

Avoiding Repayment Risks in the Child Tax Credit

Lessons from the UK, Australia, New Zealand, and Canada





Resources

Kathleen Bryant, Chye-Ching Huang, Jane Millar, and Peter Whiteford, “The Importance of Minimizing the Risk of Repayment When Delivering Monthly Child Tax Credit Payments: Lessons from the United Kingdom, Australia, New Zealand, and Canada,” SSRN, July 13, 2021,
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3883655.



Key Takeaways

- Child credit / benefit designs with repayment risks create program instability and financial hardship for families.
- Other countries' experiences with advance payments show that preventing repayments of the Advance CTC in the US should be a high priority.



Causes of Repayments

- Changes in income
- Changes in family circumstances



Three Approaches to Repayment Risks

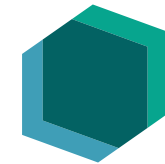
1. Requiring repayments, with some protections (UK, AU, NZ, US 2021).
2. Eliminating income-based repayment obligations but requiring reconciliation when family circumstances change (Canada).
3. Presumptive eligibility, grace period, and income lookback to protect against all sources of repayments (House W&M Bill).

United Kingdom: Scope of Repayment Risks

- In 2003–2004 and 2005–2006, “about one-third of all tax credits awards were overpaid.”
- Delays in reporting family circumstances changes were responsible for roughly 30% of all repayment obligations.

United Kingdom: Financial Hardship

- Over a quarter of those overpaid owed more than £2,500 and ten percent had been overpaid more than £5,000.
- 71% of overpaid respondents reported that tax credit debt recovery had caused their family financial difficulties.
- Some reported going without basic needs while paying down tax credit debt.



United Kingdom: Takeaways

1. Repayments can cause severe financial hardship.
2. Repayment obligations deterred take-up of advance payments.
3. Tax credit debt created political problems and administrative instability.
4. Large safe harbors in the UK were only temporary.
5. IT improvements were not a panacea.

Canada

- Canada sets child benefit levels based on the prior year's income, so changes in income midway through the year do not create repayment risks.
- However, families still need to immediately report changes in family circumstances, and delays in doing so can create repayment obligations.



Example Family Under Advance CTC 2021

- A father of two young children and one teenager earns \$60,000 in 2021.
- Parents finalize a divorce during 2021. Advance payments are distributed to the father based on 2020 tax returns, but he is ineligible to claim kids for 2021.
- \$5,100 in total advance payments were sent to the father.
- Safe harbor offers only \$3,000 of protection. Remainder could be referred to by private debt collectors.

CTC Design Changes in W&M Bill

- **2022:** Same general design as 2021, but maximum safe harbor covers full credit amount.
- **2023:**
 - Income lookback
 - Monthly eligibility
 - Presumptive eligibility and grace period

Rebalancing Reporting on Sources of the Tax Gap



Refundable Tax Credits	All Other Parts of the Tax Gap
<p>10 percent of the tax gap.</p> <p>EITC: 6%</p> <p>CTC/ACTC: 2%</p> <p>Education tax credits: 1%</p> <p>All other tax credits: 1%</p>	<p>90 percent of the tax gap.</p> <p>Underreporting Business Income Tax: 25%</p> <p>Highest-income 1% of filers: ~28%</p>

Treasury Department Annual Financial Report 2019 concluded: “refundable tax credit refunds that result in overclaims should not be reported under the improper payments framework” as defined in the Payment Integrity Information Act of 2019 and stated that “they are more appropriately addressed in the tax gap.”

Commissioner Rettig has said that IRS estimates of the tax gap are “outdated, under-inclusive, and are based on limited types of detected information.” The IRS is currently working to make its estimates of the tax gap more timely, detailed, and comprehensive.



Resources

Department of the Treasury, “Agency Financial Report: Fiscal Year 2020,” December 30, 2020, <https://home.treasury.gov/system/files/266/Treasury-FY-2020-AFR.pdf>.

Robert Greenstein, John Wancheck, and Chuck Marr, “Reducing Overpayments in the Earned Income Tax Credit,” CBPP, January 31, 2019, <https://www.cbpp.org/research/federal-tax/reducing-overpayments-in-the-earned-income-tax-credit>.

Thank you!

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