thus available to households with little or no tax liability. Tax filers will receive the credit on their tax returns the year after they pay the expenses.

First-Time Home Buyer Credit

First-time home buyers who purchase a principal residence between January 1 and December 1, 2009 are allowed a refundable tax credit equal to the lesser of $8,000 ($4,000 for married-filing-separate returns) or 10 percent of the purchase price. This is an increase of $500 from the 2008 credit amount, which still applies to purchases made between April 8 and December 31, 2008.

Under the law in effect for 2008 purchases, the credit was an interest-free loan that had to be paid back in installments over 15 years. For qualified purchases in 2009, repayment is waived for taxpayers who remain in their homes for at least three years.

The 2009 credit begins to phase out for taxpayers with adjusted gross income of $75,000 ($150,000 for joint filers) and is not available to those with an adjusted gross income of $95,000 ($170,000 for joint filers) or more.

Individuals will have the option of claiming the tax credit on either their 2008 return or their 2009 return. Taxpayers who complete their purchase before they file their 2008 returns (due April 15, 2009) or chose to file an amended return for 2008 after the purchase can take immediate advantage of the cash benefit of the credit rather than having to wait another year to claim it.

State-by-state information on the Making Work Pay Credit, the Child Tax Credit, and the Earned Income Tax Credit is available at www.nwlc.org/pdf/State-by-State_ARRA_Credits.pdf.

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